

H. 13  
No. 65

June 22, 1962

  
CAPITAL MARKET DEVELOPMENTS ABROAD

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

I. United Kingdom: Money and Capital Markets in May

Within the past three weeks, the British authorities have taken two steps to remove restraints on credit availabilities imposed during last July's crisis. On May 31, the Bank of England announced that the special deposits held at the Bank were to be reduced from 3 to 2 per cent for the London clearing banks. This relaxation will add £70 million to the cash position of the London banks. The banks were asked to continue to give priority to exports in their lending and to avoid advances for speculative purposes, particularly in areas where resources are fully employed. On June 5, the minimum down-payment requirements for hire-purchase credit on all goods except automobiles was reduced from 20 to 10 per cent.

These measures are the first steps taken by the authorities to augment credit availabilities. Despite the sluggish British recovery, the monetary authorities have reduced money rates over the past few months rather than relax their control over clearing bank reserves. The new turn in credit policy can be attributed to the spare productive capacity and the sluggish state of demand in the British economy and to the general mood of pessimism which has accompanied the steady fall in stock prices in May. For example, a May survey of the Federation of British Industry estimates that 64 per cent of the firms reported they had spare capacity. Difficulties in keeping wage rises within the 2-1/2 per cent guideline advanced by the government in its "intern incomes policy" and recent domestic political developments have undoubtedly contributed to the unpromising business outlook in the country.

While the Government had increased the availability of credit only at the end of May, the cost of credit had been declining continuously during the month. Short-term rates fell rapidly during the first part of the month, reacting to the cut in Bank Rate from 5 per cent to 4-1/2 per cent on April 26. Short-term rates continued to fall through mid-June, but at a somewhat slower rate.

Britain, like most other European countries, experienced a sharp fall in stock prices in May. Prices fell on every day during the month except on the day when the dock strike was called off and on May 30 when prices recovered from their 6 per cent decline on Tuesday, May 29. South African gold mining shares, in contrast to industrials, experienced a substantial rise in prices from mid-May to mid-June. By early June, the market was showing an interest in gilt-edged securities as an outlet for funds diverted from common stocks.

NOT FOR PUBLICATION

DECONTROLLED AFTER SIX MONTHS

Sterling was slightly weaker in the foreign exchange market in May than in the earlier months of the year. The rate for spot sterling fell during the latter part of the month, but it has stabilized during the first half of June at a level slightly below \$2.81. The weakening of sterling may be attributed partly to a worsening of the trade balance in May. Security sterling fell sharply at the end of May, reflecting the movement of foreigners out of the London stock market. Foreign exchange reserves continued to increase in May.

It has been suggested in earlier numbers of this review that the strength of sterling in the first quarter of 1962 has been the consequence, in part, of a substantial inflow of foreign capital. This view is confirmed in the estimate of capital inflow of £200 million during the first three months of 1962 made in the Bank of England Quarterly Review for June 1962. This inflow was placed principally in two types of sterling assets:

- (a) £80 million was from switching of Euro-dollar deposits with London institutions into short-term sterling assets (especially local-authority deposits); and
- (b) very large unrecorded purchases of sterling securities were made by non-residents. The £120 million of sales of Treasury bonds by the Government Broker to "other home and overseas non-official buyers" is thought to contain substantial purchases by foreigners; foreign interest in British securities is suggested by the fact that the security sterling rate remained over \$2.81 from January to April.

Money market. The decline in short-term rates which began in March continued in May and the first half of June. The after-tender market rate for Treasury bills declined from 3.97 per cent on May 14 to 3.66 per cent on June 15. (See Table and Chart 5.) Interest arbitrage opportunities during this period were very limited. On May 25, there was a covered arbitrage incentive of only 0.12 per cent in favor of holding U.K. bills, but it was eliminated during the following week.

The rates offered on three-months local authority deposits declined steadily from mid-March to the end of May, as the cash needs of the local governments were reduced, and the rate held steady at 4.56 per cent from May 25 through June 8. (See Table.) A very small covered arbitrage advantage existed during the first three weeks of May for holders of Euro-dollar deposits to switch into local authority deposits. It was eliminated towards the end of the month, as the Euro-dollar began to rise. The differentials (in per cent per annum) were as follows:

April 20	+0.10	May 11	+0.13	June 1	-0.17
27	+0.02	18	+0.10	8	-0.18
May 4	+0.06	25	-0.04	15	-0.09

Stock market. Stock prices, which had remained fairly steady in April, declined by 9 per cent during the month of May. (See table below and Chart 7.) Prices were influenced chiefly by developments on Wall Street. A dramatic illustration of London's sensitivity to New York came on May 29 when prices in London declined by 6 per cent, just as they did in New York the day before. This loss was almost fully recovered on the following day, as had occurred in New York. Prices continued to decline in the first week of June. Although stock prices remained steady during the second week of June, the present market mood may be described as brittle.

Aside from the influence of Wall Street, there appear to have been three principal domestic factors depressing stock prices in May. They were: (a) a number of reduced corporate profits statements for 1961 and for the first quarter of 1962; (b) the realization that the government was prepared to prevent further inflation by cutting back demand, even though the business recovery in Britain has been sluggish; and (c) the uncertain profits outlook for 1962 in view of the squeeze between rising business costs and stable prices for manufactured goods.

In contrast to the depressed state of industrial shares, the price of gold mining stocks has increased sharply, rising by nearly 20 per cent from mid-May to mid-June. Interest in gold stocks can be attributed to their present high yields, speculation that the U.S. may some day have to raise the price of gold, and renewed confidence in the economic future of South Africa.

Gilt-edged market. Yields on U.K. bonds behaved in a mixed manner during May and the first half of June. Yields in the short-dated sector, exemplified by the 4-1/2 per cent Conversion bond of 1964, fell steadily, from 5.02 per cent on May 3 to 4.54 per cent on June 14. (See Table and Chart 6.) The yields on long-dated securities, however, fell only during the second half of May. The yields rallied during the first week of June and then declined, for the most part, to the level prevailing at the end of May. The yield gap has declined substantially (see table below), as a result of the rapid fall in stock prices. It declined from 0.96 on May 3 to 0.22 on June 14.

Early in May, when the Government broker's supply of a 5-1/2 per cent 1982-84 bond were exhausted, it was replaced by an additional issue of a 5 per cent 1986-89 offered at a deliberately unattractive price in order to keep some control over the long-term sector of the gilt-edged market. Early in June, when the supply of the 6 per cent 1972 Conversion issue was exhausted, the Government attempted to keep control over the medium term sector by permitting a £40 million issue by the London County Council, the largest corporate issue ever floated. These securities were offered at 95-1/2, giving a gross redemption yield of 6-5/8, effectively discouraging purchases on the rest of the market.

However, this situation lasted only for one week, as investors, for the first time since stock prices began to fall, showed keen interest in the gilt-edged market as an outlet for their funds. The L.C.C. issue rose to a premium of three quarters of 1 per cent. The switch in the market's interest to gilt-edged securities is also evident from the changed pattern of new issues. In the first half of June several major companies chose to raise funds with sales of bonds rather than stocks.

London clearing banks. Bank advances to the private sector declined slightly from mid-April to mid-May, bringing outstanding advances back to the level of mid-March. It is widely believed that the increase in advances during the first quarter of 1962, most of which occurred in February, can be attributed to a temporary demand to finance tax payments. Loans to the public sector, on the other hand, increased from April to May, taking the form chiefly of additional call loans. The liquidity ratio remained at the level prevailing at mid-March, 32.6 per cent.

Recent changes in selected assets and liabilities of the London clearing banks (in millions of pounds) are as follows:

Recent changes in assets (in millions of pounds)

	Net deposits	Liquid assets		Loans to public sector			Loans to private sector	
		Amount	Per cent	Govt. securities	Treas. bills	Total a/	Advances	Total b/
<u>1960</u>								
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	+ 24	+ 47	+ 25	+ 48
<u>1961</u>								
March	-118	-212	(30.4)	- 85	-216	-349	+133	-191
June	+216	+207	(32.2)	-102	+177	+ 81	+144	+158
Sept.	- 44	+128	(34.3)	- 36	+112	+ 72	-180	-151
Dec.	+ 24	+144	(35.3)	+ 71	+ 2	+200	-115	-119
<u>1962</u>								
March	- 90	-250	(32.6)	- 23	-287	-280	+169	+190
April	- 6	+ 14	(32.6)	+ 14	+ 52	+ 13	+ 3	- 6
May	+ 16	+ 24	(32.6)	+ 3	+ 15	+ 52	- 3	- 12

a/ Includes loans to nationalized industries and call loans.

b/ Includes commercial and other bills.

Installment credit. Installment credit outstanding, which had been declining steadily since last July, continued to fall in April. The expected increase in installment sales that spring has failed to materialize. The Government announced that effective from June 5, the minimum down payment on installment sales would be reduced from 20 per cent to 10 per cent for all commodities except automobiles. The rate had been raised to this level as part of the restrictive program initiated last July in response to the serious balance of payments difficulties then. Commenting on this relaxation, the President of the Board of Trade said: "The hire purchase debt has been going down and the economic position of the country is such that it will be possible to allow this modest relaxation to take place." Changes in credit outstanding since June 1961 (in millions of pounds) were:

	Total June 1961	<u>Changes</u> 1961		1962		
		July-	Oct.-	Jan.-	Mar.	Apr.
		Sept.	Dec.	Mar.	Mar.	Apr.
Shops	306	- 3	+ 6	-13	- 5	- 3
Finance houses	651	- 1	-32	-26	- 6	- 2
Total	957	- 4	-26	-39	-11	- 5

Foreign trade. Exports continued to increase slowly in May, but there was a substantial increase in imports. The seasonally adjusted trade balance, therefore, deteriorated to a level slightly lower than that for February. However, the rise in imports in May may be attributed partly to the anticipation of a dock strike. Seasonally-adjusted trade figures (monthly averages in millions of pounds) for recent months were:

	1960	1961	1962				
			Jan.	Feb.	Mar.	Apr.	May
Imports c.i.f.	-380	-367	-380	-362	-358	-359	-380
Exports f.o.b.	296	307	300	307	312	314	316
Re-exports	12	13	12	11	11	14	15
Trade balance	- 72	- 47	- 68	- 44	- 35	- 31	- 49

Foreign exchange reserves. The gold and foreign exchange reserves continued to rise in May. The recorded £19 million increase must be adjusted upwards by £25 million to take into account the repayment to the IMF and downwards by £18 million to take into account the exchange of sterling for dollars with the Federal Reserve Bank of New York. Recent monthly changes in reserves (in millions of pounds) are as follows:

	1961		1962				
	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May
Reported figure	+ 9	-85	+33	+ 5	+10	+ 7	+19
Adjusted for special transactions	+59	-18	+33	+80	+72	+32	+26

Foreign exchange market. The spot rate remained fairly steady during the first three weeks of May, staying around \$2.81-1/4. The rate fell during the last week of the month and then stabilized during the first half of June at slightly under \$2.81. The Economist observed (June 9, 1962, p. 1021) that "the weakness of the spot rate has, however, been accompanied by continued strength in the forward rate, suggesting that some operators who were long of sterling may possibly have switched temporarily into dollars and covered their return into sterling." Selected daily rates for spot sterling from April through the first half of June (in U.S. cents per pound) were:

Apr. 6	281.38	May 4	281.28	June 1	280.97
13	281.52	11	281.24	8	280.80
20	281.45	18	281.29	15	280.97
27	281.25	25	281.15		

Security sterling fell steadily during the period under review, reflecting the attempts of foreign investors on the London stock exchange to repatriate their funds. The rate weakened along with stock prices at the end of April, falling from \$2.8150 on April 20 to \$2.7950 on June 6. End of week rates for security sterling (in U.S. cents per pound) for April, May, and June were:

Apr. 6	281.50	May 4	281.25	June 1	279.75
13	281.50	11	281.25	8	280.00
20	281.50	18	281.13	15	280.30
27	281.19	25	281.06		

On May 17, the "hard" and "soft" dollar markets were combined. Until that day, British investors could acquire U.S. dollars for investing in U.S. securities from a pool consisting of dollar proceeds fed by other investors selling U.S. securities. Likewise, they could purchase securities in other parts of the world, Continental securities in particular, using foreign exchange acquired only from the sale of "soft" currency securities by other investors. For some time, the demand for foreign currencies for investing in the Common Market countries has been relatively stronger in relation to the available supply of "soft dollars" than has been the demand for dollars to invest in the U.S. in relation to the available supply of "hard dollars". Therefore, the discount on sterling for purchases of foreign exchange from the "soft dollar" pool has been greater than that for purchases in the "hard dollar" pool. Now, with the two investment dollar pools combined, the proceeds of sales of dollar securities can be used for purchasing the securities of Continental countries if investors so desire.

At the same time that these foreign currency pools were combined, the Government announced that these funds may now be used by companies to finance direct investment abroad. This is a relaxation of the control that was placed on direct investment last July: that funds may be transferred outside the sterling area only when the investment would bring short-run "clear and commensurate benefits to the United Kingdom export earnings and to the balance

of payments." Firms not meeting this requirement can now make use of the "investment dollar" pool. The use of this pool until now had been tied exclusively to portfolio investment. The rates for these investment dollars (in U.S. cents per pound) have been as follows:

	<u>"Hard"</u>	<u>"Soft"</u>		<u>"Hard"</u>	<u>"Soft"</u>
Jan. 25	281.15	272.84	May 3	279.04	275.35
Feb. 22	281.23	273.84	10	278.78	268.91
Mar. 29	280.18	277.92	17	274.01	266.03
Apr. 26	279.39	276.89			
			24	272.17	
			31	267.30	

Bullion market. The gold market became increasingly active towards the end of May and during the first half of June. Gold purchases increased in response to bleak reports from the world's stock exchanges. The prices at the London fixing during April, May and the first half of June were (in U.S. dollars per ounce):

Apr. 6	35.074	May 4	35.076	June 1	35.085
13	35.081	11	35.079	8	35.099
19	35.075	18	35.075	15	35.107
27	35.074	25	35.091		

The New York Times reported (June 7, 1962, p. 47) that when market demand for gold was very low in the months preceding the recent flurry of gold purchases, there was considerable buying of gold for reserves, "probably through the new gold pool formed by United States, United Kingdom, and Continental central banks". The Financial Times reported that there was a good demand for gold by private buyers from Continental countries for short periods both at the end of May and the middle of June.

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

- Chart 1 - Interest Arbitrage, United States/Canada
- Chart 2 - Interest Arbitrage, New York/London
- Chart 3 - Interest Arbitrage for German Commercial Banks
- Chart 4 - Interest Arbitrage, Frankfurt/London
- Chart 5 - Short-term Interest Rates
- Chart 6 - Long-term Bond Yields
- Chart 7 - Industrial Stock Indices
- Chart 8 - Spot Exchange Rates -- Major Currencies  
Against U.S. Dollar
- Chart 9 - 3-month Forward Exchange Rates

United Kingdom: Treasury Bill Yields and Exchange Rates

	<u>3-mo. Treasury bill arbitrage calculation</u>					<u>Spot pound (U.S. cents)</u>	<u>London deposit rates</u>	
	<u>U.K.</u>	<u>U.S. \$/£</u>	<u>Difference</u>	<u>3-mo. pounds/</u>	<u>In favor U.K. bill</u>		<u>U.S. dollar (3-mo.)</u>	<u>Local authority (3-mo.)</u>
1961 - High	6.74	2.74	4.45	-0.79	1.13	281.62	4.00	7.50
Low	4.17	2.16	1.88	-4.36	-2.12	278.47	3.13	6.00
Mar. 23	4.38	2.70	1.68	-2.08	-0.40	281.32	3.63	5.69
30	4.34	2.75	1.59	-1.93	-0.34	281.39	3.69	5.69
Apr. 6	4.28	2.70	1.58	-1.86	-0.28	281.38	3.63	5.50
13	4.25	2.74	1.51	-1.92	-0.41	281.52	3.50	5.34
20	4.19	2.73	1.46	-1.71	-0.25	281.45	3.50	5.31
27	4.03	2.74	1.29	-1.48	-0.19	281.25	3.50	5.00
May 4	3.97	2.73	1.24	-1.32	-0.08	281.28	3.56	4.94
11	3.88	2.63	1.25	-1.07	+0.18	281.24	3.63	4.81
18	3.78	2.68	1.10	-1.04	+0.06	281.29	3.56	4.70
25	3.72	2.69	1.03	-0.91	+0.12	281.15	3.69	4.56
June 1	3.69	2.69	1.00	-1.01	-0.01	280.97	3.72	4.56
8	3.69	2.65	1.05	-1.05	--	280.80	3.69	4.56
15	3.66	2.71	0.95	-0.87	+0.08	280.97	3.66	4.44

a / Spread between spot and 3-month forward rate in per cent per annum. Discount equals (-).

United Kingdom: Selected Capital Market Yields

	<u>U.K. Government bond yields</u>					<u>Share yield a/</u>	<u>Yield gap b/</u>	<u>Share prices c/</u>
	<u>4-1/2% 1964</u>	<u>3% 1965-75</u>	<u>5-1/2% 2008-12</u>	<u>3-1/2% War Loan</u>	<u>2-1/2% Consols</u>			
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
Mar. 22	5.08	6.24	6.25	6.33	6.26	5.25	0.91	295.2
29	5.18	6.25	6.30	6.38	6.23	5.37	0.86	292.6
Apr. 5	5.27	6.25	6.30	6.38	6.22	5.21	1.01	301.5
12	5.25	6.24	6.30	6.43	6.26	5.22	1.04	300.9
19	5.07	6.22	6.25	6.31	6.15	5.25	0.90	298.6
26	4.95	6.22	6.20	6.27	6.13	5.15	0.98	305.1
May 3	5.02	6.23	6.20	6.25	6.13	5.17	0.96	305.5
10	4.95	6.25	6.20	6.30	6.20	5.31	0.91	297.5
17	4.84	6.22	6.20	6.30	6.15	5.28	0.87	296.5
24	4.81	6.22	6.15	6.28	6.14	5.50	0.64	284.3
31	4.76	6.26	6.20	6.33	6.19	5.71	0.48	273.8
June 7	4.55	6.28	6.25	6.37	6.23	5.85	0.38	267.4
14	4.54	6.25	6.20	6.32	6.17	5.95	0.22	262.9

a/ Financial Times.

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

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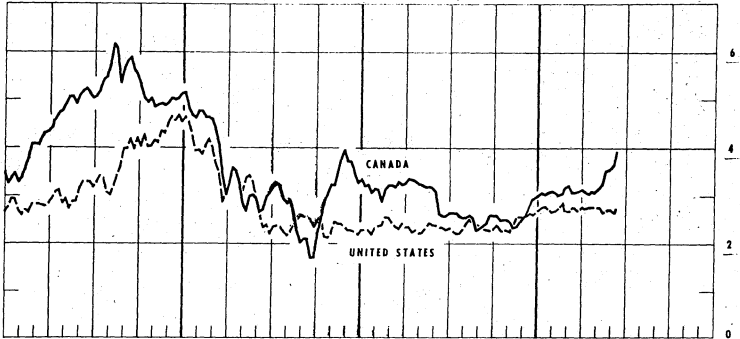
Chart 1

### INTEREST ARBITRAGE, UNITED STATES / CANADA

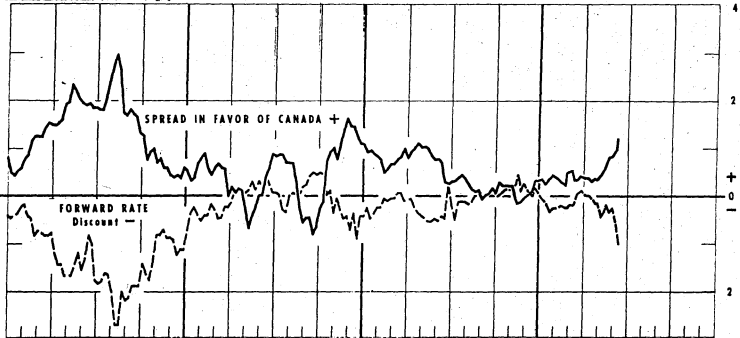
Thursday figures

#### THREE-MONTH TREASURY BILL RATES

Per cent per annum



#### RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



#### RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

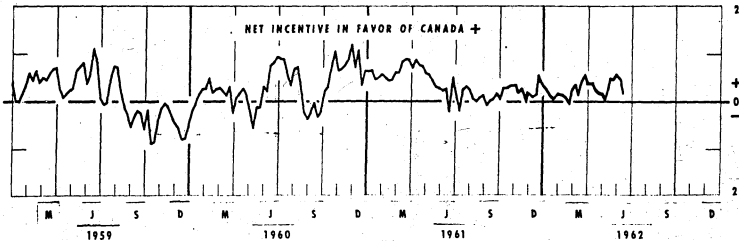


Chart 2

# INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

Per cent per annum

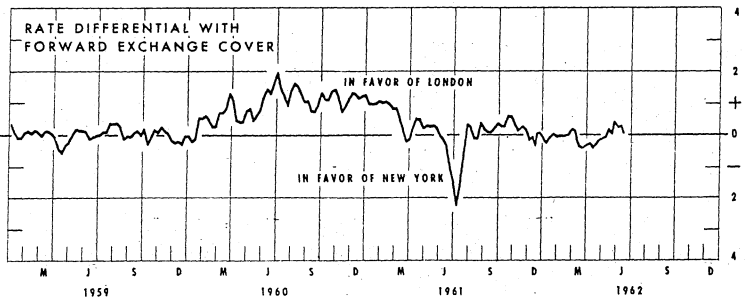
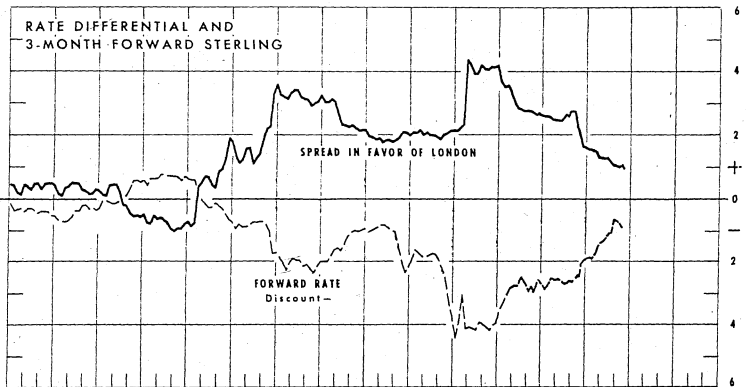
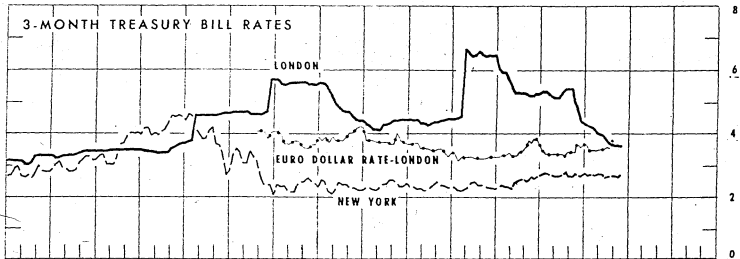
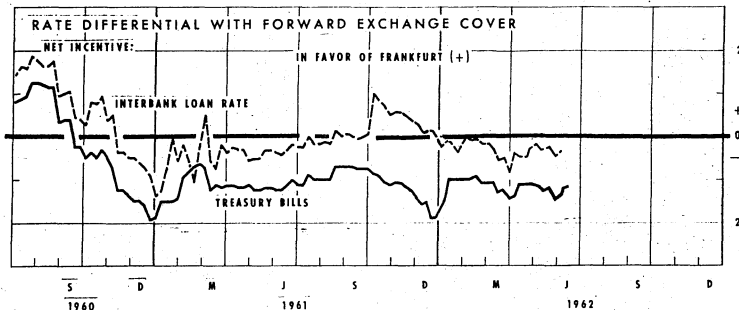
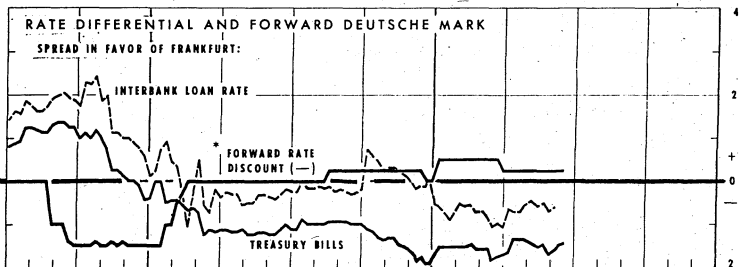
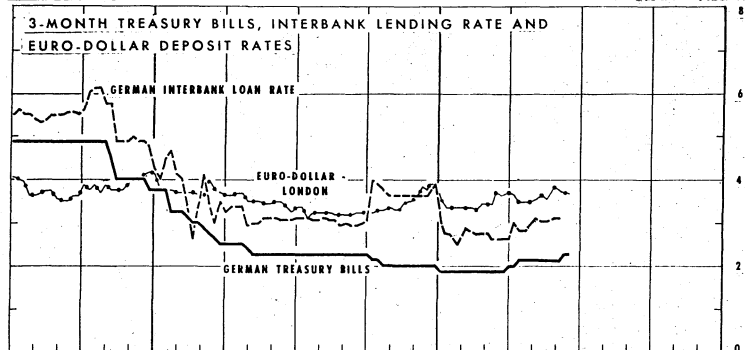


Chart 3

**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 Per cent per annum

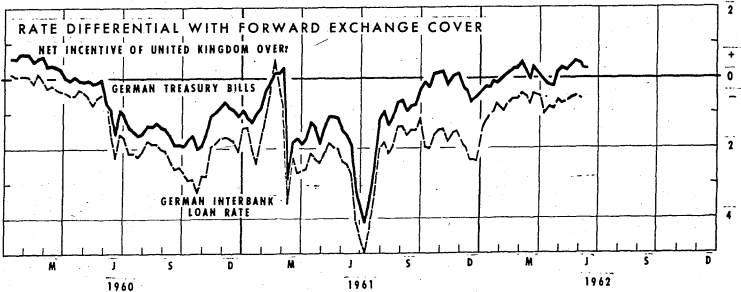
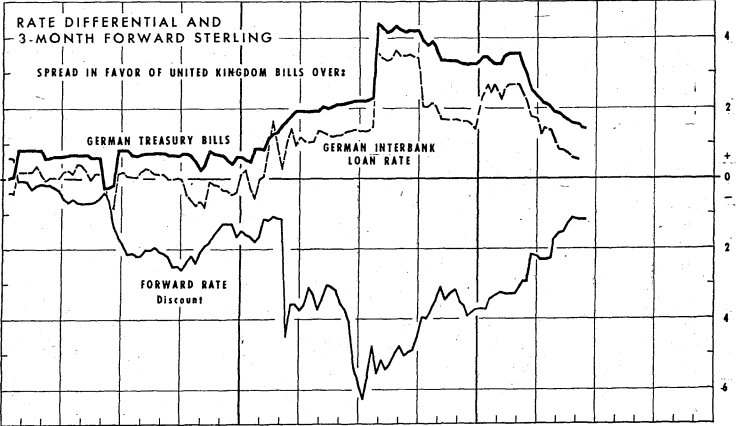
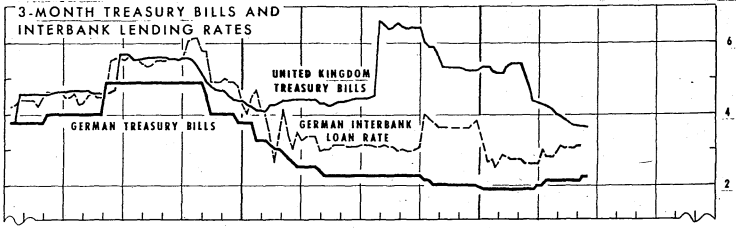
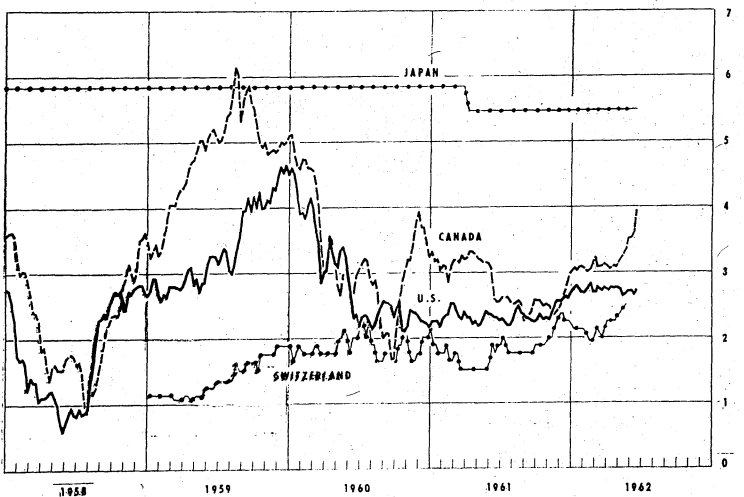
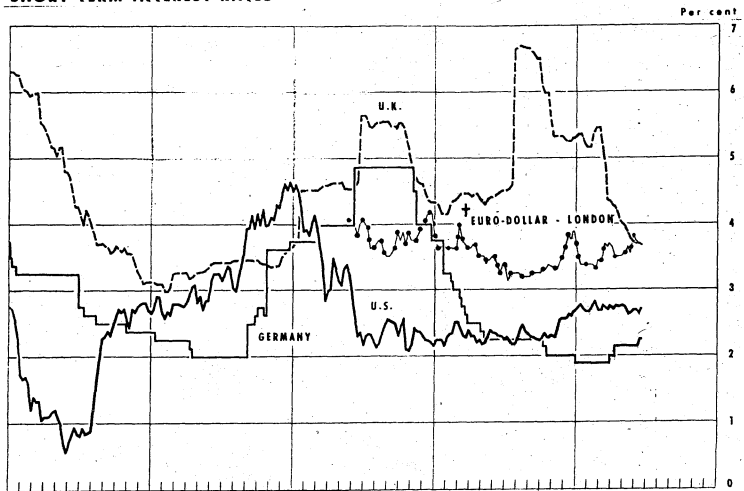


Chart 5  
SHORT-TERM INTEREST RATES \*



\* 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**

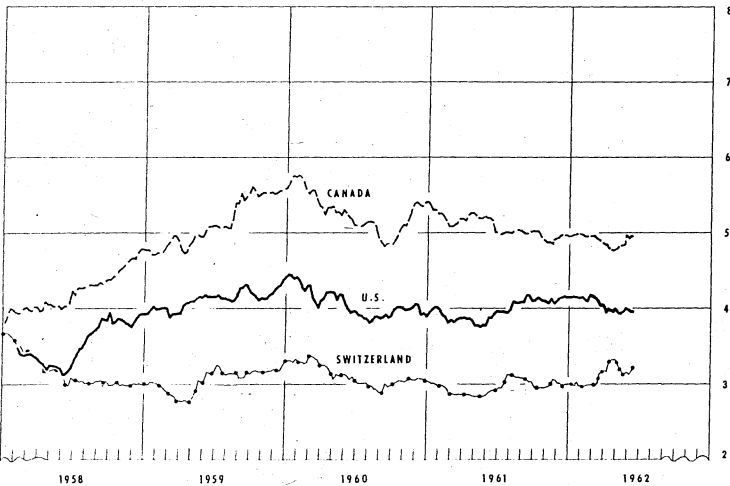
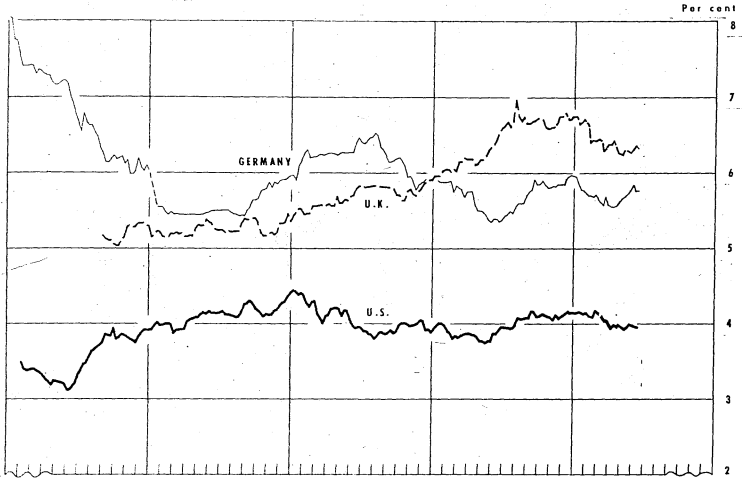
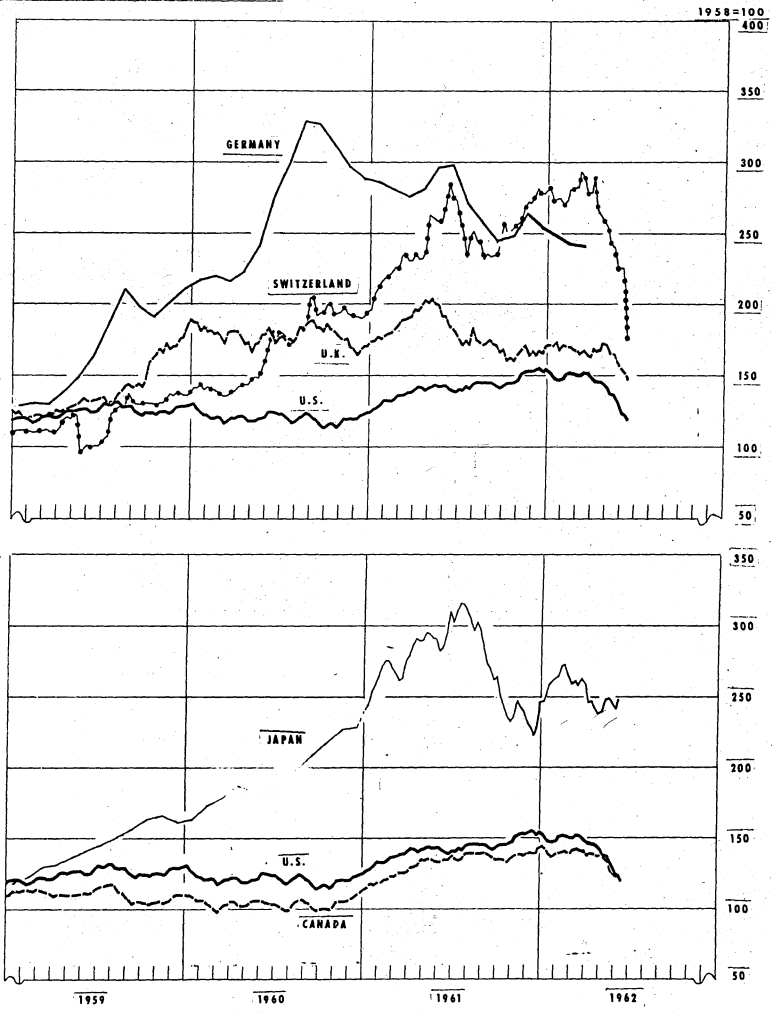


Chart 7  
INDUSTRIAL STOCK INDICES\*



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

Chart 8

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

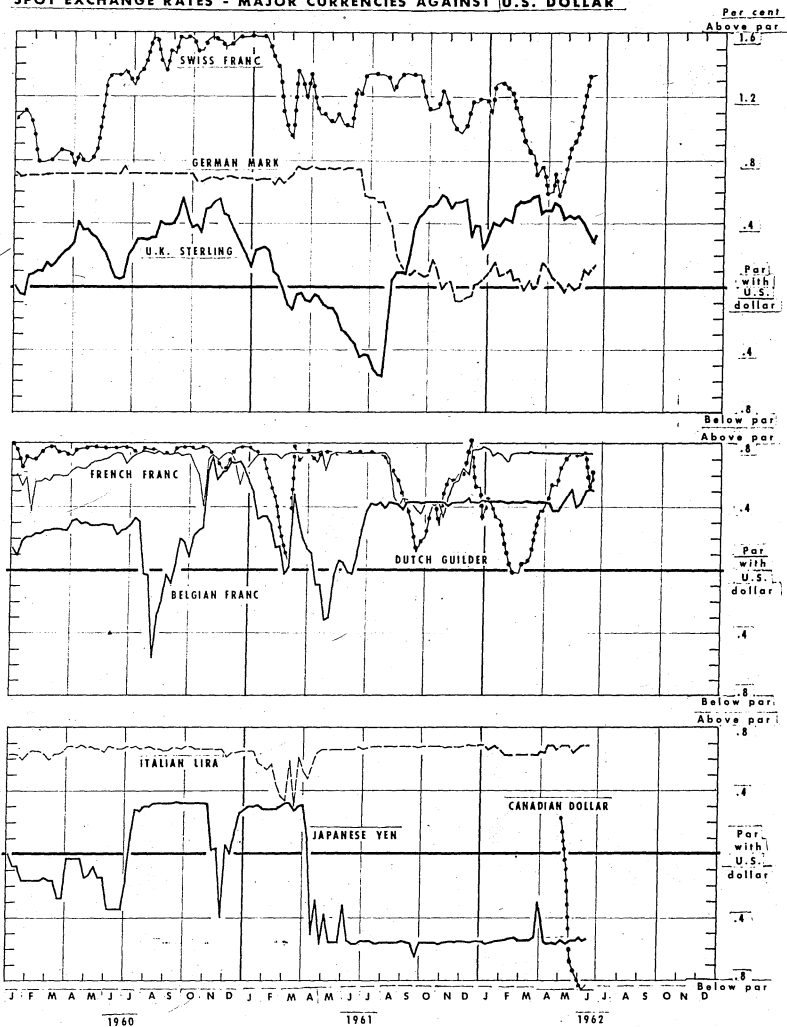




Chart 9

### 3-MONTH FORWARD EXCHANGE RATES

