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BOARD OF GOVERNORS
OF THE
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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 January

Purchases by domestic and foreign investors brought about general declines in interest rates in London money and capital markets in January and early February. The monetary authorities intervened vigorously in mid-February in an attempt to check the tendency for interest rates to move to lower levels.

In the first days of January rates on local-authority and Euro-dollar deposit rates fell rapidly from the year-end highs with the return to London of European banking funds, withdrawn for year-end window-dressing purposes. But the Treasury bill rate eased only fractionally from the January 5 to January 12 tender, despite substantial bill purchases by the clearing banks from the discount houses.

After mid-January, a downward trend had become apparent in both the bill and the gilt-edged markets. The market rate for the 91-day bill had dropped from 5.34 per cent on January 12 to 5.16 per cent by January 26 on the basis of expectations that Bank rate was about to be reduced. A similar trend became evident in the gilt-edged market later in January, particularly after January 19 when the Government broker exhausted his tap supplies of the 2008-12 Treasury bond which had served to anchor the long end of the yield curve. The concentration of price rises in the long end of the market can be seen in the selected government bond price changes over the past five weeks:

	Jan. 2	Feb. 1	Feb. 8
5-1/2% Exchequer 1966	98-3/16	+ 5/32	+ 5/32
2-1/2% Savings, 1964-67	84-7/16	+ 11/32	+ 23/32
5% Conversion 1971	90-23/32	+ 8/32	+ 1/32
5-1/2% Funding 1982-84	90-9/32	- 7/32	+ 3/32
3-1/2% Funding 1999-2004	57-1/32	+ 28/32	+ 22/32
5-1/2% Treasury 2008-12	83-3/16	+1-9/16	+2-29/32
3-1/2% War Loan	51-3/4	+1-1/16	+1-14/16

An unexpected boom in long-term securities developed in early February when British institutional investors, especially insurance companies and pension funds, entered as purchasers of long-term and undated bonds

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DECONTROLLED AFTER SIX MONTHS

in a volume described by dealers as "the biggest for some considerable time." These investors considered current yields to be attractive, both as a long-term return and by comparison with stock yields, given the present uncertain industrial outlook. The large price rises in long bonds between February 1 and 8 are shown above.

Declining money rates were accompanied by a capital inflow from abroad which accounted for the £33 million rise in official reserves and the rise in the spot pound from 280.97 U.S. cents to 281.16 U.S. cents during the month of January. The early-February momentum in bond prices must also have further stimulated capital from abroad.

In the first week in February, the monetary authorities acted firmly to check the declines in interest rates and the expectations of a Bank rate cut. In the week ending February 10, a majority of the discount houses (perhaps as many as seven or eight) were forced to borrow at the penalty Bank rate, according to press reports. As a result, the bill rate moved from 5.16 per cent on February 2 to 5.34 per cent in after-tender trading on February 9. The Government broker also kept a tight rein on the price of the 5-1/2 per cent Funding issue, 1982-84, the longest maturity now in his portfolio on a volume basis.

Despite a deteriorating labor situation in Britain and, on February 14, the announcement of an appreciable worsening of Britain's trade position in January, the demand for spot sterling was maintained in mid-February. This continued strength of sterling may have reflected both the shift into sterling assets of a part of the large volume of Euro-dollar deposits placed by German and other continental banks in London during January and some direct foreign purchases of British financial assets. In early February the covered yield on 3-month local-authority deposits exceeded the Euro-dollar rate by 0.34 to 0.46 per cent per annum. The Economist commented that foreign funds had entered the local-authority market not in 7-day but 3-month deposits (February 10, 1962, page 548). With the exchange risk from dollars to D-marks covered by a contract with the Bundesbank, a German commercial bank can be indifferent between a U.S. dollar and a sterling-denominated deposit with exchange cover. In addition, the prospects for short-run capital gains in the bond market could have attracted uncovered funds from abroad as a short-run speculation.

Money market. The market yield in after-tender trading on the 91-day Treasury bill declined from 5.34 per cent on January 5 to 5.16 per cent on January 26 at a time when financial markets regarded a further cut in Bank rate as imminent (see Table and Chart 2). With surplus funds available, the clearing banks were active purchasers of bills, adding £120 million to their holdings between mid-December and mid-January.

The monetary authorities began to exert strong pressures on the discount houses in early February and the bill rate was pushed up to 5.34 per cent on February 9 (see Table and Chart 2). The bill houses were forced to borrow from the Bank of England on six occasions in the last few weeks and a majority of the houses (perhaps seven or eight) had to borrow during the week of February 5-10.

The rates on Euro-dollar and local-authority deposits declined rapidly in the early days of January when European banking funds, withdrawn in December for year-end window-dressing purposes, were returned (see Table). The 3-month local-authority deposits dropped from 7 per cent at the year-end to 6-1/2 per cent on January 5 and to 6-1/4 per cent thereafter. Euro-dollar deposits were quoted at 3.88 per cent on December 29 but fell to 3.50 per cent on January 5 and 3.38 per cent on January 12. Throughout the period under review, the net return on local-authority deposits (with exchange risk covered) was substantially in excess of the rate on Euro-dollar deposits as the following figures show (in per cent per annum):

	Jan.5	Jan. 12	Jan. 19	Jan.26	Feb.2	Feb.9
Local authority deposit	6-1/2	6-1/4(to 3/8)	6-1/4(to 5/16)	6-1/4	6-3/8	6-3/8
Forward exchange cover	-3.88	-3.67	-2.50	-2.56	-2.53	-2.66
Net return	3.87	3.58	3.75	3.69	3.84	3.72
Euro-dollar deposit	3.50	3.38	3.38	3.38	3.38	3.38
Incentive in favor of local-authority deposit	0.37	0.20	0.37	0.31	0.46	0.34

Despite the incentive in favor of covered local-authority deposits, press reports indicated that only "fair" quantities of foreign money were coming directly into the market. Some of the funds may have been supplied indirectly through London institutions. Demand conditions pushed up the local-authority rate to 6-3/8 per cent in early February.

Since early January, the difference in favor of the British Treasury bill has flucuated between 2.49 and 2.62 per cent but the discount on the forward pound wiped out this advantage (see Table and Chart 1).

Gilt-edged market. There was a continuing demand for government securities during the period under review. During the first half of January, yields on shorter- and medium-term bonds declined but long-term yields eased only slightly (see Table and Chart 6). During the week of January 19 when the Government broker's supplies of 5-1/2 per cent Treasury bonds, 2008-12, were sold out, longer-term yields began to move down. The availability of this issue on a tap basis had served to anchor longer-term yields.

Boom conditions developed in the long-term and undated sectors of the market in early February when institutional investors, especially insurance companies and pension funds, became substantial buyers. Between February 1 and 8, the yield on War Loan dropped 23 basis points, Consols

24 points and that on the 2008-12 issue 25 basis points, as may be seen in the following changes in bond yields (in per cent per annum):

	3% 1965-75	5-1/2% 1982-84	3-1/2% 2008-12	3-1/2% War Loan	2-1/2% Consols	Index of prices of government securities
1961						
Nov. 24	6.29	6.26	6.69	6.82	6.55	83.3
1962						
Jan. 5	6.27	6.30	6.65	6.77	6.57	83.3
18	6.21	6.33	6.60	6.68	6.52	84.5
Feb. 1	6.25	6.35	6.50	6.63	6.44	84.5
8	6.18	6.30	6.25	6.40	6.20	85.5

Institutional investors were anxious to maintain current yields on a long-term basis. Official intimations that a lower level of bond yields in Britain might be in order and the uncertain outlook for equities were important reasons contributing to the demand for long-term bonds.

The local-government market has been quite active during the past six weeks. On January 11, three local authorities offered £5 million each in a 6-1/2 per cent issue 1971-72 at a price of 99-1/2. On February 1, a £12 million 6-1/4 per cent City of London issue was on offer at £97. On February 14, a £12 million 6-1/4 per cent Corporation of London issue, 1971-72 was opened for applications at £97.

Exchequer receipts and payments. British Treasury fiscal returns through the end of January add further doubts that the Chancellor's hopes for a substantial reduction in the over-all deficit for 1961-62 (ending March 31) will be realized. Estimates for the ten months ending on February 3 show a current year's deficit as large as that in 1960-61 as the following data (in millions of pounds) demonstrate:

	April to February 3		Fiscal year	
	1960-61	1961-62	1961-62 estimate	1960-61 actual
Above-the-line				
Revenue	4,608	5,033	6,508	5,934
Expenditure	4,703	5,051	6,002	5,787
Balance	- 95	- 18	+ 506	+ 147
Below-the-line net expenditure	- 478	- 567	- 575	- 541
Over-all deficit	- 573	- 585	- 69	- 394

The work-to-rule in the postal service in January may have reduced tax receipts during January and to some extend have exaggerated the unfavorable 1961-62 position as of February 3.

London clearing banks. For the first time since August, advances of the London clearing banks to the private sector rose between mid-December and mid-January by £30 million. Despite the new loans, the banks showed an average liquidity ratio of 36.1 per cent (33.1 per cent in January 1960) largely because of a £120 million expansion in Treasury bills. Recent quarterly changes in selected bank assets (mid-month data in millions of pounds):

		Liquid assets		Loans to public sector			Loans to private sector	
	Net deposits	Amount	Per cent	Govt. securities	Treas. bills	Total a/	Advances	Total b/
1960								
(March)	(6,073)	(2,217)	(31.5)	(1,368)	(941)	(2,937)	(2,933)	(3,086)
June	+ 103	+ 36	(31.4)	- 123	+ 17	- 122	+ 137	+ 129
Sept.	+ 101	+ 23	(31.6)	- 62	+ 24	- 4	+ 64	+ 51
Dec.	- 15	+ 123	(31.9)	- 24	+ 47	+ 25	+ 48	
1961								
March	- 118	- 212	(30.4)	- 85	- 216	- 349	+ 133	+ 191
June	+ 216	+ 207	(32.2)	- 102	+ 177	+ 83	+ 144	+ 158
Sept.	- 44	+ 128	(34.3)	- 36	+ 112	+ 72	- 180	- 151
Dec.	+ 24	+ 156	(35.3)	+ 6	+ 4	+ 129	- 75	- 77
1962								
Jan.	+ 133	+ 124	(36.1)	+ 3	+ 120	+ 104	+ 30	+ 43

a/ Includes loans to nationalized industries and call loans.
b/ Includes commercial and other bills.

Exporter finance. New arrangements under which banks and insurance companies will provide exporters of capital goods financing at favorable rates of interest were announced on January 23. The press estimates that the total sums involved may exceed £200 million of export financing.

The London and Scottish clearing banks have agreed to provide 3- to 5-year credits at a fixed 5-1/2 per cent regardless of changes in Bank rate. In addition, sixty insurance companies are to establish a revolving fund of £100 million for over 5-year credits at a fixed rate of 6-1/2 per cent. The companies plan to form a new company through which the funds will be channelled to exporters. These arrangements will apply only to credits guaranteed by the Export Credit Guarantee Department. For credits beyond 5 years, the banks would finance the first 5 years and the insurance companies beyond. At present, the banks are now charging about 7 per cent and insurance companies on longer-term export finance about 7-1/2 per cent.

The Financial Times calculates, on the assumption that average credit term will be for 8 years, that the insurance companies would provide £100 million (years 6 to 8) and the banks £160 million (years 1 to 5). Thus, credits available under this scheme should not be more than about £65 million per year.

Installment credit. Total installment credit outstanding declined by £4 million during December, despite an all-time high in retail sales recorded for the month. The fall reflected an unexpectedly sharp drop in credit by finance houses due mainly to the 30 per cent decline in commercial vehicles and the 33 per cent decline in motor cycle sales. The increase in credit by household goods shops exceeded the usual seasonal growth. During January, credit sales on new and used vehicles rose 18 per cent above the very low December level but were 25 per cent below the total in January 1961. Recent monthly changes in installment credit outstanding (in millions of pounds) were:

	Total for July	Monthly changes Aug.	Sept.	Oct.	Nov.	Dec.
Shops	306	- 1	- 2	0	0	+ 6
Finance houses	662	+ 4	- 16	- 11	- 11	- 10
Total	968	+ 3	- 18	- 11	- 11	- 4

Foreign trade. Britain's trade position underwent a substantial deterioration in January when the seasonally-adjusted trade deficit rose to £68 million compared with an average deficit of £41 million in the last three quarters of 1961. Exports declined from £305 million in the fourth quarter to £300 million in January and imports rose sharply from £363 million in the fourth quarter to £380 million in January. Recent seasonally-adjusted trade statistics (monthly averages in millions of pounds) are:

	1960 Year	1961 I	II	III	IV	1962 Jan.
Imports	380	385	363	357	363	380
Exports	296	309	305	309	305	300
Re-exports	12	12	13	15	13	12
Trade balance	- 72	- 64	- 45	- 33	- 45	- 68

Foreign exchange reserves. During January, Britain's gold and convertible currency reserves rose by £33 million ($92 million) to £1,218 million ($3,410 million). The rise in part reflected the return of European banking funds which had been withdrawn from London markets late in December for year-end window-dressing purposes. Recent monthly changes in reserves (in millions of pounds) were:

	1961				1962
	Sept.	Oct.	Nov.	Dec.	Jan.
Reported figure	+ 24	- 8	+ 9	- 85	+ 33
Adjusted for special transactions	+107	+112	+ 59	- 18	+ 33

Foreign exchange market. The pound was in active demand during the period under review. The spot rate moved upward from 280.96 U.S. cents on January 2 to 281.21 U.S. cents on January 31 and to 281.51 U.S. cents on February 14 (see Table and Chart 8). The continued strength of the rate reflected foreign inflows of funds into London financial markets since Britain's trade accounts deteriorated to mid-January.

London gold market. Activity picked up in the gold market in mid-January and the biggest private demand was reported since the closing months of 1960. The fixing price rose from $35.1375 per ounce on December 27 to a peak of $35.168 on January 19 and declined thereafter to $35.137 on February 14. The financial press reported that the turnover on January 19 when the flurry reached its climax "could safely be put at over $10 million" (London Times, January 26, 1962, page 20). Demand came "largely from Switzerland on behalf of other clients" and the news report identified the upsurge in demand as coming from France where the French insurgents in Algeria had made "an appeal ... to their followers to buy gold." Recent Friday prices at the London fixing were as follows (in U.S. dollars per ounce):

Jan. 5	35.154	Jan. 26	35.168
12	35.166	Feb. 2	35.163
19	35.168	9	35.149

Stock market. During January and early February, the stock market underwent only minor price adjustment. The index of share prices rose from 304.8 on December 28 to a peak of 209.6 on January 18 and was at 304.4 on February 8 (see Table and Chart 1).

Late in January, the London office of the Merrill, Lynch firm obtained a license to deal in securities. The firm intends to interest British investors -- both small and large -- in American securities and apparently intends, contrary to present British practice, to advertise. It will not attempt to develop business in British securities.

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

United Kingdom: Treasury Bill Yields and Exchange Rates

	3-mo. Treasury bill arbitrage calculation U.K. a/	U.S. b/	Difference	3-mo. pound b/	In favor U.K. bill c/	Spot pound (U.S. cents)	London deposit rates U.S. dollar (3-mo.)	Local authority (7 days not.)
1961- High	6.74	2.74	4.45	-0.79	1.13	281.62	4.00	7-1/2
Low	4.17	2.16	1.88	-4.36	-2.12	278.47	3.13	6
Nov. 17	5.31	2.53	2.78	-2.49	0.29	281.53	3.44	6-1/4
24	5.31	2.55	2.76	-2.60	0.16	281.56	3.50	6
Dec. 1	5.28	5.53	2.75	-2.92	-0.17	280.90	3.63	6-1/4
8	5.25	2.57	2.68	-2.77	-0.09	281.12	3.81	6-1/4
15	5.25	2.63	2.62	-2.93	-0.31	281.06	3.75	6-1/2
22	5.28	2.60	2.68	-2.62	0.06	280.73	3.88	6-1/2
29	5.28	2.67	2.61	-2.54	0.07	280.80	3.88	7
Jan. 5	5.34	2.74	2.60	-2.88	-0.28	280.97	3.50	6-3/4
12	5.34	2.76	2.58	-2.67	-0.09	281.15	3.38	6-1/4
19	5.22	2.71	2.51	-2.50	0.01	281.185	3.38	6-1/4
26	5.16	2.67	2.49	-2.56	-0.07	281.16	3.38	6-1/4
Feb. 2	5.16	2.67	2.49	-2.53	-0.04	281.27	3.38	6-3/8
9	5.34	2.72	2.62	-2.66	-0.04	281.45	3.38	6-3/8

a/ Market quotation for Friday.
b/ Spread between spot and 3-month forward rate in per cent per annum. Discount equals (-).
c/ Net of difference in bill yield less discount on 3-month sterling.

United Kingdom: Selected Capital Market Yields

	U.K. Government bond yields 4-1/2% 1964	3% 1965-75	3-1/2% War Loan	2-1/2% Consols	Share yield a/	Yield gap b/	Share prices c/
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
Nov. 23	5.98	6.29	6.82	6.55	5.38	1.17	293.4
30	5.90	6.23	6.77	6.49	5.29	1.20	298.0
Dec. 7	5.97	6.29	6.84	6.58	5.41	1.17	291.8
14	5.95	6.24	6.73	6.55	5.30	1.25	297.9
21	5.93	6.27	6.78	6.60	5.22	1.28	302.1
28	5.87	6.27	6.78	6.59	5.19	1.40	304.8
Jan. 4	5.85	6.27	6.77	6.57	5.15	1.42	307.1
11	5.80	6.20	6.64	6.50	5.17	1.33	305.3
18	5.65	6.21	6.68	6.52	5.10	1.42	309.6
25	5.71	6.23	6.71	6.53	5.21	1.32	302.8
Feb. 1	5.71	6.25	6.63	6.44	5.18	1.26	304.9
8	5.67	6.18	6.40	6.20	5.19	1.01	304.4

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

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Chart 1.

INTEREST ARBITRAGE, UNITED STATES/CANADA

Thursday figures

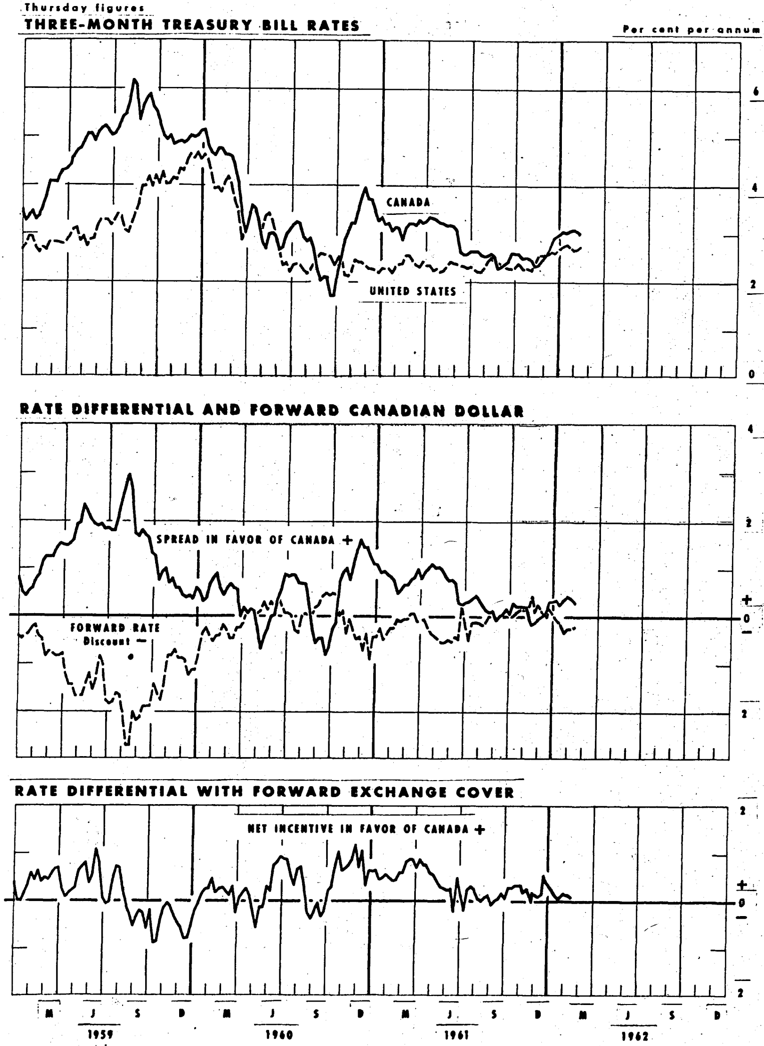


Chart 2

INTEREST ARBITRAGE, NEW YORK/LONDON

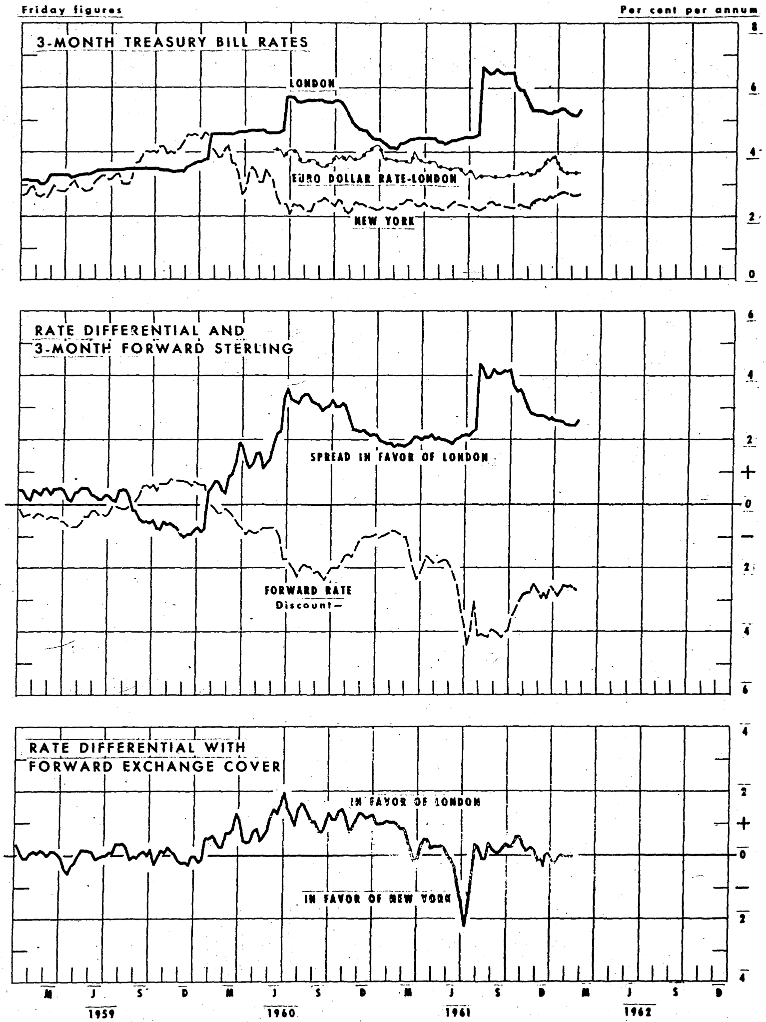
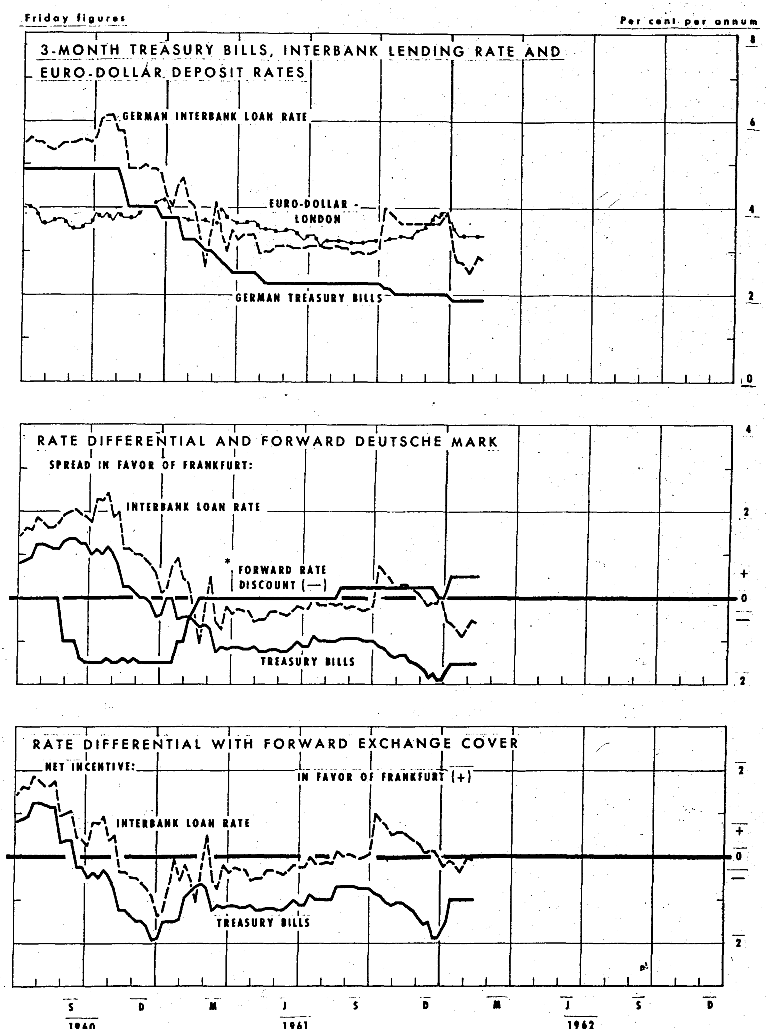


Chart 3

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

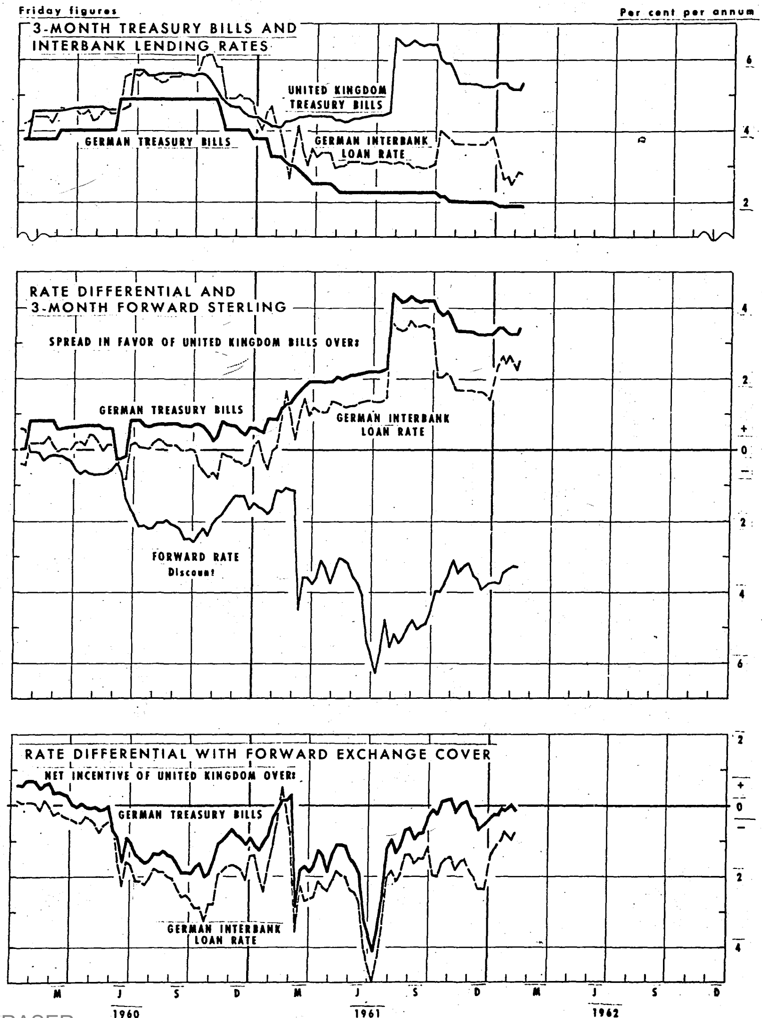
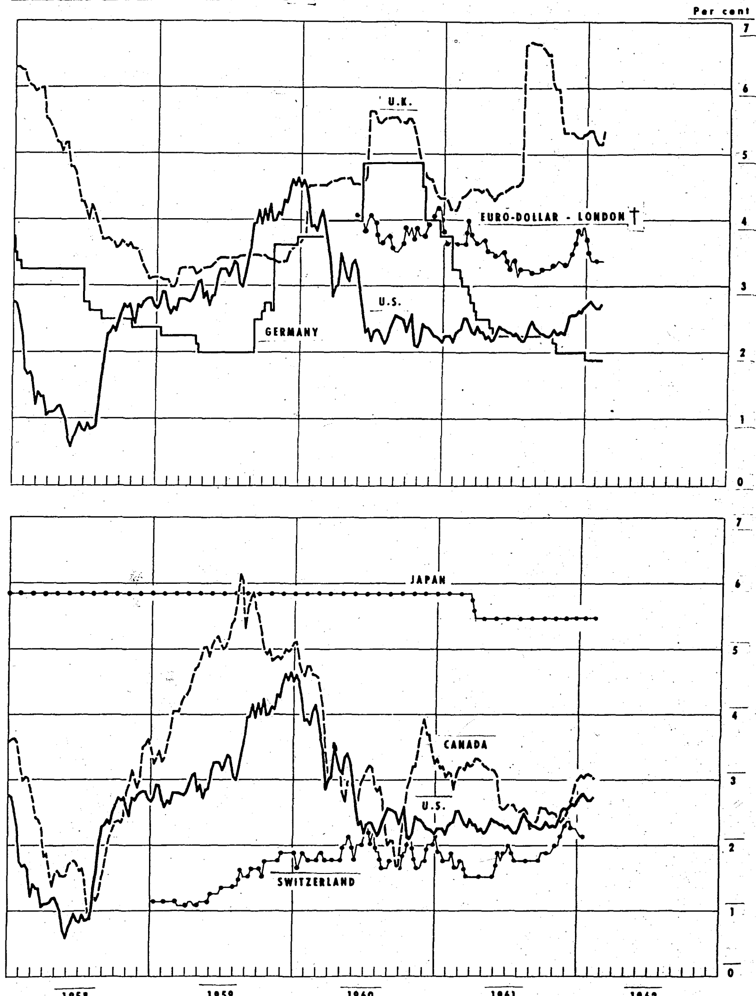


Chart 5

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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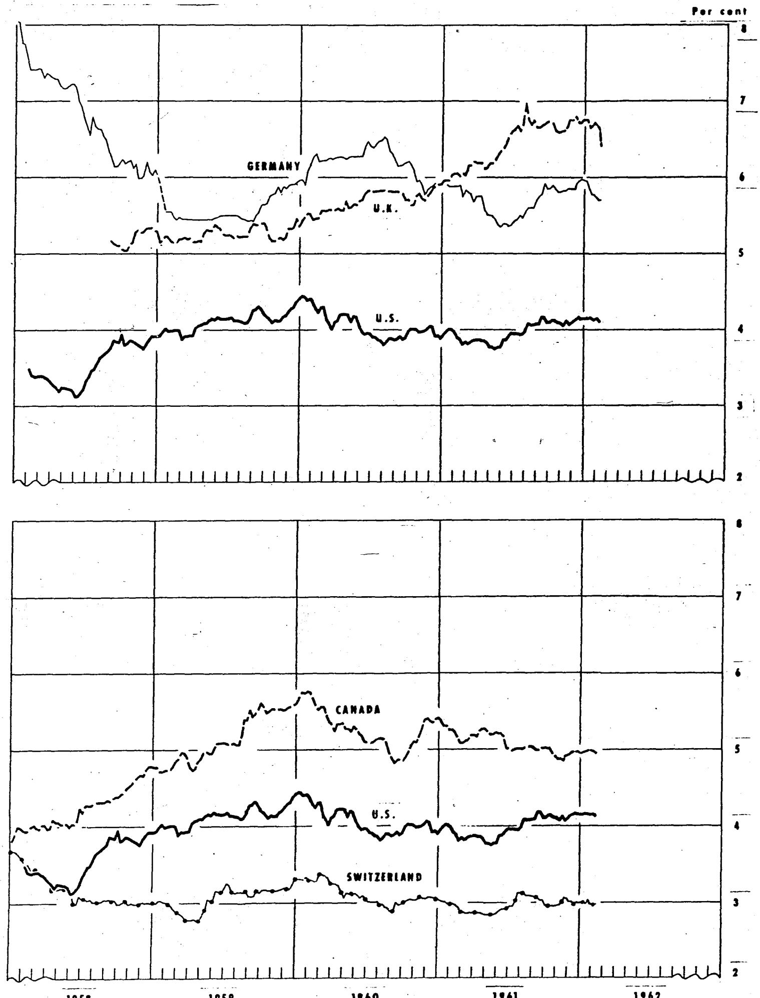
Chart 6

LONG-TERM BOND YIELDS



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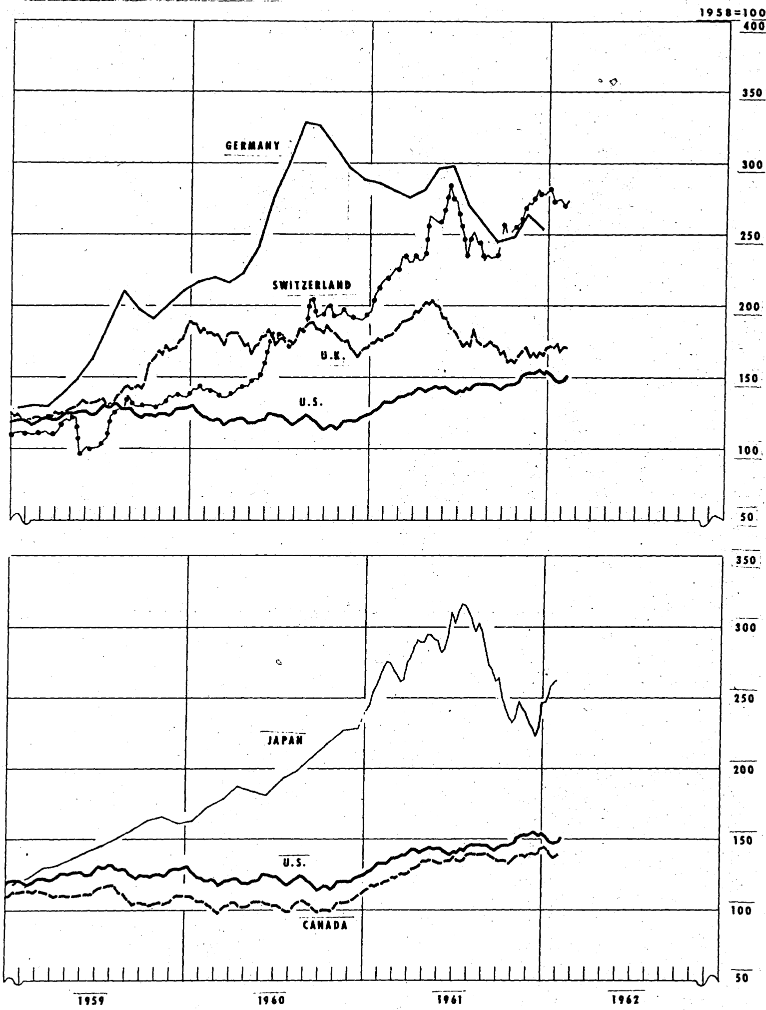
INDUSTRIAL STOCK INDICES*



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

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Chart 8

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

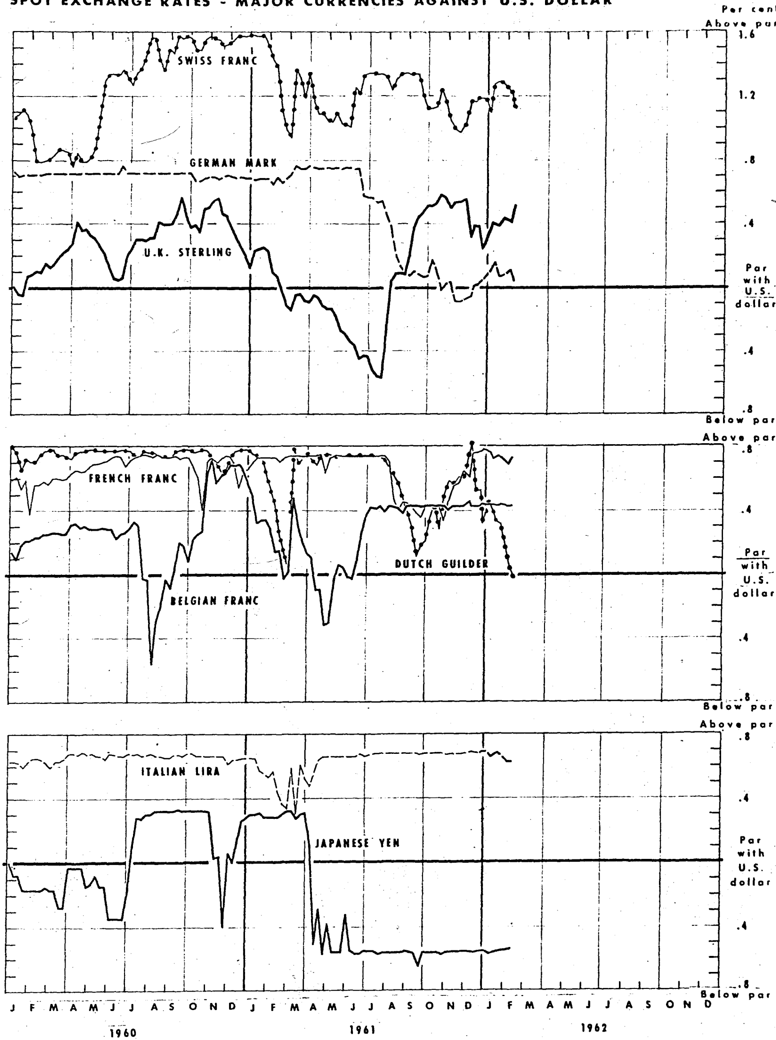

Chart 9
3-MONTH FORWARD EXCHANGE RATES