DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

H.13
No. 12

June 19, 1961

CAPITAL MARKET DEVELOPMENTS ABROAD

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

I. United Kingdom: Money and Capital Markets during May

Money and capital markets in London took an increasingly grave view of Britain's external position during late May and early June and long-term interest rates increased sharply. By June 9, the yields on undated Government securities were significantly above the highest levels previously on record (these records extend back 240 years to 1720). The recent increases in British Treasury bill and bond yields have been as follows (in per cent per annum):

	Jan. 6 1961	Change from Jan. 6 to May 5	Change from May 5 to June 9
Treasury bill - 3 month	4.34	+ 0.03	+ 0.10
5-1/2 per cent Exchequer 1966	6.11	- 0.12	+ 0.16
3 per cent Savings 1965-75	5.97	+ 0.16	+ 0.12
3-1/2 per cent War Loan	5.95	+ 0.24	+ 0.22
2-1/2 per cent Consols	5.70	+ 0.24	+ 0.23

The decline in the exchange rate for the pound and uneasiness over Britain's trade deficit prompted the concern in financial markets about the outlook for sterling. Recent changes in the sterling exchange rates (in U.S. cents per pound) have been as follows:

	February 3		May 5		June 9	
	Rate	Discount per annum	Rate	Discount per annum	Rate	Discount per annum
Spot	280.20	--	279.61	--	278.98	--
3 month	279.65	0.79	278.34	1.82	277.43	2.22
6 month	279.29	1.30	277.19	2.03	276.21	3.99
Security	278.63	--	279.13	--	278.38	--

The sharp widening of the discount on the forward pound has now made it more profitable to hold funds in New York rather than in London, even though the yield on the Treasury bill in London is about 2 per cent above the New York bill rate.

NOT FOR PUBLICATION

DECONTROLLED AFTER SIX MONTHS

The withdrawal of funds from London has apparently not ceased although the extent of the outflow is uncertain. Official reserves declined by $45 million during May but these figures no longer reflect current transactions because of the special intercentral bank credits granted to Britain in March following the revaluations of the D-mark and guilder. Unusually large sales of gold by the Bank of England outside the London gold market have been made recently to European central banks.

There were general increases in other money rates in Britain. Domestic interest rates tended to rise with the charge on new home loans increased from 6 to 6-1/2 per cent and a general all round rise in the Treasury's rates for new loans to local authorities.

In spite of the weakness in other markets, the equity market had shown extraordinary strength until mid-May when it stood at its all-time high. Thereafter it fell sharply with the Financial Times Industrial Ordinary index declining by over 6 per cent in three weeks.

Investments in British Government securities of the London clearing banks continued to decline in the month between mid-April and mid-May while loans to the private sector increased by £24 million. The extent of installment credit outstanding began to rise again in March and April in response to the relaxation in credit terms of January 20.

Money market. After declining from 4.37 per cent to 4.32 per cent in the first part of May, the yield on the 3-month Treasury bill increased to 4.44 per cent by the end of the month. It increased further in early June to 4.47 per cent (see Table and Chart 2). Earlier speculation about a further decline in Bank rate has now been completely replaced by comments in the financial press concerning a possible rise in Bank rate. This has been prompted by the continued outflow of short-term capital, the current account deficit, and increasing signs of renewed pressure on economic resources throughout the country. However, the use of one of the two new "economic regulators" -- most probably an increase in indirect taxes -- would seem more likely, but this cannot be done until the Finance Bill becomes law some time in July. The spread between the bill yields in London and New York narrowed throughout May and early June. The incentive to move funds to London on a covered basis declined steadily after mid-May and by early June was reversed with the covered incentive turning in favor of New York (see Table and Chart 2).

Bond market. The yields on British Government bonds have risen sharply in May and early June and are at all-time highs (see Table and Chart 6). The jump in yields was especially marked in undated War Loan and Consols. The yield on 3-1/2 per cent War Loan increased from 6.19 per cent on May 5 to 6.41 per cent on June 9.

The steady rise in yields to record peaks reflects the uncertain sterling outlook and the increasing pressure on economic resources in the domestic economy. The financial press suggests that the decline in

Government bond prices is due mainly to small sales on a market with even fewer purchasers. The recent failures of the Glasgow and New Zealand loans have contributed to gilt-edged difficulties because these underwriters had to sell other investments to take up their unsold bonds. The amendment to the Trustee Act which will enable trustees to switch from Government securities to equities continues to have a depressing effect on the Government securities market.

The Government of New Zealand made an issue of £20 million 6 per cent stock 1972 at a price of 98-1/2 on May 18. Approximately 88 per cent of the issue was left with the underwriters.

New capital issues. New capital issues on the London market (excluding Treasury operations) during the first four months of 1961 totaled £165.9 million compared with issues over the same period of 1960 equivalent to £161.9 million and in 1959 to £173.7 million. Total new issues were broken down as follows (in millions of pounds):

Borrowers	First four months of 1958	1959	1960	1961
United Kingdom	115.0	151.6	139.0	164.8
Overseas	33.0	22.1	22.9	1.1
Total	148.0	173.7	161.9	165.9

The sharp decline in new overseas issues was largely offset by the increase in new issues for companies resident in the United Kingdom.

Interest rate changes. The interest rate on new home loans will in the future be 6-1/2 per cent. The Building Societies Association announced that the increase from 6 per cent, which has been in effect for over four years, will apply to new home loans immediately and to existing loans from October 1. The rate paid on money invested in building society shares will be increased from 3-1/2 to 3-3/4 per cent on October 1. The building societies have suffered recently from the diversion of the flow of investors funds to alternative forms of savings offering higher interest rates and to the decreasing margin between borrowing and lending rates caused by the further budget increase in profits tax.

Further evidence of the trend toward higher money rates is the increase of between one-eighth and one-fourth per cent in the rates charged by the Public Works Loan Board for loans to local authorities. The increases reflect the Treasury policy of keeping the lending rates of the P.W.L.B. in line with those in the gilt-edged market. The most recent movements have been:

Duration of loans	1961 June 3	1960 Aug. 20	July 16	Jan. 30
Up to 5 years	6-3/8	6-1/4	6-1/4	5-1/2
Over 5, not more than 15	6-3/8	6-1/4	6-1/4	6
Between 15 and 30	6-1/2	6-1/4	6-1/8	6
Over 30 years	6-1/4	6-1/8	6	5-7/8

London clearing banks. Bank loans to the private sector increased by £24 million between mid-April and mid-May. This compares with increases of £68 million in the month to mid-April and £50 million in the month to mid-March. Net deposits declined in the month to mid-May by £27 million while the liquidity ratio declined to 31.5 per cent from 32 per cent in mid-April. Total investments in British Government securities declined by £7 million in the month to mid-May. The ratio of investments in Government securities to net deposits has declined by 25 per cent over the past year.

Installment credit. The January 20 relaxation in installment credit terms account for increases in total credit outstanding in March and April after a steady decline in the previous seven months. Recent figures in installment credit outstanding are (in millions of pounds):

	Household shops	Finance houses	Total	Change
1959 - July	273	469	742	--
1960 - July (peak)	332	639	971	+ 229
December	325	610	935	- 36
1961 - February	315	607	922	- 13
March	312	622	934	+ 12
April	308	631	939	+ 5

The major impact of the credit relaxation has been concentrated in the increase in credit extended by finance houses whose principal business is automobile financing. Total credit outstanding of finance houses is only 1-1/4 per cent below the peak of July 1960.

Foreign trade balance. The effect of the London dock strike in late April and early May has been to distort trade figures for these two months. Based on seasonally adjusted figures for April and preliminary estimates for May, the British trade deficit averaged £57 million per month compared with £65 million in the first quarter. The major improvement came from the decline in imports since exports actually declined. The Board of Trade estimated that in the three months, March through May, seasonally adjusted exports declined by 4-1/2 per cent and imports by 5-1/2 per cent below those for the preceding three months. Recent monthly averages of seasonally adjusted trade figures (in millions of pounds) were:

	Exports	Re-exports	Imports	Trade balance
1960 - I	305	10	369	- 54
II	295	11	375	- 69
III	290	13	385	- 82
IV	295	12	390	- 83
1961 - I	309	12	385	- 64
April	306	12	354	- 36
May[a]	278	12	367	- 77

a/ Rough estimate from press reports.

Foreign exchange reserves. The sterling area's gold and convertible currency reserves fell by £16 million to £1,037 million in May. This compares with a drop of £26 million in April and £62 million in March and is the first published May reserve loss for ten years. However, these figures do not actually reflect the basic underlying reserve movements for two reasons. Firstly, since the mid-March agreement by central banks to cushion each other's reserve losses and "to cooperate closely in the exchange markets" the decline in Britain's foreign exchange reserves has been understated in the published figures. Secondly, in May the reserves were supported further by an Australian drawing on the International Monetary Fund of £62.5 million of which £51.8 million was drawn in currencies other than sterling. The financial press reports that a large, but unknown, portion of this drawing was temporarily deposited in London, which acts as banker for the overseas sterling area.

Sterling liabilities. Overseas sterling holdings fell in the first quarter by £164 million. Those of nonsterling countries were down by £131 million (including a fall of £160 million in North American holdings, which was largely due to the purchases by the Ford Motor Co. in January of the minority interest in the U.K. company). European holdings rose by £48 million, and those of the sterling area fell by £37 million. Recent movement in overseas holdings of sterling are as follows (in millions of pounds):

End of period	Total	Non-North America	Western Europe	Other countries	Rest of sterling area	Non-territorial organizations
			Outstanding			
March 1960	4,180	58	408	356	2,670	688
			Change			
June 1960	+ 295	+ 33	+ 81	+ 4	+ 4	- 27
Sept. 1960	+ 72	+ 42	+ 143	+ 41	- 97	- 57
Dec. 1960	+ 89	+ 170	+ 67	+ 4	- 97	- 5
March 1961	- 164	- 160	+ 48	- 19	- 37	+ 4

Gold market. The Presidential order requiring that United States residents sell their overseas gold holdings by June 1, 1961 created no flurry of sales in the London gold market and it appears holdings have been dispersed gradually in recent months. The price of gold in the London gold remained at about the $35.06-07 level throughout May and early June.

According to a South African Reserve Bank report, sales of newly mined gold from South Africa by the Bank of England have been unusually heavy recently amounting to $140 million in the first quarter of this year compared with sales of $86 million in the first quarter of 1960. In addition, the financial press reports that the Bank of England has sold directly to European central banks a quantity of South African gold which did not go through the London market.

Foreign exchange rates. The rate on spot sterling continues to decline and is now at its lowest level in four years. The continued sales of spot sterling reflect the still unsolved balance-of-payments problem and the outflow of short-term funds. The seasonally weak period for sterling in the autumn has still to be faced. The spot pound declined from 279.57 U.S. cents on May 1 to 279.09 U.S. cents on June 1 and by June 9 it fell further to 278.98 U.S. cents (see Table and Chart 2). The per annum discount on 3-month forward sterling tended to narrow slightly from 1.82 per cent to 1.70 per cent during the first half of May but later widened sharply and by June 9 stood at 2.22 per cent (see Table and Chart 2). Security sterling fluctuated about 279.00 U.S. cents over the period with a slight decline in early June.

Stock market. Industrial stock prices declined sharply in the latter part of May. The Financial Times industrial ordinary index rose steadily from 362 on May 2 to its all-time high of 365.7 on May 15 but thereafter fell closing the month at 351 (see Chart 7). Early in June it dropped sharply again and on June 9 was 341.8 (see Table). The declines in the price of industrials since mid-May reflect (a) narrowing profit margins, (b) weakness of the pound, (c) the natural reaction to the rapid rise in share prices in the past three months and (d) the threat of the introduction of one of the two "economic regulators" presented in the budget.

British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

Chart 1 - Interest Arbitrage U.S./Canada
Chart 2 - Interest Arbitrage New York/London
Chart 3 - Interest Arbitrage New York/Frankfurt
Chart 4 - Interest Arbitrage Frankfurt/London
Chart 5 - Short-term Bond Yields
Chart 6 - Long-term Bond Yields
Chart 7 - Industrial Stock Indices
Chart 8 - Major Currencies in Terms of Spot United States Dollar
Chart 9 - 3-month Forward Rate--London Quotations

United Kingdom: Treasury Bill Yields and Exchange Rates

Date	3-mo. Treasury bill U.K.[a/]	3-mo. Treasury bill U.S.[b/]	3-mo. Treasury bill Difference	Discount on 3-mo. sterling[c/]	Net incentive to hold U.K. bill[d/]	Exchange rate Spot sterling[e/]	Exchange rate Discount on 3-mo. sterling[f/]
1959 - High	3.6	4.7	-1.1	--	--	--	--
Low	3.0	2.6	0.4	--	--	--	--
1960 - High	5.68	4.95	3.63	(P).64	1.95	281.58	1.64
Low	2.13	2.05	-0.84	2.33	- .23	279.83	(P).47
Apr. 14	4.48	2.30	2.18	1.59	0.59	279.80	1.11
21	4.49	2.23	2.26	1.72	0.54	279.65	1.20
28	4.41	2.27	2.14	1.83	0.31	279.55	1.28
May 5	4.37	2.18	2.19	1.82	0.37	279.61	1.27
12	4.32	2.22	2.10	1.76	0.34	279.49	1.23
19	4.41	2.29	2.12	1.70	0.42	279.22	1.19
26	4.44	2.39	2.05	1.76	0.29	279.17	1.23
June 2	4.44	2.47	1.97	1.93	0.04	279.09	1.35
9	4.47	2.35	2.12	2.22	-0.10	278.98	1.55

a/ Average yield at Friday weekly tender.
b/ Closing market yield for Friday in New York.
c/ Spread between spot and forward rate in per cent per annum.
d/ Net of difference in bill yield less discount on 3-month sterling.
e/ Spot rate in New York market in U.S. cents.
f/ Spread between spot and forward rates in U.S. cents.

United Kingdom: Selected Capital Market Yields

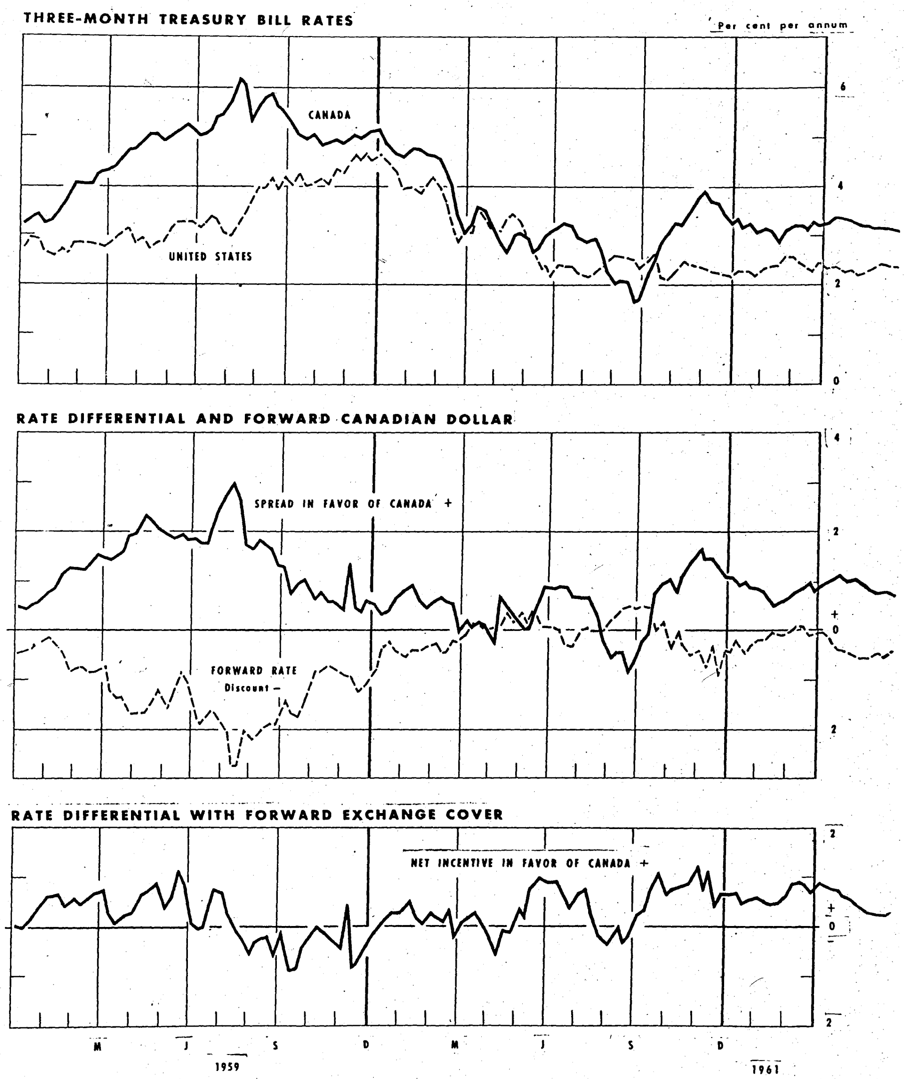
	6-year bond[a/]	15-year bond[b/]	War loan[c/]	Consols[d/]	Share yield[e/]	Yield gap[f/]	Share prices[g/]
1960 - High	6.11	6.00	5.94	5.70	4.96	1.49	338.6
Low	4.93	5.33	5.53	5.02	3.74	0.63	294.6
Apr. 14	6.03	6.11	6.20	5.98	4.39	1.59	348.8
21	5.96	6.11	6.15	5.92	4.32	1.60	356.7
28	5.97	6.12	6.15	5.90	4.24	1.66	362.8
May 5	5.99	6.13	6.19	5.94	4.30	1.64	359.1
12	5.95	6.13	6.20	5.94	4.22	1.72	365.3
19	5.97	6.13	6.23	5.98	4.33	1.65	357.3
26	6.05	6.18	6.28	6.08	4.33	1.75	356.3
June 2	6.09	6.19	6.33	6.08	4.53	1.55	342.0
9	6.15	6.25	6.41	6.17	4.58	1.59	341.8

a/ 5-1/2 per cent Exchequer, 1966.
b/ 3 per cent Savings Bond 1965-75.
c/ 3-1/2 per cent War Loan (undated).
d/ 2-1/2 per cent Consol (undated)
e/ Financial Times.
f/ Difference between yield on 2-1/2 per cent Consols and share yield.
g/ Financial Times.

Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures



9

Chart 2

INTEREST ARBITRAGE, NEW YORK / LONDON

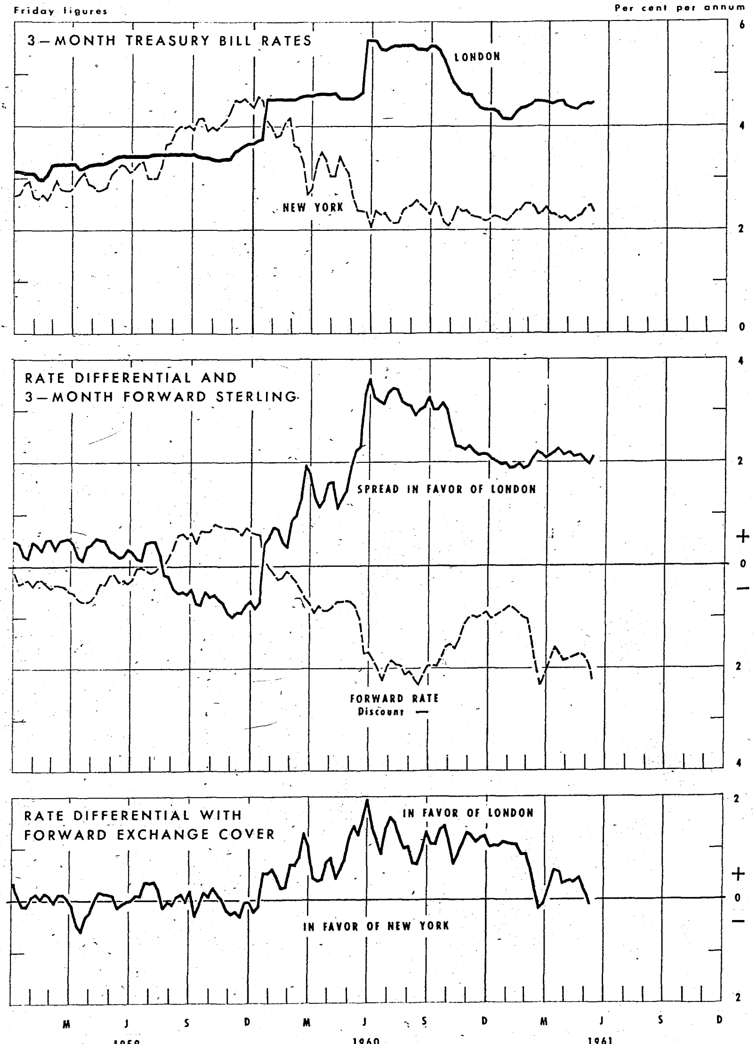
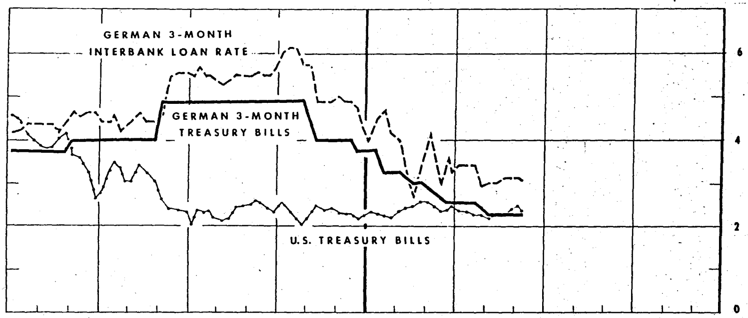


Chart 3

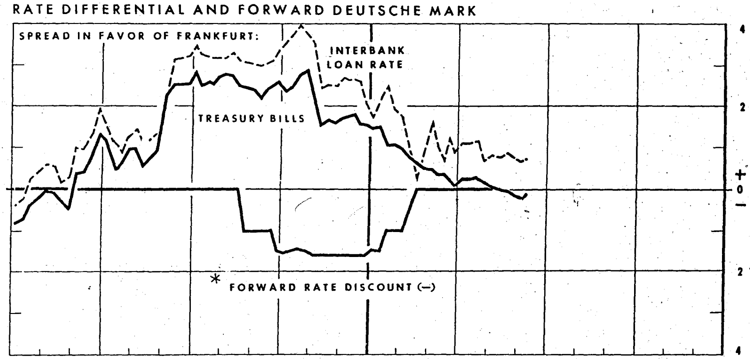
INTEREST ARBITRAGE, NEW YORK/FRANKFURT

Friday figures

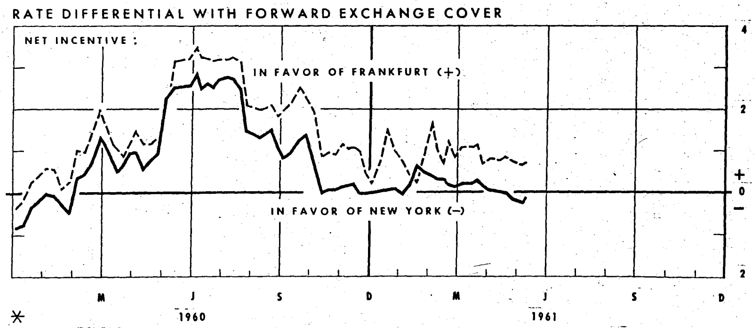
3-MONTH TREASURY BILL RATES AND
GERMAN 3-MONTH INTERBANK LOAN RATES



RATE DIFFERENTIAL AND FORWARD DEUTSCHE MARK



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER



* Note: Special forward dollar rate (either flat or premium on spot) available to German commercial banks.

Chart 4

INTEREST ARBITRAGE, FRANKFURT/LONDON

Friday figures

Per cent per annum

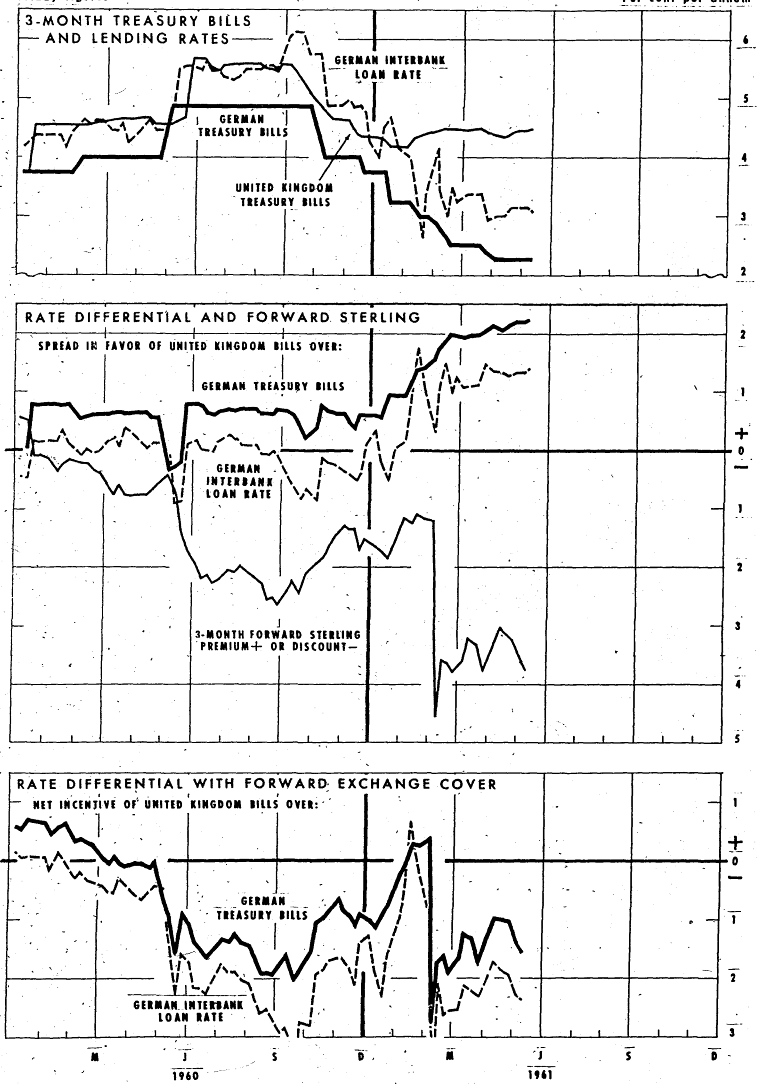
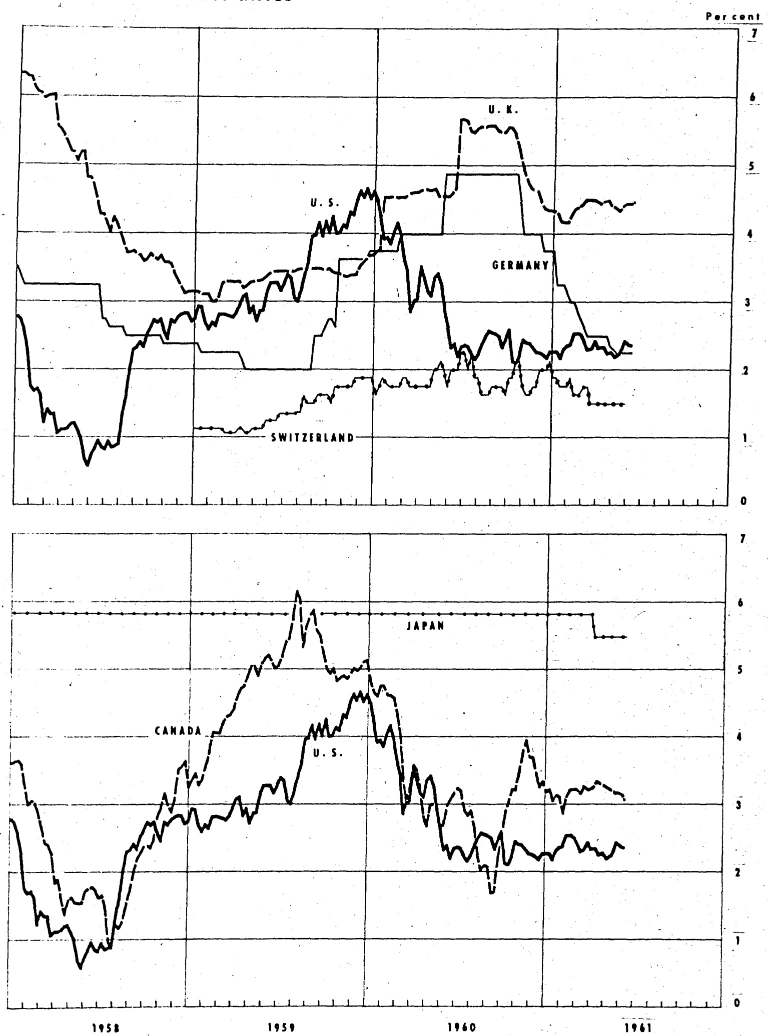


Chart 5

SHORT-TERM INTEREST RATES *



*

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

13

Chart 6

LONG-TERM BOND YIELDS

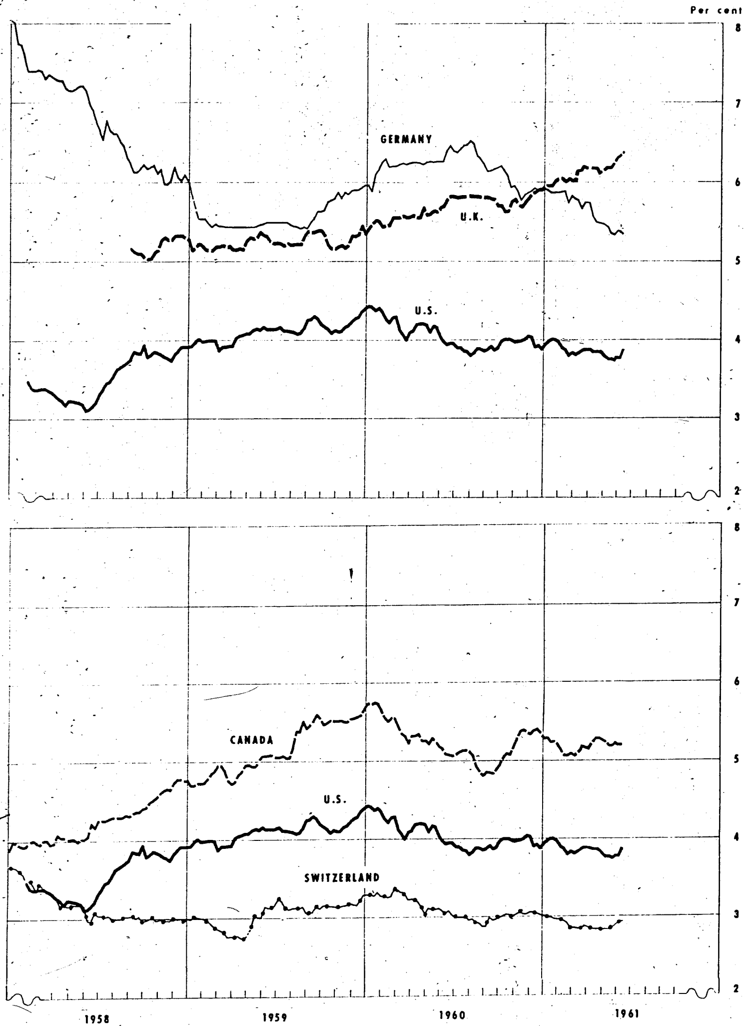
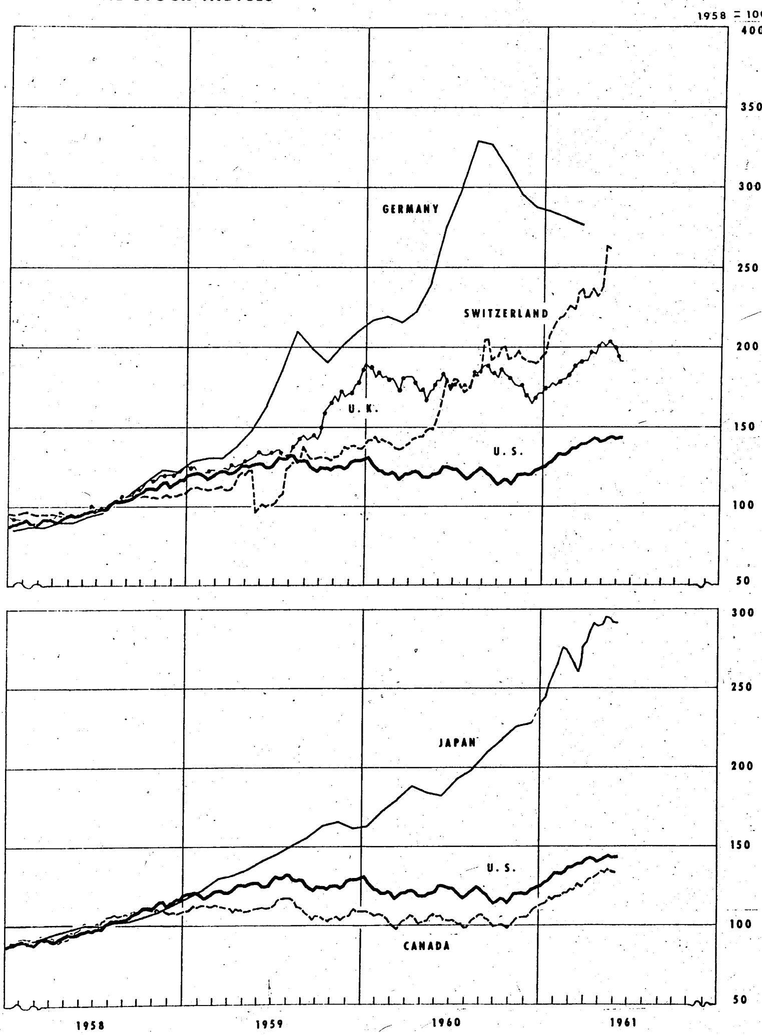


Chart 7

INDUSTRIAL STOCK INDICES *



*

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

15

Chart 8

MAJOR CURRENCIES IN TERMS OF THE SPOT U. S. DOLLAR

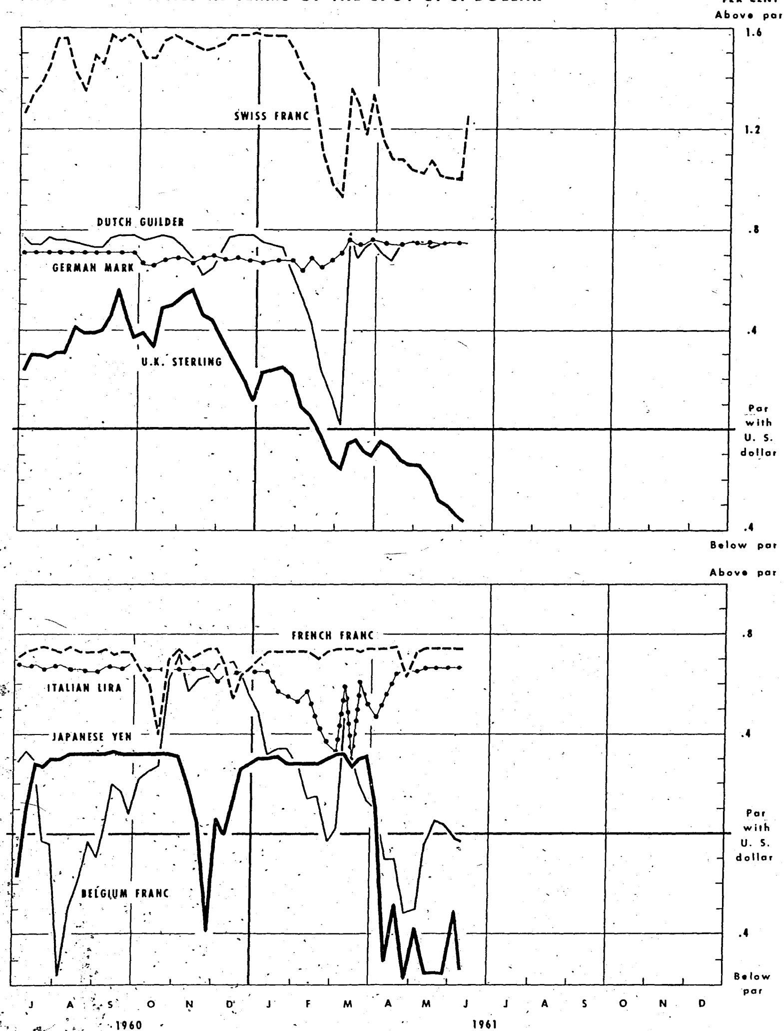


Chart 9

3-MONTH FORWARD RATES - LONDON QUOTATIONS