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H.13 FEDERAL RESERVE BANK
No. 20 OF RICHMOND

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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 during July

The dominant influence in financial markets in the United Kingdom during July was the Government's new restrictive measures on July 25. All interest rates rose following the increase in Bank rate from 5 to 7 per cent. Money market yields rose sharply with the yield on the 3-month Treasury bill rising from 4.63 per cent on July 21 to 6.69 per cent on August 4. As a result, the incentive to hold Treasury bills on a covered basis moved in favor of London, but a large discount on forward sterling, over 4 per cent, held this covered incentive to less than one-half per cent. Yields on longer-term Government securities, which were already high, rose about one-fourth per cent further, partly reflecting the rise in the general level of interest rates, as well as in expectation of the squeeze on bank and nonbank liquidity likely to result from increases in Special Deposits and in excise and sales tax rates. The rise was reinforced by sales from trustees following the passage of the Trustee Investment Act which permits them to hold up to half of their funds in equities.

The increase of Special Deposits from 2 to 3 per cent was aimed at curtailment of the rise in bank loans which in the first half of 1961 was substantially larger than that of the last half of 1960. This rise was principally financed by sales of British Government securities. The increased restrictions on bank credit and the increase in indirect taxes combined with the general rise in interest rates are expected to hold down any rise in domestic demand.

The decline in official gold and convertible foreign exchange reserves in July, which was the largest of any month for many years, reflected further outflows of private funds and also partial repayments to certain European central banks which had agreed to hold part of their sterling accruals following the revaluations of the German mark and the Netherlands guilder in early March. The seasonally adjusted foreign trade figures for the second quarter of 1961 were noticeably improved over the preceding quarter but this was entirely due to a decline in imports rather than any marked rise in exports. The spot rate on sterling strengthened sharply following the measures of July 25 and the drawing of \$1.5 billion from the IMF (plus a \$500 million standby). On the other hand the discount on 3-month forward sterling remained large.

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DECONTROLLED AFTER SIX MONTHS

Money market. The sharp increase in Bank rate from 5 to 7 per cent brought a corresponding rise in money market rates, as well as in bank lending and deposit rates. The yield on the United Kingdom Treasury bill rose from 4.63 per cent on the July 21 tender to 6.69 per cent on July 28, and showed little change thereafter (see Table and Chart 2). The movement in the spread between U.K. and U.S. Treasury bill yields from 2.47 per cent on July 21 to 4.45 per cent on July 28 was due wholly to the rise in the U.K. bill yield. The spread in favor of London had been more than offset over the first three weeks of July by the large discount on 3-month forward sterling, over 4 per cent near the beginning of the month and later about 3 per cent. In the last week of July and the first week of August, despite return of the forward discount to about 4 per cent, the incentive to shift funds on a covered basis was slightly in favor of London. On August 4 the net covered incentive was 0.42 per cent in favor of London compared with about 0.52 per cent in favor of New York before the change in Bank rate.

Other money market rates also increased in the last week of the month with the cost of day-to-day loans up from 3-3/8 to 4-3/8 per cent to 5-3/8 to 5-7/8 per cent.

Government securities market. Following the presentation of new restrictive measures designed to reduce domestic demand, yields on British Government bonds moved up further by about one-fourth per cent. The sharp increase in the general level of lending and deposit rates and the possibility of further sales of Government securities by the banking sector to supplement its liquidity position in the face of the new call for Special Deposits, reinforced the rise. (It is to be noted, however, that the Chancellor stated that "in making this call the Governor of the Bank of England has made it clear that the impact should fall on advances.") Some sales by trustees following the passage of the Trustee Investment Act on August 3 also contributed to pushing yields higher. The announcement of the Government Broker in the securities market on August 12 that brokers should not expect the authorities to support Government bond prices at any particular level against a falling trend was evidently a warning to trustees and the London clearing banks that further large sales by them could result in substantial capital losses. By early August the yield on undated 3-1/2 per cent War Loan was only slightly below 7 per cent (see Table and Chart 6) compared with 6.17 per cent in mid-June and 5.95 per cent in early January.

Lending and deposit rates. The jump in the Bank rate has affected most interest rates in the United Kingdom. The interest rates on 7-day bank deposits was increased from 3 to 5 per cent while the interest on finance house deposits at 6 months' notice was up from 6 to 7 per cent. The recommended rates for the loans of the London clearing banks to the nationalized industries have been raised from 5 to 7 per cent, for loans to first class industrial borrowers from 5-1/2 to 7-1/2 per cent, and for loans to other business and private borrowers from 6 to 6-1/2 per cent to 8 to 8-1/2 per cent.

Maximum interest rates on installment credit for the purchase of automobiles were raised in early August by 1 per cent to 10 per cent for new cars, 11 per cent for cars under 3 years old and to 12 per cent for autos over 3 years old and all motor cycles. Rates of interest charged by the Public Works Loan Board on new loans to local authorities were increased. The most recent movements in these rates have been:

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

New restrictive measures. In order to relieve the immediate strain on the balance of payments and overcome some of the longer-run structural problems which the British economy is facing, new restrictive measures were announced in Parliament on July 25 and an IMF drawing of \$1,500 million with a standby of \$500 million were requested. The most important of the domestic measures include:

- (a) A rise in Bank rate from 5 to 7 per cent;
- (b) A rise in Special Deposits from 2 to 3 per cent;
- (c) A 10 per cent increase in indirect taxes.

The 10 per cent rise in indirect taxes, to the maximum provided for in this year's budget, is expected to yield about £210 million, or more than 1 per cent of total consumer expenditure. This additional revenue will have the effect of converting the £69 million over-all budget deficit into a substantial surplus. Other measures that will go into effect immediately are a rise in postal rates and telephone charges. A freeze on Civil Service salaries was announced last week.

Measures that will become effective later include more cooperation between Government, labor and management "... to hold back further increases in wages and profits" and a possible reduction in farm support prices. The Government also announced its intention to hold down its overseas expenditures in the next fiscal year beginning April 1962, to 20 per cent below the amount to which they would otherwise have risen. This is to be done in part by cutting military expenditures in NATO; outlays for diplomatic services abroad are also to be reduced.

The banks and insurance companies are being asked to curtail credit for personal consumption and speculative real estate development rather than for industrial investment.

Clearing bank statistics. The rise in outstanding loans of the London clearing banks to private borrowers continued in the month ending in mid-July with an increase of £42 million to £3,478 million. The banks

sold £36 million of British Government securities during the month and the liquidity ratio increased to 32.9 per cent from 32.2 per cent in the month to mid-June. The increase in Special Deposits from 2 to 3 per cent, half to be deposited at the Bank of England on August 16 and the remainder on September 20, will tend to reduce the liquidity ratio, which was higher in July than at the corresponding time in either 1959 or 1960. Recent figures for the clearing banks are as follows (in millions of pounds):

	<u>Private advances</u>	<u>Invest- ments</u>	<u>Liquidity ratio</u>
<u>Total</u>			
1958 - July	1,932	2,193	33.8
<u>Change to:</u>			
1959 - July	+ 570	- 382	- 1.1
1960 - July	+ 659	- 471	- 1.5
1961 - May	+ 222	- 346	+ 0.3
June	+ 52	- 22	+ 0.7
July	+ 42	- 36	+ 0.7

Installment credit. The fourth successive monthly increase in the total debt outstanding on installment credit in June was due completely to new credit extended by finance houses, principally for automobile financing. In addition to the increase in interest costs of installment credit reported above, minimum deposit rates of between one-fourth and one-third, depending on the age of the vehicle, were announced. Recent figures of installment credit outstanding are (in millions of pounds):

	<u>Household goods stores</u>	<u>Finance houses</u>	<u>Total</u>	<u>Change</u>
1959 - July	273	469	742	--
1960 - July (peak)	332	639	961	+ 219
December	325	610	935	- 26
1961 - April	308	631	939	+ 4
May	306	643	949	+ 10
June	306	651	957	+ 8

New capital issues. The value of new capital issues excluding Treasury operations during the first half of 1961 was sharply up over recent years. The rise in June was especially large and partially reflected the desires of British industry to meet their capital needs without being subject to the increasing credit restraints on the banking sector. Total new issues were broken down as follows (in millions of pounds):

	<u>Total</u>	<u>United Kingdom</u>	<u>Geographical distribution</u>	
			<u>British overseas countries</u>	<u>Foreign countries</u>
1959 - 1st half	243.8	212.8	30.9	0.1
2nd "	236.5	222.4	4.4	9.8
1960 - 1st "	271.8	243.7	24.6	3.5
2nd "	284.9	270.6	9.2	5.0
1961 - 1st "	339.8	304.7	30.4	4.7

Foreign trade. The seasonally adjusted trade deficit in June was £20 million compared with £70 million the month before. While the May increase and the June decline continued to reflect the distortions of the April-May unofficial London stock strike, the second-quarter average deficit of £42 million compared favorably with the £64 million average in the first quarter. However, this second-quarter improvement reflected a sharp fall-off in imports while exports showed little change from the first quarter. Recent monthly averages of seasonally adjusted trade figures (in millions of pounds) are:

	<u>Exports</u>	<u>Re- exports</u>	<u>Imports</u>	<u>Trade balance</u>
1960	296	12	380	- 72
1961 - I	309	12	385	- 64
II	307	13	362	- 42
April	306	12	354	- 36
May	283	12	365	- 70
June	331	15	366	- 20

Foreign exchange reserves. The sterling area's official reserves of gold and convertible currencies took their largest fall in over ten years in July when they declined by £114 million to £876 million. This is the sixth successive monthly fall and brought the total loss of reserves this year to £278 million. The new IMF drawing amounts to £535 million. Part of the July outflow is reported to have been due to partial repayments to European central banks which had increased their short-term sterling holdings under the "Basle Agreement." Some £200 million was still outstanding on these debts at the time of the drawing, and is to be repaid over the next few months.

Foreign exchange rates. The exchange rate on spot sterling declined through mid-July to its low for the year. Immediately following the Chancellor of the Exchequer's message to Parliament on July 25, the spot rate began to strengthen and by early August was well over par (see Table and Chart I). The per annum discount on 3-month forward sterling rose above 4 per cent to its high for the year in early July and then declined to about 3 per cent on July 21. Thereafter the discount rose

sharply (see Table and Chart 9) in response to the rise in Bank rate and some continuing apprehension in the market that the Government's new program might not be sufficient to meet Britain's long-term needs.

Bullion market. The dollar equivalent of the fixing price of gold in July continued the slight upward movement which began in early June. By early August the price was at its highest level since mid-February.

	<u>Fixing price</u> <u>(in dollars)</u>
April 7	35.0779
May 5	35.0673
June 2	35.0739
July 7	35.0951
August 11	35.1517

Stock market. Prices on the London stock market declined generally through July but by early August showed renewed buoyancy reflecting the passage of the Trustee Investments Act which allows trustees to invest up to half of their funds in equities. After declining to 307.3 on July 28, the Financial Times industrial index rose 7 per cent to 328.6 on August 4. This rise was followed by some profit taking (see Table and Chart 7).

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

- 7 -

Date	3-mo. Treasury bill			Discount on 3-mo. sterling ^{c/}	Net incentive to hold U.K. bill ^{d/}	Exchange rate	
	U.K. ^{a/}	U.S. ^{b/}	Differ- ence			Spot sterling e/	Discount on 3-mo. sterling ^{f/}
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
1961 - High	6.71	2.52	4.45	4.36	1.13	280.73	3.04
Low	4.17	2.16	1.88	0.79	-2.12	278.47	0.55
June 9	4.47	2.35	2.12	2.22	-0.20	279.98	1.55
16	4.50	2.33	2.17	2.48	-0.31	279.73	1.73
23	4.53	2.28	2.25	3.20	-0.95	278.82	2.23
30	4.54	2.27	2.27	3.59	-1.42	278.82	2.57
July 7	4.54	2.30	2.24	4.35	-2.12	278.59	3.04
14	4.57	2.20	2.37	3.85	-1.48	278.47	2.68
21	4.53	2.26	2.47	2.99	-0.52	278.47	2.08
28	6.69	2.24	4.45	4.07	0.38	279.28	2.84
Aug. 4	6.71	2.29	4.42	4.00	0.42	280.18	2.80

^{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	228.6
Low	4.93	5.33	5.53	5.02	3.74	0.63	294.6
1961 - High	6.55	6.55	6.92	6.78	5.14	1.98	365.3
Low	5.95	5.97	5.95	5.70	4.22	0.97	306.2
June 9	6.15	6.25	6.41	6.17	4.58	1.59	341.8
16	6.15	6.25	6.41	6.17	4.73	1.44	331.0
23	6.26	6.33	6.53	6.32	4.83	1.49	327.2
30	6.37	6.44	6.64	6.45	4.87	1.58	322.8
July 7	6.36	6.43	6.64	6.48	5.00	1.48	313.5
14	6.37	6.48	6.72	6.53	5.13	1.40	306.2
21	6.34	6.47	6.62	6.44	5.01	1.43	313.8
28	6.52	6.55	6.72	6.57	5.14	1.43	307.3
Aug. 4	6.65	6.65	6.92	6.78	4.80	1.98	328.6

^{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.

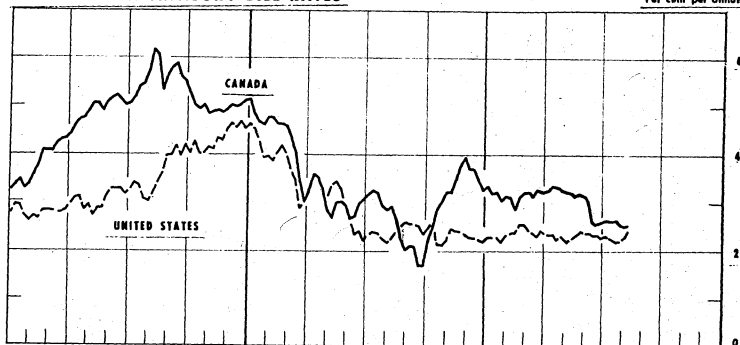
^{g/} Financial Times.

INTEREST ARBITRAGE, UNITED STATES / CANADA

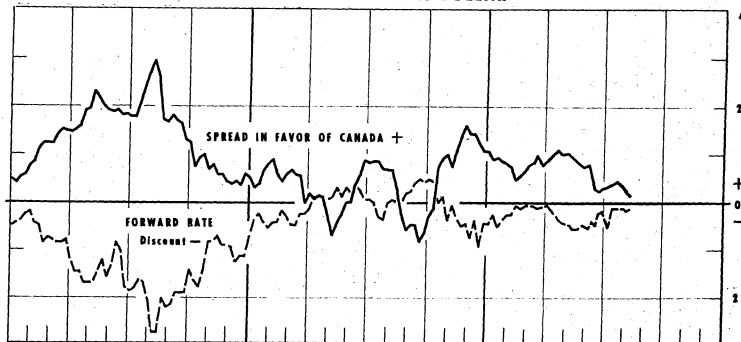
Thursday figures

THREE-MONTH TREASURY BILL RATES

Per cent per annum



RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

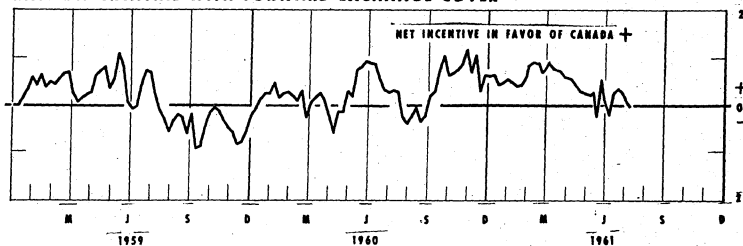
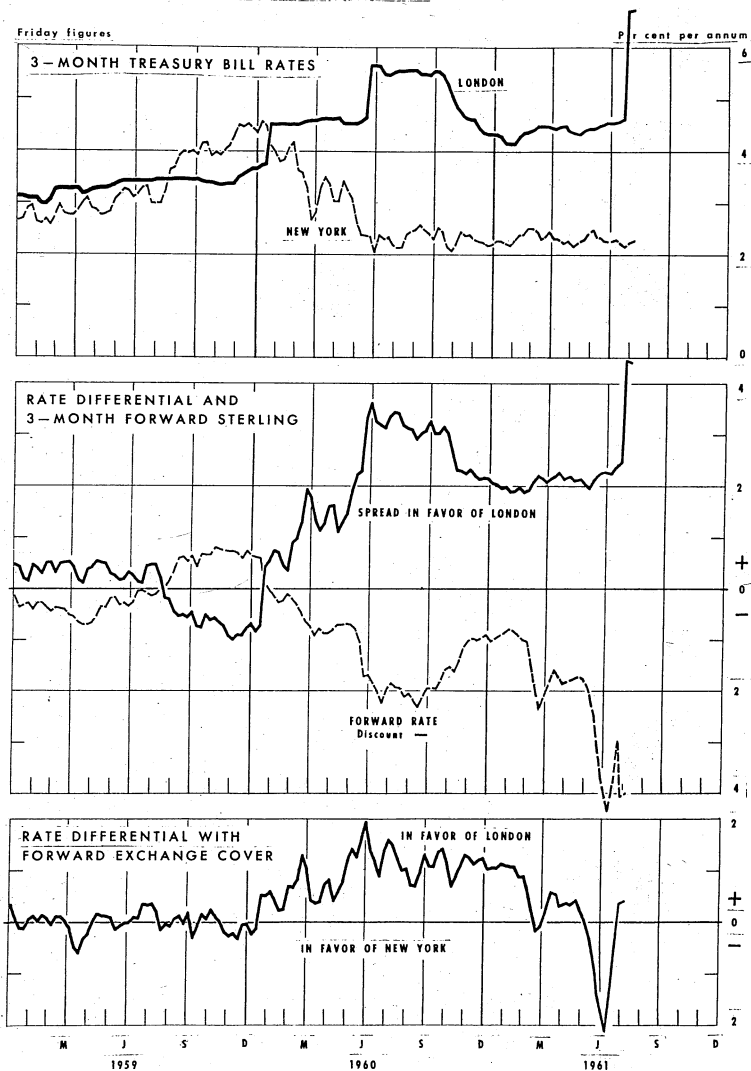


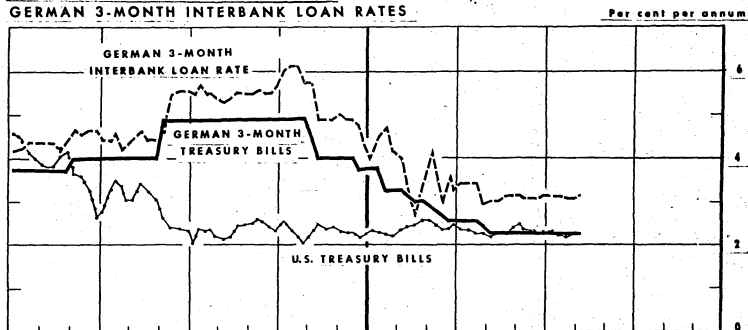
Chart 2

INTEREST ARBITRAGE, NEW YORK / LONDON

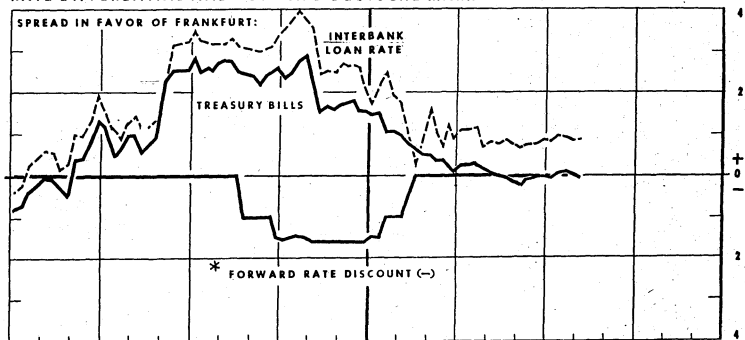


INTEREST ARBITRAGE, NEW YORK / FRANKFURT

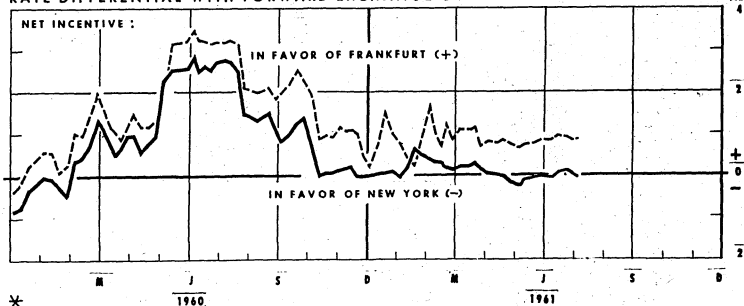
Friday figures

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

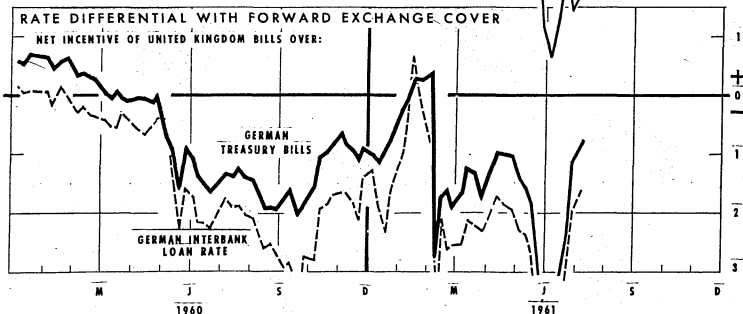
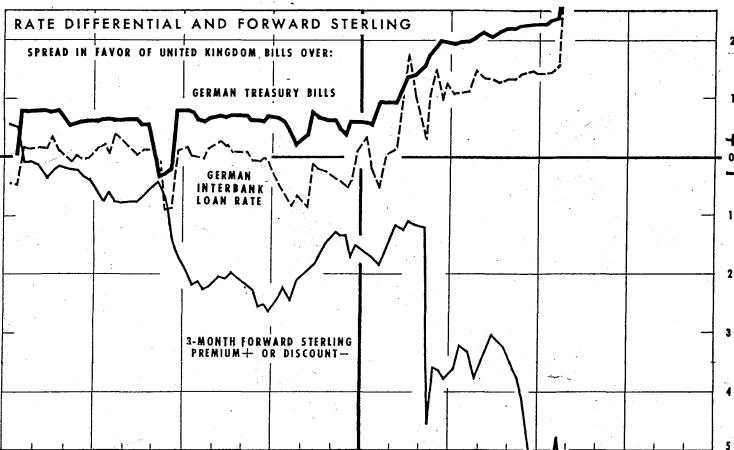
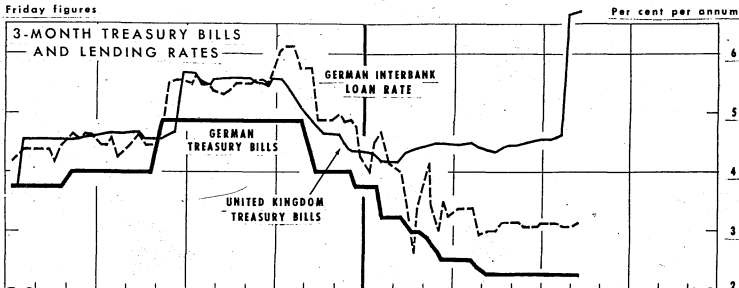
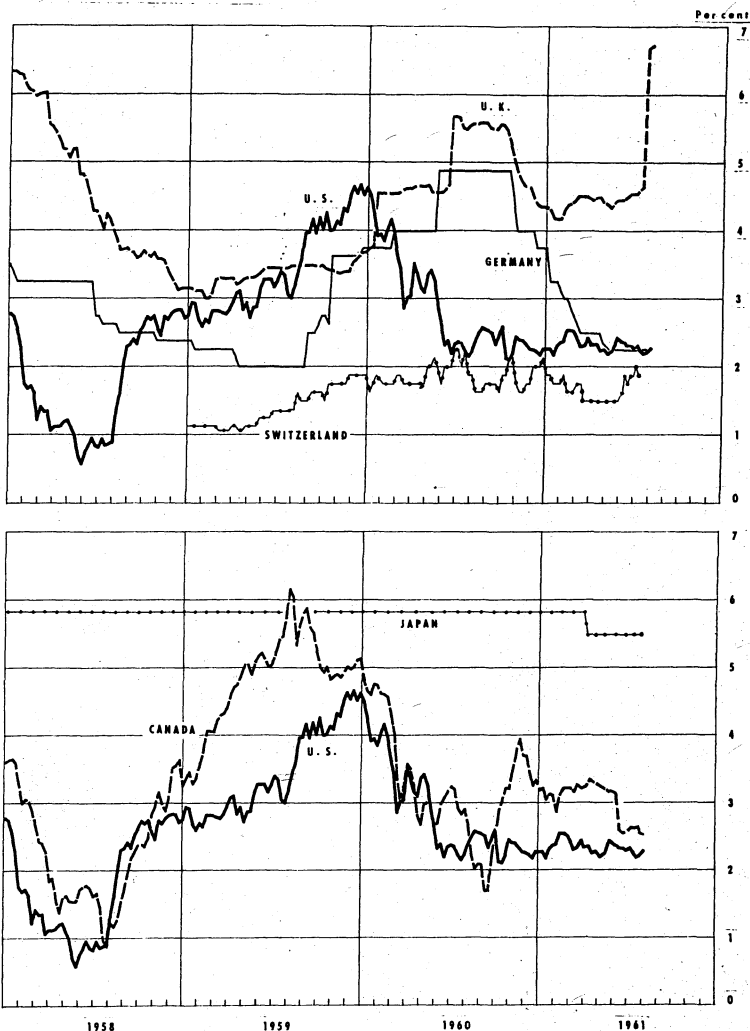


Chart 5.

SHORT-TERM INTEREST RATES *



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

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Chart 6

LONG-TERM BOND YIELDS

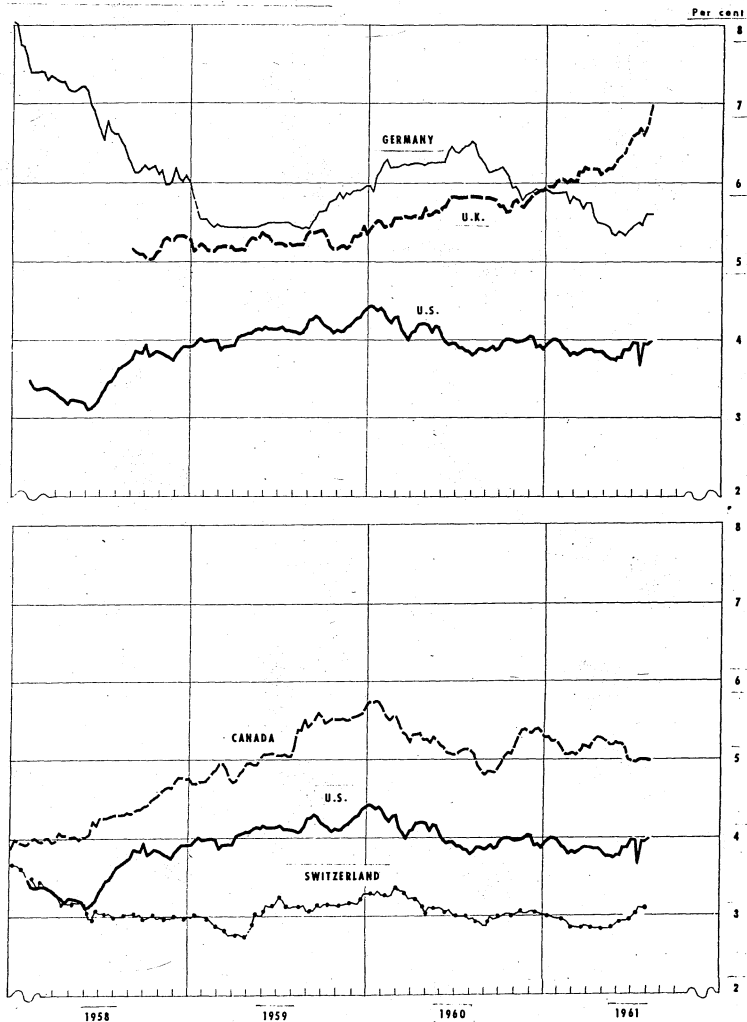
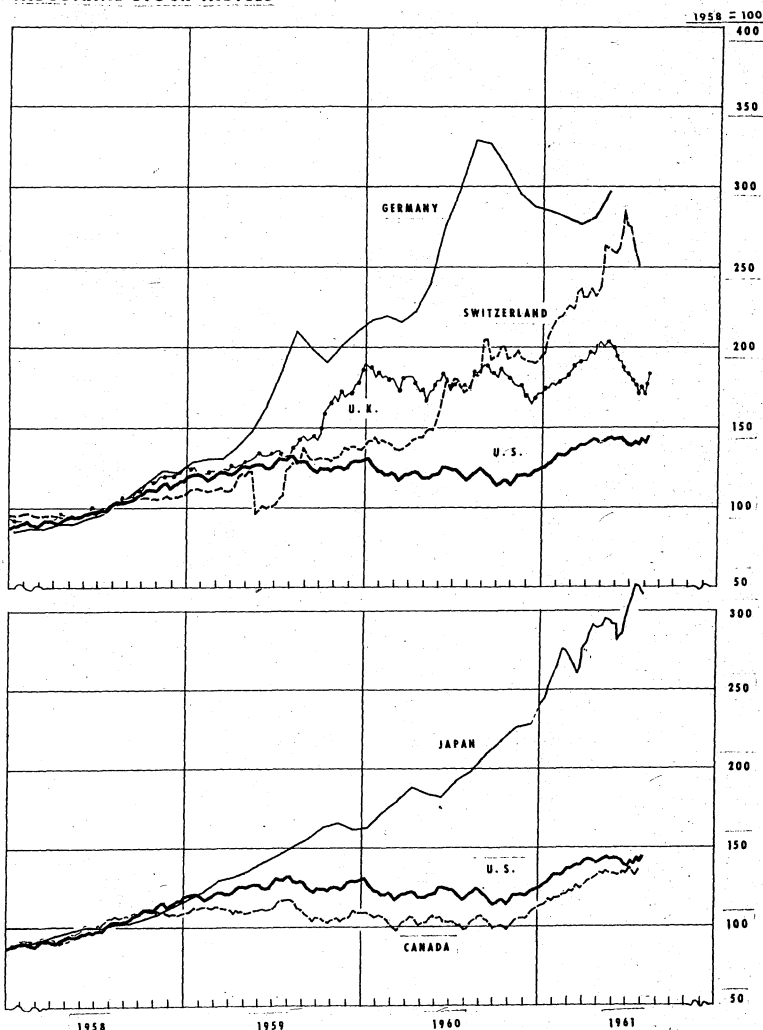


Chart 7

INDUSTRIAL STOCK INDICES *



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

Chart 8

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

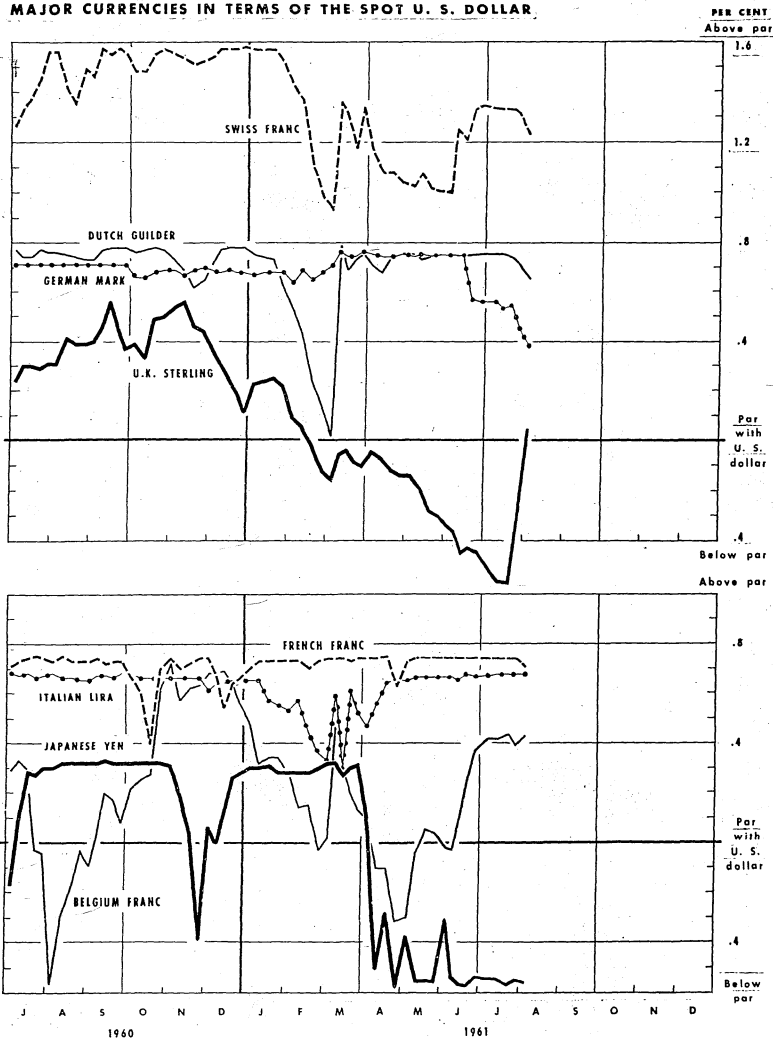


Chart 9

3-MONTH FORWARD RATES - LONDON QUOTATIONS

