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## CAPITAL MARKET DEVELOPMENTS ABROAD

FEDERAL RESERVE BANK  
OF RICHMOND

I. United Kingdom

II. Nine Charts on Financial Markets Abroad

I. United Kingdom: Money and Capital Markets in July and August

The interest rate structure in the United Kingdom moved steadily downward in July and in August. The movement affected all sectors of the market, from the Treasury bill rate to  $2\frac{1}{2}$  per cent consols. In the stock market, there was a major revival of confidence in early August, causing stock prices to move upwards by over 10 per cent in one week of trading. Interest in the gilt-edged market remains strong, partly because investors feel that the Government will include lower interest rates as an integral part of its economic policy for the near future. Bank advances did not show any net increase in the period from mid-June through mid-August, and the banks' liquidity ratio remains above 33 per cent.

In the foreign exchange markets, sterling weakened somewhat during July and August, but the level of the spot rate was high for this time of the year. Foreign exchange reserves fell by £2 million in July after adjustment for the £183 million repayment to the IMF. This was the first month in 1962 in which reserves after adjustment for special transactions fell. July exports continued at a high level, though slightly below June totals. Imports rose sharply in July, mainly on account of abnormally large food imports encouraged by bad weather conditions in Britain.

**Money market.** Short-term interest rates continued to decline in July and August. The Treasury bill rate was at 3.81 per cent on July 6 and 3.69 per cent on August 24. There were some small covered arbitrage opportunities for moving from dollars to sterling from late July through early August and again at the end of August (see Table). However, the covered margin in favor of the U.K. bill went only as high as a quarter of one per cent. The arbitrage opportunities arose in both of these periods as the result of a decline in the forward discount on sterling.

The rate on three-month deposits with local authorities rose from 3.50 per cent to 3.62 per cent and remained at this higher level from late July through early August (see Table). The rate then fell steadily through August. This fluctuation is a seasonal one; most money needs for August are usually secured in late July on account of the summer holidays.

**Stock market.** The stock market, after remaining quiet during most of July, made a partial recovery from the losses sustained in May. Stock prices remained steady from June 27 through July 17, fluctuating within a two point range around 267 on the Financial Times industrial ordinary index. During the following week and a half, the index fell by ten points, then recovered most

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DECONTROLLED AFTER SIX MONTHS

of the losses. On August 9, prices rallied again, rising to over 283 by August 15. The price rise from the low on July 23 to August 15 was over 10 per cent. The revival of confidence in equities may be attributed partly to the recovery in Wall Street and partly to encouraging developments in Great Britain, mainly company profits reports, which were less pessimistic than those of last Spring, and the stimulating effects of bids for mergers by some major companies (National Provincial Bank and The District Bank - see comment below - and Burmah Oil and Lobitos).

The recovery of the stock market took place while the gilt-edged market continued to show strength (see below). But the yield on industrial stocks fell faster than the yield on gilt-edged securities. This is shown by the widening of the gap between late July and late August. During June and the first half of July the gap closed; and, for a few days was reversed, with equities yielding slightly more than  $2\frac{1}{2}$  per cent consols. The yield gap in June through August was as follows (excess yield on equities over consols; per cent per annum):

June 7	0.38	July 5	0.38	August 2	0.01
14	0.22	12	0.08	9	0.14
21	0.23	19	-0.04	16	0.28
28	0.30	26	0.07	20	0.29

The London stock market will be in a position to attract more foreign investment in the future. On July 23, approval was given for the establishment by Stock Exchange brokers of branch offices abroad. Eight firms have expressed an interest in opening branches in Amsterdam, Brussels, Düsseldorf, Frankfurt, Geneva, Paris, Zurich, and New York. Increasing foreign portfolio investment in London will make Britain's gold and foreign exchange reserves more vulnerable to strains caused by sudden outflows of capital, but it is considered desirable that the flow of savings to the London capital market be increased if London is to maintain its ascendancy in an enlarged common market.

Gilt-edged market. Prices of gilt-edged securities continued to move upwards steadily during the months of July and August, as may be seen from the decline in yields (see table). The Economist (July 28, 1962, p. 372) notes that in June the rise in the price of gilt-edged securities was restricted to medium-dated issues and to the War Loan, but that in July the price rises had extended to long-dated securities. This tendency has continued through August. As yields fell on the medium-dated securities, institutional investors moved into long-dated issues to take advantage of the relatively high rates of interest while they were still available.

The Treasury has assisted the decline in yields on gilt-edged securities by restraining issues of bonds by local authorities so that the market can absorb each issue, before the next one is offered. New issues have been forthcoming at the rate of approximately £5 million per week. (see The Times (London) August 23, 1962, p. 12).

To some extent, the demand for bonds in August was speculative. Looking at the short-run economic situation, investors are assuming that a lower interest rate structure will be an essential part of the new cabinet's economic policy. Also, there is some feeling that interest rates are due to remain low in the next few years. Professor R. S. Sayers, writing in the Banca Nazionale del Lavoro Quarterly Review, (June 1962), believes that interest rates must move from the present 6 per cent level to around 5 or 4 per cent in the next two years as the demand for capital is likely to be much less intense than it has been in the recent past.

London clearing banks. The figures for advances during the months from mid-May through mid-August reveal a slackness in the demand for credit. The increases shown for June and July are accounted for entirely by the semi-annual debiting of interest charges. Therefore, there was no net additional bank lending activity after the increase in advances for tax purposes which occurred earlier in the year. The £72 million of special deposits with the Bank of England released at the end of May were invested in gilt-edged securities. These investments continued to expand in July, but ceased in the month of July 19 through August 15. The liquidity ratio for July and August was 33.1 per cent, slightly lower than that for mid-June.

On August 14, it was announced that the National Provincial Bank, one of Britain's "big five," and the District Bank are planning to merge. This prospective merger is viewed as one of the last moves of the late 19th and early 20th century consolidation of regional banks into large national institutions. The District Bank operates primarily in the northwestern part of England, where the National Provincial has few branches. If this merger takes place, Martins Bank will be left as the only remaining independent regional bank.

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London Clearing Banks: Net Deposit Liabilities and Selected Assets,  
January - August 1962  
 (In millions of pounds)

	C h a n g e s					Out- standing August p/
	Jan.- Mar.	Apr. June	June	July p/	Aug. p/	
Net Deposits	- 90	+142	+222	+ 41	- 21	6,412
Liquid Assets						
Cash	- 16	+ 16	+ 25	--	+ 10	636
Call money	+ 33	- 29	- 19	+ 15	- 24	701
Treasury bills	-287	+124	+ 57	- 18	- 4	896
Other bills	+ 21	+ 3	+ 13	+ 9	+ 2	287
Loans and other investments						
Gilt-edged	- 23	+ 91	+ 74	+ 27	+ 1	1,103
Other market investments	--	--	--	--	--	112
Advances:						
Nationalized industries	- 3	- 29	- 20	+ 19	+ 6	61
Other (net)	+169	+ 54	+ 54	+ 37	- 10	3,391
Special deposits with Bank of England	- 1	- 71	- 72	+ 1	+ 1	151
Selected assets as percentage of gross deposits (end of period)						
Total liquid assets	32.6	33.4	33.4	33.1	33.1	33.1
Cash	8.2	8.3	8.3	8.2	8.4	8.4
Special deposits	3.0	2.0	2.0	2.0	2.0	2.0

p/ Preliminary.

Installment credit. Total installment credit increased slightly in May and again in June by £2 million in each month. The June increase is attributed entirely to increased sales of durable goods on credit, and is related to the reduction from 20 to 10 per cent in minimum down payment requirements. The net new business of finance houses was slightly lower in May than in June, but the decline was due mainly to seasonal influences. Changes in credit outstanding since June 1961 (in millions of pounds) were:

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	Total June 1961	C h a n g e s					
		1961			1962		
		July- Sept.	Oct.- Dec.	Jan.- Mar.	Apr.	May	June
Shops	306	- 3	+ 6	-13	- 3	- 1	+ 2
Finance houses	651	- 1	-32	-26	- 2	+ 3	--
Total	957	- 4	-26	-39	- 5	+ 2	+ 2

Foreign trade. Exports for July fell slightly from the high level reached in June, but they are still considered very satisfactory. July imports increased substantially from the June level and were even above the monthly average figure for 1960. Some fear was expressed that the rise in imports might be the result of a reversal of the inventory cycle - that the decumulation of inventories has ceased and that industrial restocking is underway again with the attendant strain on the balance of payments. However, most of the increase in imports consisted of food imports, like those in May, can be attributed to bad weather, and may, therefore, be temporary. Seasonally adjusted trade figures (monthly averages in millions of pounds) for recent months were:

	1962						
	1960	1961	Jan.-	Apr.-	May	June	July
			Mar.	June			
Imports c.i.f.	-380	-367	-367	-369	-379	-369	-391
Exports f.o.b.	296	307	306	319	316	328	327
Re-exports	12	13	12	14	15	14	14
Trade balance	- 72	- 47	- 49	- 36	- 48	- 27	- 50

Foreign exchange reserves. In July, reserves of gold and convertible currencies fell by £185 million. However, this figure reflects the repayment of the United Kingdom's outstanding debt to the International Monetary Fund of £183 million, the balance of the drawing in August 1961. This repayment reduced the IMF's holdings of sterling to 75 per cent of the British quota. The standby arrangement with the IMF was renewed for one year, this time for one billion dollars. Recent monthly changes in reserves (in millions of pounds) are as follows:

	1962						
	Jan.	Feb.	Mar.	Apr.	May	June	July
Reported figure	+33	+ 5	+10	+ 7	+19	- 33	-185
Adjusted for special transactions	+23	+80	+72	+32	+26	+ 6	- 2

Foreign exchange market. Sterling weakened from the latter part of July through late August, mainly as the result of seasonal pressure (see Table and Charts 8 and 9). The spot rate fell from 280.77 cents on July 23 to 280.22 on August 30. The market during this period was relatively thin, and it was quick to react to small pressures, such as speculation on Bank rate changes, the Berlin situation, and the covering of short dollar positions.

Even though sterling was somewhat soft, a number of operators sold spot sterling short and purchased forward during the third week of August because they believed that sterling was unnaturally high for this time of the year. This, of course, reduced the forward discount on sterling as well as further weakening the spot rate.

Exchange control was liberalized on August 17. British residents are now permitted to obtain £250 of foreign exchange for each trip abroad rather than for the entire year. However, there is some criticism of another feature of this relaxation of control: the traveller abroad no longer has to have his foreign currency allotment recorded in his passport. Therefore, it is easy, although illegal, for individual travelers to secure foreign exchange for investment outside the sterling area, while business firms must still meet a very stringent Treasury test to do likewise.

Security sterling remained steady at 280.13 cents during most of this period, but it fell slightly to 279.88 towards the end of August. Selected daily rates for security sterling (in U.S. cents per pound) were:

June 1	279.75	July 6	279.75	August 3	280.13
8	280.00	13	280.13	10	280.13
15	280.20	20	280.13	17	280.13
22	280.19	27	280.13	24	279.88
29	280.00				

Bullion market. There was a strong demand for gold in mid-July, but this ceased after President Kennedy's dramatic Telstar statement on July 23. The gold market has remained quiet since then, although there was a minor burst of activity on August 9 and 10. The London fixing price on selected days was as follows (in U.S. dollars per ounce):

June 1	35.085	July 6	35.113	August 3	35.105
8	35.099	13	35.122	10	35.126
15	35.107	20	35.143	17	35.140
22	35.104	27	35.116	24	35.127
29	35.106				

United Kingdom: Treasury Bill Yields and Exchange Rates

		<u>3-mo. Treasury bill</u>			<u>arbitrage calculation</u>		<u>Spot</u>	<u>London deposit rates</u>	
		<u>U.K.</u>	<u>U.S.</u>	<u>Differ-</u>	<u>3-mo.</u>	<u>In favor</u>	<u>pound</u>	<u>U.S.</u>	<u>Local</u>
			<u>a/</u>	<u>ence</u>	<u>pound</u>	<u>U.K. bill</u>	<u>(U.S.</u>	<u>dollar</u>	<u>authority</u>
							<u>cents)</u>	<u>(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
May	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
	22	3.78	2.74	1.04	-0.83	+0.21	280.93	3.66	4.32
	29	3.84	2.90	0.94	-0.81	+0.13	280.86	3.69	4.56
	6	3.81	2.93	0.88	-0.83	+0.05	280.66	3.66	4.56
July	13	3.81	2.96	0.85	-0.86	-0.03	280.75	3.94	4.50
	20	3.88	2.91	0.97	-0.85	+0.12	280.78	3.72	4.50
Aug.	27	3.81	2.88	0.93	-0.66	+0.27	280.55	3.94	4.62
	3	3.75	2.82	0.93	-0.76	+0.17	280.56	3.81	4.62
	10	3.69	2.83	0.86	-0.77	+0.09	280.51	3.78	4.56
	17	3.69	2.83	0.86	-0.73	+0.13	280.48	3.72	4.44
	24	3.69	2.82	0.87	-0.61	+0.26	280.26	3.72	4.38

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</u>	<u>Yield</u>	<u>Share</u>
		<u>4-1/2%</u>	<u>3%</u>	<u>5-1/2%</u>	<u>3-1/2%</u>	<u>2-1/2%</u>	<u>yield</u>	<u>gap</u>	<u>prices</u>
		<u>1964</u>	<u>1965-75</u>	<u>2008-12</u>	<u>War Loan</u>	<u>Consols</u>	<u>a/</u>	<u>b/</u>	<u>a/</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
May	24	4.81	6.22	6.15	6.28	6.14	5.50	0.64	284.3
June	31	4.76	6.26	6.20	6.33	6.19	5.71	0.48	271.8
	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
	21	4.62	6.22	6.20	6.36	6.21	5.98	0.23	261.4
July	28	4.54	6.22	6.20	6.31	6.16	5.86	0.30	266.9
	5	4.52	6.14	6.15	6.24	6.18	5.80	0.38	269.6
	12	4.50	5.82	6.00	6.10	5.94	5.86	0.08	266.9
	19	4.50	5.81	6.05	6.12	5.97	6.01	-0.04	260.2
Aug.	26	4.23	5.79	6.00	6.09	5.95	5.88	0.07	265.3
	2	4.26	5.77	6.05	5.11	5.97	5.96	0.01	261.9
	9	4.20	5.76	6.05	6.10	5.97	5.83	0.14	267.4
	16	4.12	5.68	5.95	5.97	5.82	5.54	0.28	281.5
	23	4.12	5.65	5.95	5.92	5.79	5.50	0.29	283.8

a/ Financial Times.

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

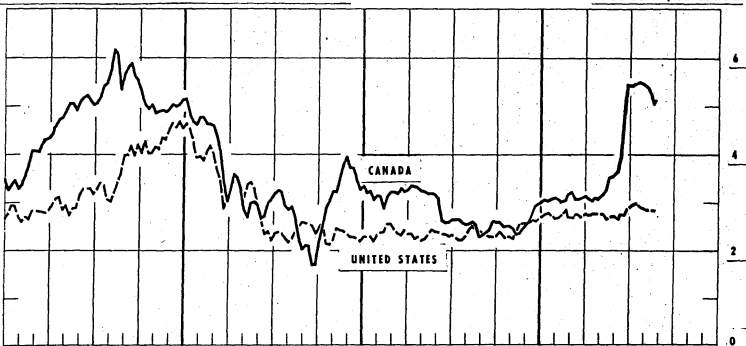
Chart 1

# INTEREST ARBITRAGE, UNITED STATES / CANADA

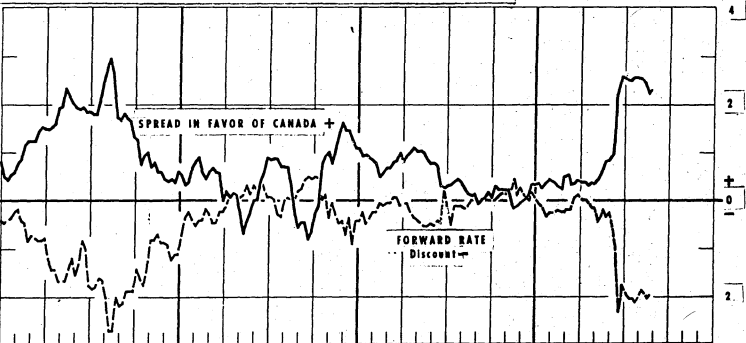
Thursday figures

## THREE-MONTH TREASURY BILL RATES

Per cent per annum



## RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



## RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

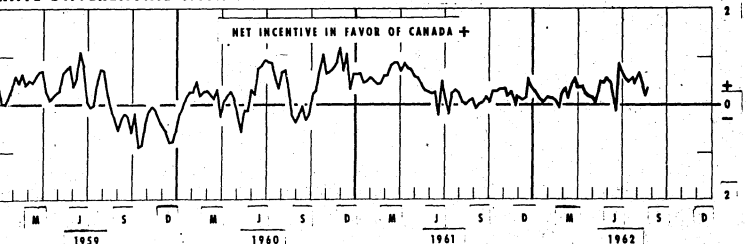




Chart 2

# INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

Per cent per annum

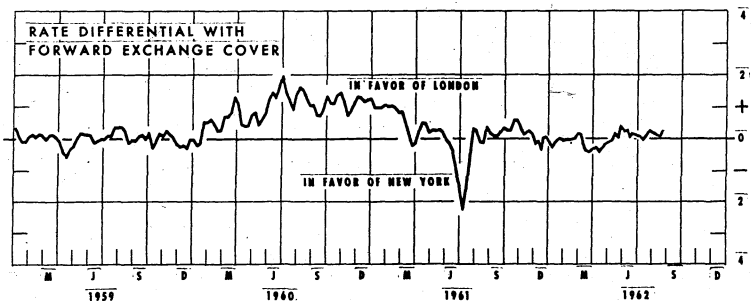
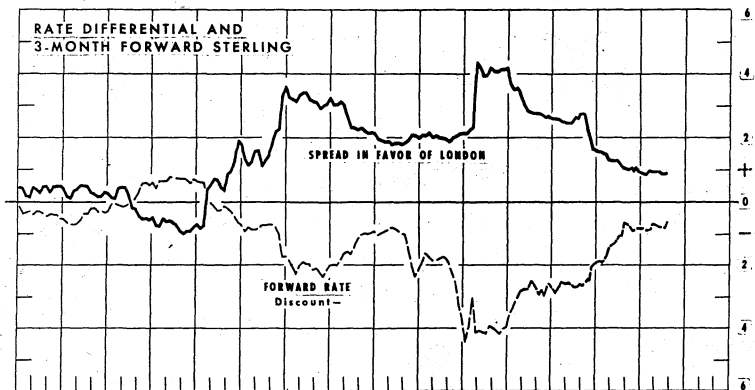
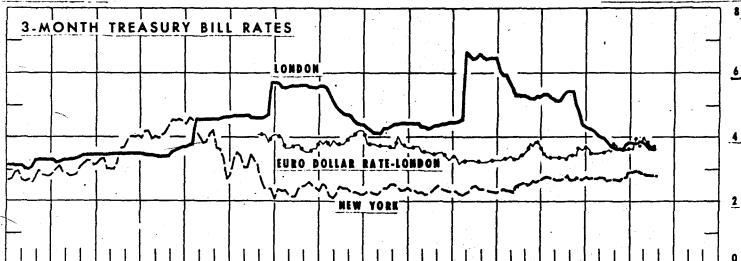
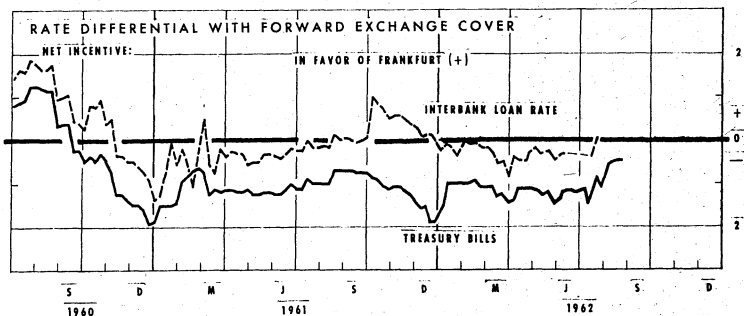
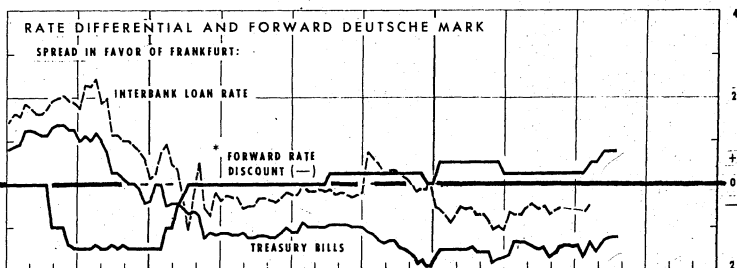
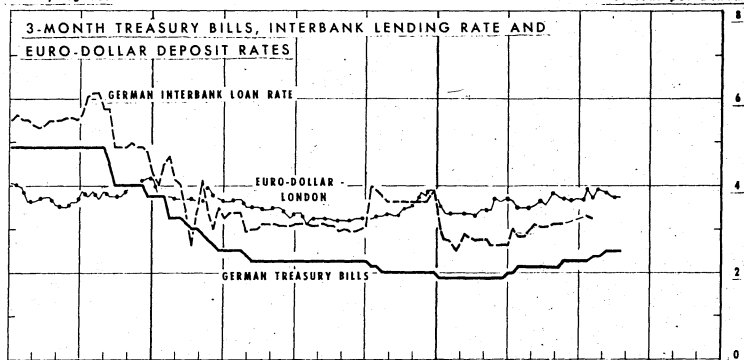


Chart 3  
**INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS**

Friday figures

Per cent per annum



Notes: Special forward rate available to German commercial banks

Chart 4

# **INTEREST ARBITRAGE, FRANKFURT / LONDON**

Friday figures

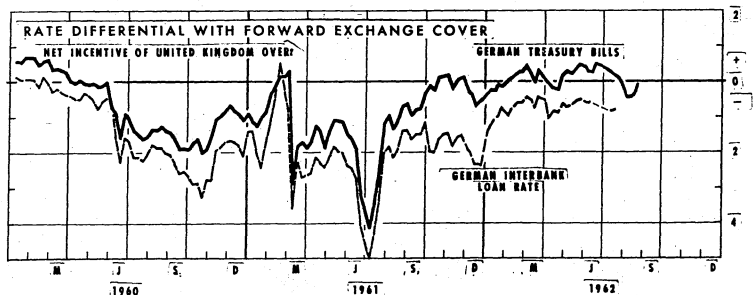
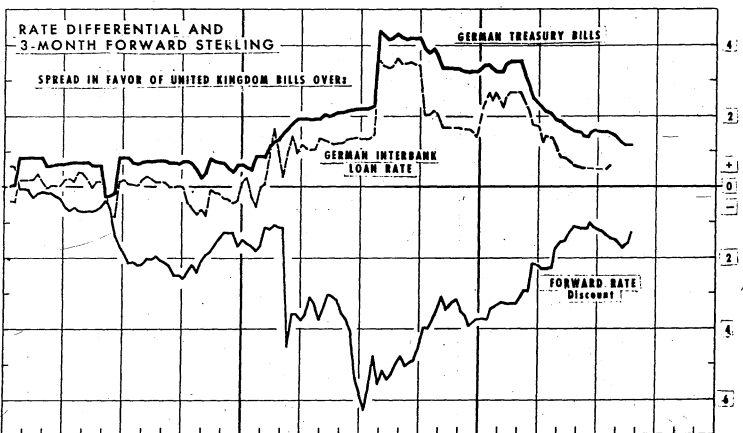
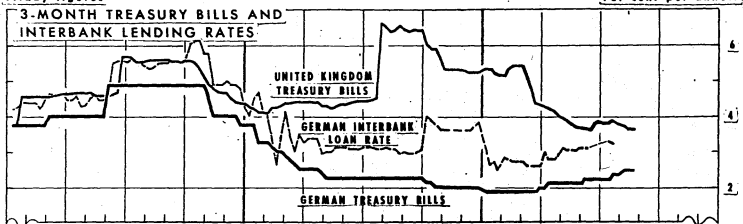
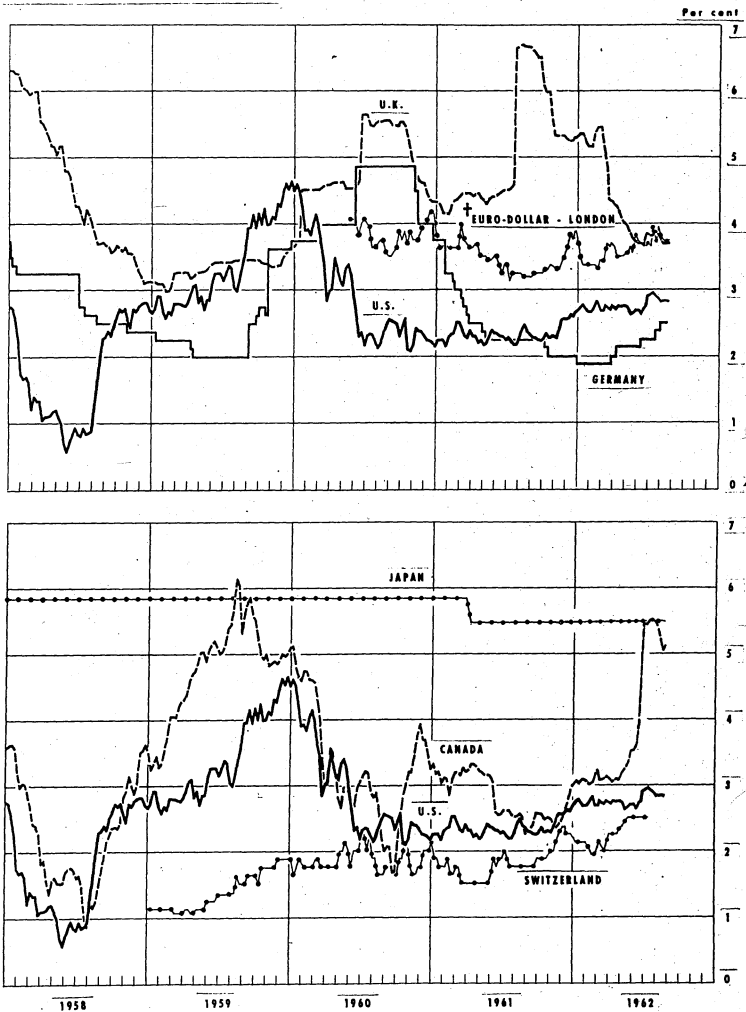


Chart 5

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**

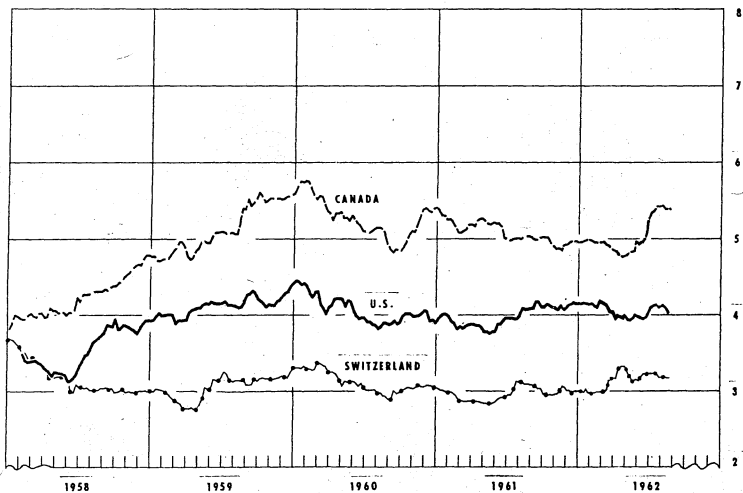
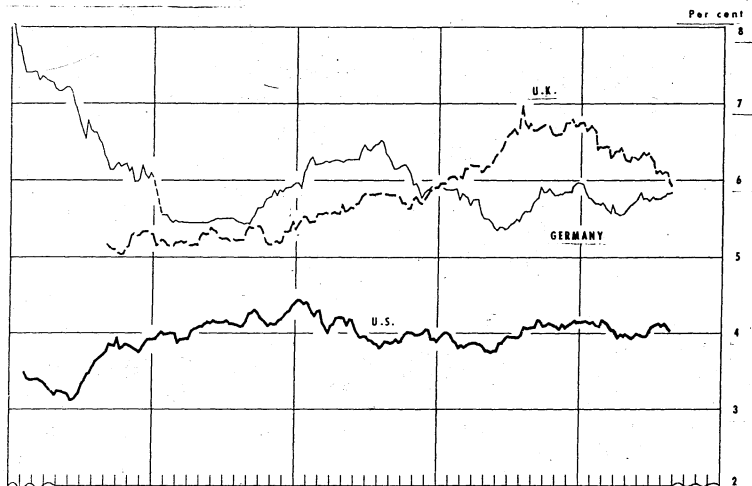
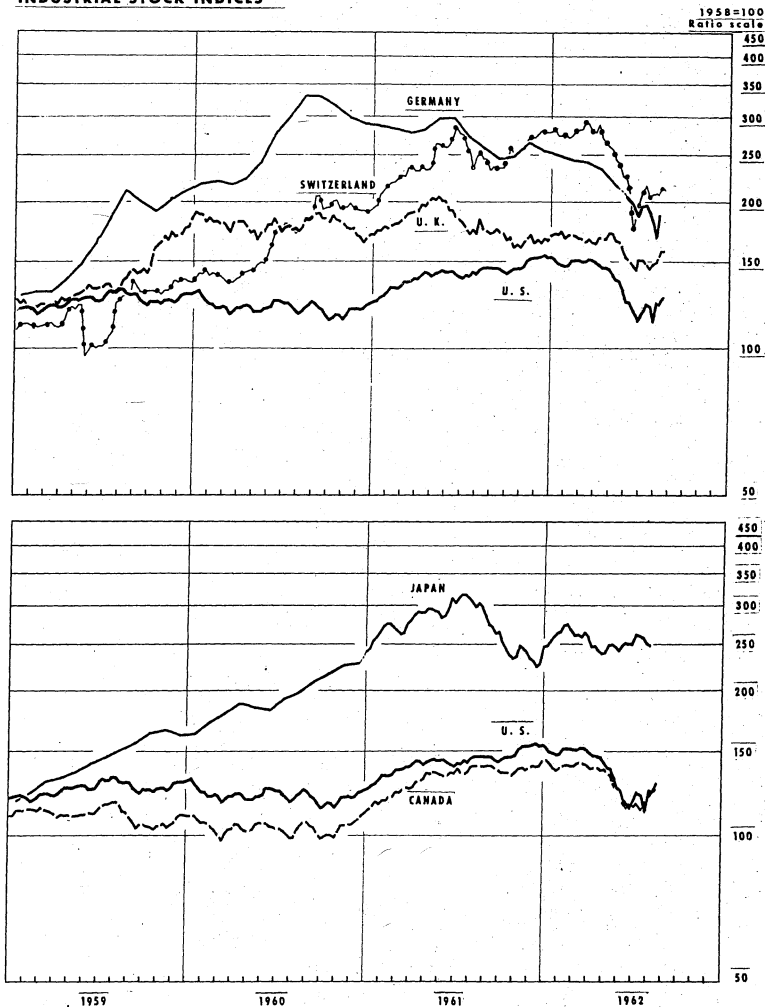


Chart 2

# INDUSTRIAL STOCK INDICES\*



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

Chart 8

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

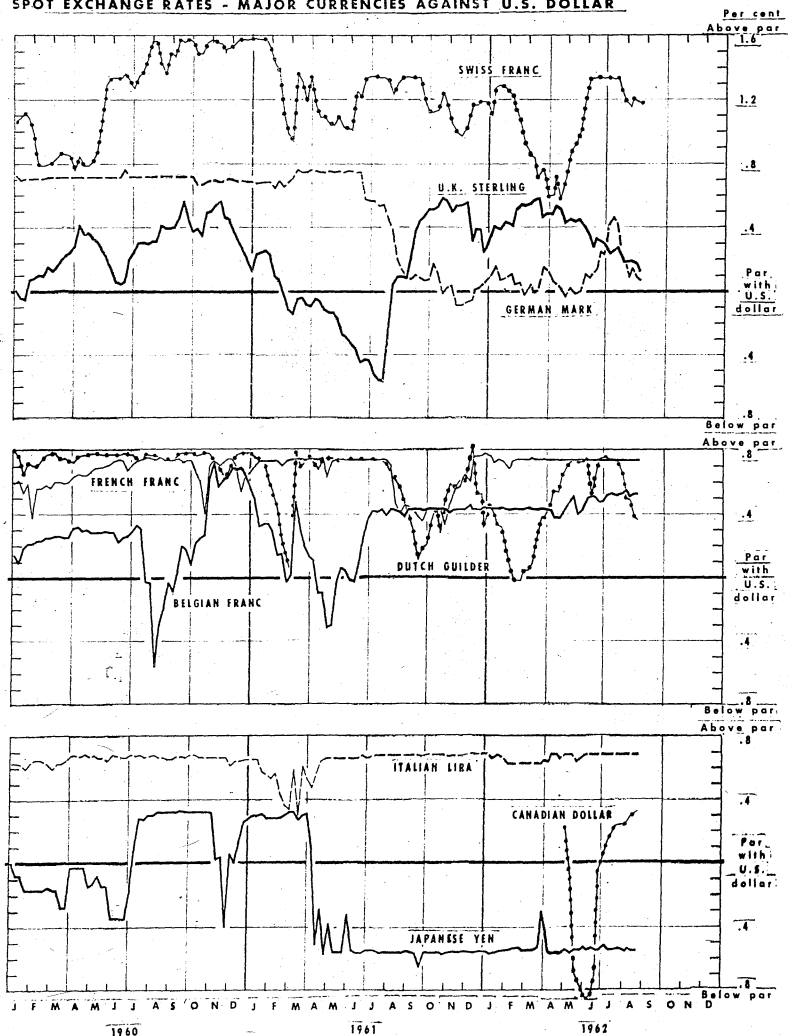


Chart 7

# 3-MONTH FORWARD EXCHANGE RATES

