

H. 13  
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February 15, 1963

## CAPITAL MARKET DEVELOPMENTS ABROAD

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FEDERAL RESERVE BANK  
OF RICHMOND

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

I. United Kingdom: Money and Capital Markets in January 1963

Short-term money rates eased in the United Kingdom early in January after Bank rate was cut from 4-1/2 to 4 per cent on January 3, but an upward push developed in government bond yields during the second half of the month. Gilt-edged prices weakened under the impact of selling provoked by the Common Market crisis which had a marked effect on security markets, especially on longer-term gilt-edged yields. Between January 3 and February 7, long-term bond yields rose about 20 basis points, intermediate maturities about 12-15 basis points and short-term bonds only a few points. (See Table 1.) Some 82 per cent of a 14 year Australian bond offering, which happened to come to the market on the day of the de Gaulle press conference, was left with the underwriters.

Table 1. United Kingdom: Change in Government Security Yields,  
January 3 to February 7, 1962  
(In per cent per annum)

	4-1/2% Conversion Stock Bill	5% Conversion Stock 1971	3% Savings Bonds 1965-75	5-1/2% Funding Stock 1982-84	3-1/2% Funding Stock 1999-2004	Undated 3-1/2% War Loan	Bonds 2-1/2% Consols
Jan. 3	3.56	3.79	5.00	5.04	5.45	5.37	5.68
Feb. 7	3.48	3.83	5.13	5.19	5.57	5.57	5.80
Change	-.08	.04	.13	.15	.12	.20	.26

The private demand for credit remained sluggish. For the month ending January 16, the London clearing banks failed to show any net increase in loans to the private sector. Instead, they were substantial buyers of Treasury bills and, to a lesser extent, of gilt-edged securities. Combining results for November and December, there was no increase in instalment credit.

On the external side, the pound was strong on foreign exchange markets during the early part of the month. Many continental commercial banks shifted funds into British financial markets which they had withdrawn for year-end window-dressing: they acquired both Euro-dollar and sterling market assets. The break-off of Common Market negotiations produced sharp selling of sterling. The rate eased slightly and the press reported some official support operations for a few days at the month-end.

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Britain's trade deficit in the fourth quarter was slightly below the third-quarter level, but exports failed to rise above the level reached during the second quarter of 1962. Official reserves, which did not fully reflect month-end support operations in the spot market, showed a gain of \$58 million for January.

Money market. Following the reduction in Bank rate from 4 to 4-1/2 per cent on January 3, the Treasury bill fell by only ten basis points, as the bill rate was already reduced late in December in anticipation of the Bank rate reduction. (See Table 7 and Chart 4.) With the exception of a dip to 3.37 per cent on February 1, the bill rate remained at 3.41 per cent throughout the month.

Covered arbitrage possibilities into the U.S. Treasury bills from British bills became possible during the first week of February when the forward discount on sterling widened. (See the discussion of "Foreign exchange markets", below.) On February 1, the covered premium in favor of the U.S. bill was 0.22 per cent but the press had no reports of funds moving to New York.

Other interest rates were reduced in January in the wake of the Bank rate cut. On January 4, Barclays Bank reduced its nominal rate on personal loans from 5-1/2 to 5 per cent. The Agricultural Mortgage Corporation cut its mortgage rate from 6-1/2 to 6 per cent. The Building Societies Association, on January 11, recommended that its members lower their charges on new home loans from 6-1/2 to 6 per cent on February 1. Late in 1962, several large societies, both inside and outside of the Association, had already reduced their lending rates.

Local authorities rates were relatively low during most of January, ranging around 4.19 per cent for 30-day money. Funds were in greater demand in early February, and, consequently, this rate rose to 4.31 per cent. The high cost of forward cover eliminated any possibility of covered movement into local authorities loans from the Euro-dollar market.

The Euro-dollar itself was very attractive early in January to Continental investors, particularly German commercial banks. While the Euro-dollar deposit rates fell after December 31, the inter-bank rate in Frankfurt fell even further. The uncovered interest differential was 0.85 per cent on January 4, and the covered differential was 0.45 per cent.

Gilt-edged market. Government bond prices fell steadily during January and the first week of February, (see Table 8 and Chart 6), mainly as the result of uncertainty over the Common Market negotiations. General de Gaulle's comment that he did not wish Britain in the Common Market coincided with an Australian issue in London, and 82 per cent was left with the underwriters. Gilt-edged prices recovered after the end of January for a few days.

Stock market. Stock prices showed little net movement during the period under review. (See Table 8 and Chart 7.) They rose during the first week of January in response to the cut in Bank rate and the reduction in

purchase tax on some luxury items. These gains were reversed as the Common Market negotiations became clouded. Quite unexpectedly, stock prices moved up when the negotiations were broken off. Observers say that it was the uncertainty, more than the question of "in-or-out" that had depressed stock prices. During the first week of February the Financial Times industrial ordinary index levelled out slightly below 290.

London clearing banks. The reduction in Bank rate, which were reflected in lower bank lending charges, and the release of the final portion of special deposits with the Bank of England had virtually no effect on commercial bank lending to the private sector in the month ending January 16. (See Table 2.) Advances did rise by £46 million, but this reflected mainly the debiting of semi-annual banking charges to customers' accounts. Instead, the banks used their increased liquidity to add to their claims on the public sector. They were substantial buyers of Treasury bills. The liquidity ratio on January 16 stood at 34.6 per cent, somewhat below the year-ago ratio of 36.1 per cent, but higher than the 33.1 per cent in January 1961 when unemployment was much lower.

Table 2. United Kingdom: London Clearing Banks, Net Deposits and Selected Assets  
(In millions of pounds)

	Net Deposits	Claims on Public Sector			Claims on Private Sector		Special Deposits at Bank of England	Liquidity Ratio
		Total	of which: Govt. Bonds	Short Term	Total	of which: Advances		
<b>Outstanding:</b>								
March 16, 1960	6,073	2,937	1,368	1,496	3,219	2,933	--	31.5
<b>Changes: c/</b>								
1960-61	+ 71	-428	-294	-123	+399	+359	+143	30.4
1961-62	+106	+ 33	+ 90	+120	+117	+ 58	+ 77	32.6
1962-63 d/	+452	+568	+248	+319	+165	+172	-220	34.6
<b>1961:</b>								
I	+118	-349	- 85	-256	+175	+133	--	30.4
II	+216	-419	-102	-316	+157	+144	+ 2	32.2
III	- 44	+572	- 36	+607	-151	-180	+ 76	34.3
IV	+ 24	+160	+ 71	+ 83	- 79	- 75	--	35.3
<b>1962:</b>								
I	- 90	-240	- 23	-214	+150	+129	- 1	32.6
II	+142	+157	+ 91	+ 95	+ 57	+ 54	- 71	33.4
III	+ 77	+ 99	+ 48	+ 32	+ 9	+ 9	+ 2	33.7
IV	+106	+208	+ 81	+112	+ 55	+ 63	-113	34.0
<b>1963:</b>								
Jan.	+127	+104	+ 28	+ 80	+ 44	+ 46	- 38	34.6
<b>Outstanding:</b>								
Jan. 16, 1963	6,702	3,150	1,232	1,852	3,860	3,482	--	34.6

a/ Includes loans to nationalized industries.

b/ Treasury bills and call loans.

c/ Measured from the third Wednesday of each month. Fiscal year ends in March.

d/ Through January 1963.

**Installment credit.** In the months of November and December combined, total installment credit remained unchanged. A \$14 million expansion in credit granted by household goods shops, largely for household durables, was offset by the net reduction in credit extended by finance houses. (See Table 3.) Installment sales of hardware, radios and other electrical goods in December 1962 were up 20 per cent over their level a year ago. The decline in net credit outstanding of finance houses is attributed mainly to a seasonal fall in automobile sales. In January, however, the number of installment contracts on automobiles issued rose 5,000, from December and 4,500 above the January 1962 level.

Table 3. United Kingdom: Hire Purchase Credit  
(in millions of pounds)

	Changes 1962						Outstanding December 1962
	Jan.- Mar.	Apr.- June	July- Sept.	Oct.- Dec.	Nov.	Dec.	
Shops	-13	-2	+6	+18	+4	+10	318
Finance houses	-26	+1	-3	-21	-8	-6	569
Total	-39	-1	+3	-3	-4	+4	887

**Trade balance.** With a cutback in industrial materials imports, the trade deficit for the fourth quarter was reduced from the third quarter. However, exports in the fourth quarter remained roughly at the same level as in the second quarter. The slackening in the growth of exports in the second half of 1962 was due to sharp falls in shipments to Canada and Latin America and a levelling out of exports to other areas--particularly the EEC countries. The monthly rate of exports in the fourth quarter of 1962 was only 3 per cent above the 1961 average.

The long-run significance of British exclusion from the Common Market for exports is suggested by the fact that 51 per cent of the growth in exports between 1958 and the fourth quarter of 1962 is explained by the expansion of exports to EEC countries. (See Table 4.) The EFTA countries accounted for only 28 per cent of the increase; the expansion in North American markets was insignificant; and there was a slight decline in exports to the sterling area.

Table 4. United Kingdom: Foreign Trade  
(In millions of pounds; monthly averages; seasonally adjusted)

	1958	1961	1962				
			Year	I	II	III	IV
Trade Balance	-	-	-	-	- 36	- 52	- 46
Imports, c.i.f.	-312	-366	-374	-367	-369	-384	-378
Re-exports, f.o.b.	12	13	13	12	14	12	14
Exports, f.o.b.	265	307	316	306	319	320	318
<b>By area:</b>							
Sterling area	116	117	112	108	111	112	114
EEC	35	51	60	55	60	63	62
EFTA	29	40	43	42	43	43	44
U.S.A. and Canada	39	42	44	45	43	44	42
Other	46	57	57	56	59	58	56

Foreign exchange market. The pound was affected by large flows of capital during January: a movement into sterling during the second week of the month and a movement out during the final few days of the month. The inward flows were from Continental commercial banks which were unwinding window-dressing operations. Part of the money went into Euro-dollars but, since sterling rose above 280.50 cents and substantial official purchases of dollars were noted by the market, funds must have moved into sterling assets as well.

When the Common Market negotiations broke down, there were heavy selling pressures, concentrated on January 29 and 30. Funds were reported to have moved into the United States and France. The spot rate fell to 280.36 cents on January 29 (see Table 5). Speculation also took the form of forward sales. The discount on sterling widened so that it became profitable on a covered arbitrage basis to move funds to New York, but the incentives were too small to get a movement started. (See Table 8, below.)

Table 5. United Kingdom: Selected Exchange Rates  
(in U.S. cents per pound)

	Spot	3-month Fwd. <sup>a/</sup>	Security Sterling	Investment dollar <sup>a/</sup> Premium
<u>1962</u>				
Nov. 30	280.33	-.44	280.00	5-1/4
Dec. 28	280.24	-.43	279.87	6-7/8
<u>1963</u>				
Jan. 4	280.38	-.44	279.87	7.
11	280.56	-.46	279.87	6-3/4
18	280.54	-.54	279.87	8-5/8
25	280.54	-.60	279.62	9-1/8
29	280.36	-.68	279.37	10-1/4
30	280.45	-.93	279.87	9-1/2
31	280.47	-.83	279.25	9-1/16
Feb. 1	280.40	-.74	279.87	7-7/8
8	280.31	-.69	279.37	6-5/8

<sup>a/</sup> In per cent per annum.

Security sterling fell during these days, representing attempts by foreigners to move out of British securities. The investment dollar premium rose to over 10 per cent on January 29, representing the attempts of British investors to acquire foreign securities and British companies to secure additional funds for direct investment abroad. The investment dollar premium arises because British investors must bid on a small pool of foreign exchange that is available without having to secure permission from the exchange control authorities.

On February 1 the Chancellor of the Exchequer announced that: "It would be foolish unnecessarily to discourage external investment of a kind that will in the long run promote both the invisible income of this country and also the healthy expansion of our own industry." This modifies the strict criterion imposed on July 25, 1961 that applications for foreign exchange at the official rate to finance direct investment outside the sterling area would be approved only if the investment would be immediately profitable from the point of view of the U.K. balance of payments. The investment dollar premium fell to 6-5/8 per cent by February 8.

Gold and foreign exchange reserves. Reserves for the month of January showed an increase of \$58 million, but support operations on January 29 and 30 were not actually settled in the market until February 1. (See Table 6.) The Financial Times (February 5) estimated that, had these losses been included in the January figures, there would have been a net loss--rather than a net gain--for the month. The reserve acquisitions in January probably mainly reflect the movement of funds into Britain during the earlier part of the month.

Table 6. United Kingdom: Official Reserves  
(In millions of U.S. dollars)

	<u>1962</u>				<u>1963</u>	<u>Outstanding January 31, 1963</u>
	<u>Jan.- June</u>	<u>July- Dec.</u>	<u>Nov.</u>	<u>Dec.</u>	<u>Jan.</u>	
Gold and convertible currency	-115	-626	+62	-78	+59	2,864
Adjusted for special transactions	+690	= 20	+62	-78	+59	--

December reserve losses of \$78 million were due mainly to the repayment of the U.S. and Canadian loans (\$181 million). Because, in previous years, the loss of reserves has exceeded the debt obligation, the December figures were regarded by the market as favorable to Britain. Over the course of 1962, the British reserve position increased substantially in the first half of the year, and there was a small net loss in the second half of the year, even after adjustment for repayments to the IMF.

Bullion market. The market was quiet for the first three weeks of January as is reflected by the decreasing gold prices at the fixing. (See Table 7.) On January 9, the fixing price was \$35.0549 per ounce, the lowest price since December 28, 1959. In late January, there was an active demand for gold as a result of international developments but prices moved up only fractionally. The demand for gold coins strengthened, especially in Germany. The market was quiet again in the first week of February.

Table 7. United Kingdom: Fixing Price for Gold Bullion  
(In U.S. dollars per fine ounce)

Dec. 14	35.074	Jan. 4	35.063	Jan. 25	35.060
21	35.083	11	35.052	Feb. 1	35.074
28	35.069	18	35.054	8	35.069

The first three weeks in January has reached the quietest period in gold trading since the London gold market was opened in 1954. Contributing to the slackened demand for gold is the recent Indian restrictions on possessing gold in forms other than in ornaments. The Times (London) predicts (January 11, 1963, p. 4) that enforcement of this regulation will result in even less business for London's bullion dealers. Russian sales are reported to have added to market supply during the past few months.

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

Table 7. United Kingdom: Treasury Bill Yields and Exchange Rates

	3-mo. Treasury bill arbitrage calculation					Spot pound (U.S. cents)	London deposit rates	
	U.K.	U.S.	Difference	3-mo. pounds <sup>a/</sup>	In favor U.K. bill		U.S. dollar (3-mo.)	Local authority
1962 - High	3.78	2.73	1.05	-0.31	0.74	281.71	4.13	4.87
	Low	4.25	2.74	1.51	-1.92	280.04	3.44	4.19
Nov. 16	3.72	2.83	0.89	-0.43	+0.46	280.15	4.06	4.31
	23	3.66	2.84	0.82	-0.54	280.35	4.13	4.31
	30	3.63	2.86	0.77	-0.44	280.34	3.94	4.31
Dec. 7	3.56	2.84	0.72	-0.37	+0.35	280.36	4.06	4.53
	14	3.53	2.85	0.68	-0.51	280.35	4.31	4.53
	21	3.53	2.89	0.64	-0.61	280.35	4.12	4.69
	28	3.66	2.98	0.68	-0.43	280.24	4.12	4.87
1963								
Jan. 4	3.50	2.90	0.60	-0.44	+0.16	280.38	3.97	4.25
	11	3.41	2.89	0.52	-0.46	280.56	3.69	4.19
	18	3.41	2.92	0.49	b/ -0.56	280.50	3.59	4.19
	25	3.41	2.93	0.48	b/ -0.60	280.53	3.59	4.19
Feb. 1	3.37	2.94	0.43	b/ -0.74	-0.22	280.39	3.56	4.31
	8	3.41	2.93	0.48	b/ -0.69	280.31	3.56	4.31

a/ Market quotation for Friday.

b/ Premium on U.S. dollar.

Table 8. United Kingdom: Selected Capital Market Yields

	U.K. Government bond yields					Share yield a/	Yield gap b/	Share prices a/
	4-1/2%	3%	5-1/2%	3-1/2%	2-1/2%			
	1964	1965-75	2008-12	War Loan	Consols			
1962 - High	5.85	6.28	6.35	6.77	6.57	5.15	1.42	309.6
	Low	3.90	5.00	5.45	4.80	5.51	-0.27	261.3
Nov. 15	4.12	5.07	5.75	5.82	5.75	5.30	0.45	293.9
	22	4.09	5.10	5.75	5.83	5.71	0.44	295.2
	29	4.02	5.12	5.75	5.84	5.70	0.43	295.6
Dec. 6	4.01	5.07	5.70	5.76	5.60	5.36	0.24	291.9
	13	3.95	5.08	5.65	5.71	5.56	0.14	288.9
	20	3.90	5.13	5.70	5.77	5.64	0.13	281.3
	27	3.87	5.10	5.75	5.75	5.61	0.20	284.2
1963								
Jan. 3	3.79	5.04	5.65	5.68	5.54	5.33	0.21	286.7
	10	3.77	5.02	5.70	5.74	5.59	0.34	292.7
	17	3.79	5.10	5.75	5.81	5.65	0.32	288.3
	24	3.86	5.19	5.80	5.88	5.75	0.33	284.1
	31	3.79	5.20	5.85	5.90	5.77	0.43	288.5
Feb. 7	3.83	5.19	5.80	5.90	5.80	5.34	0.46	288.4

a/ Financial Times.

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



## INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures

Per cent per annum

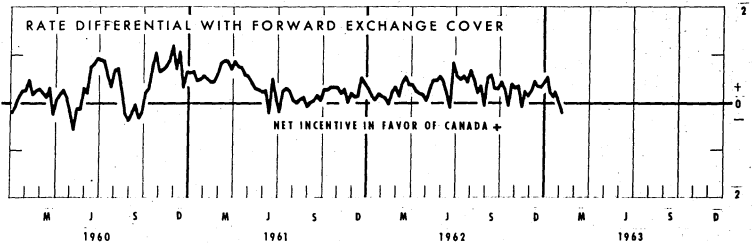
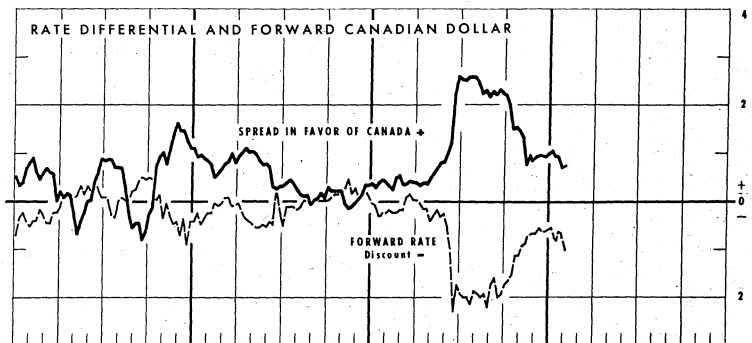
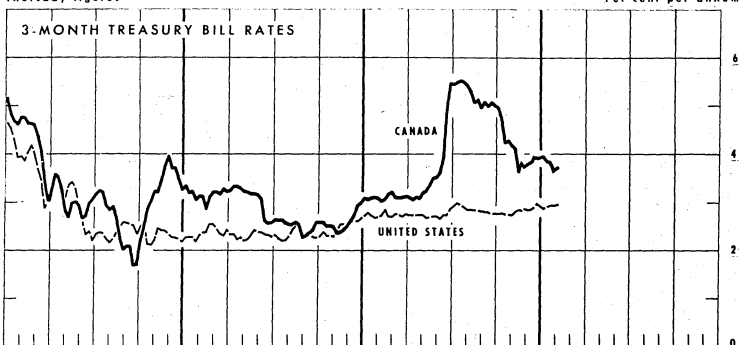


Chart 2  
**INTEREST ARBITRAGE, NEW YORK/LONDON**

Friday figures Per cent per annum

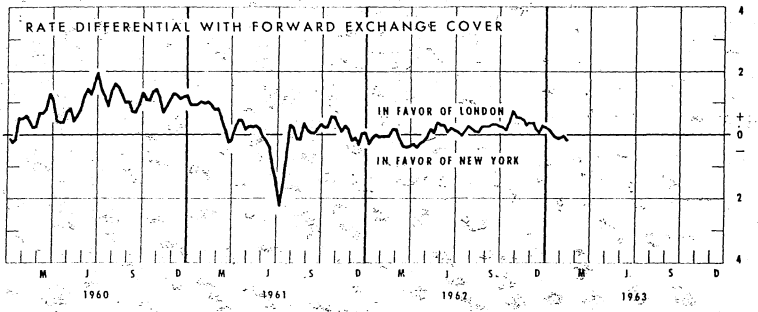
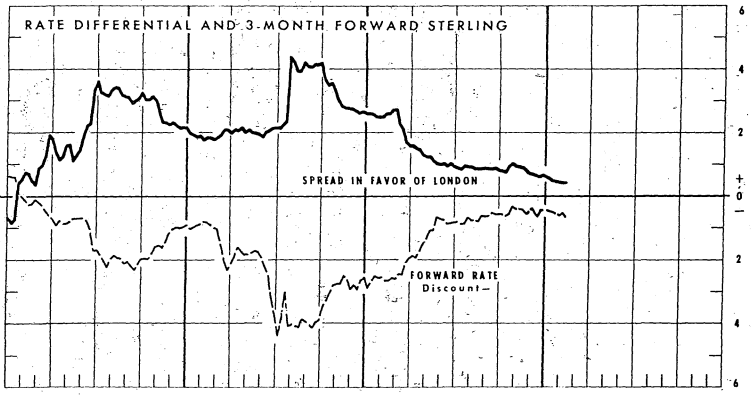
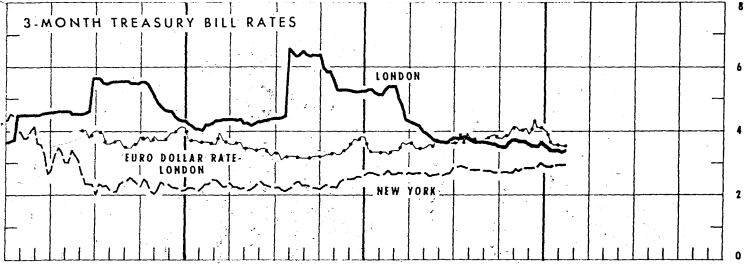
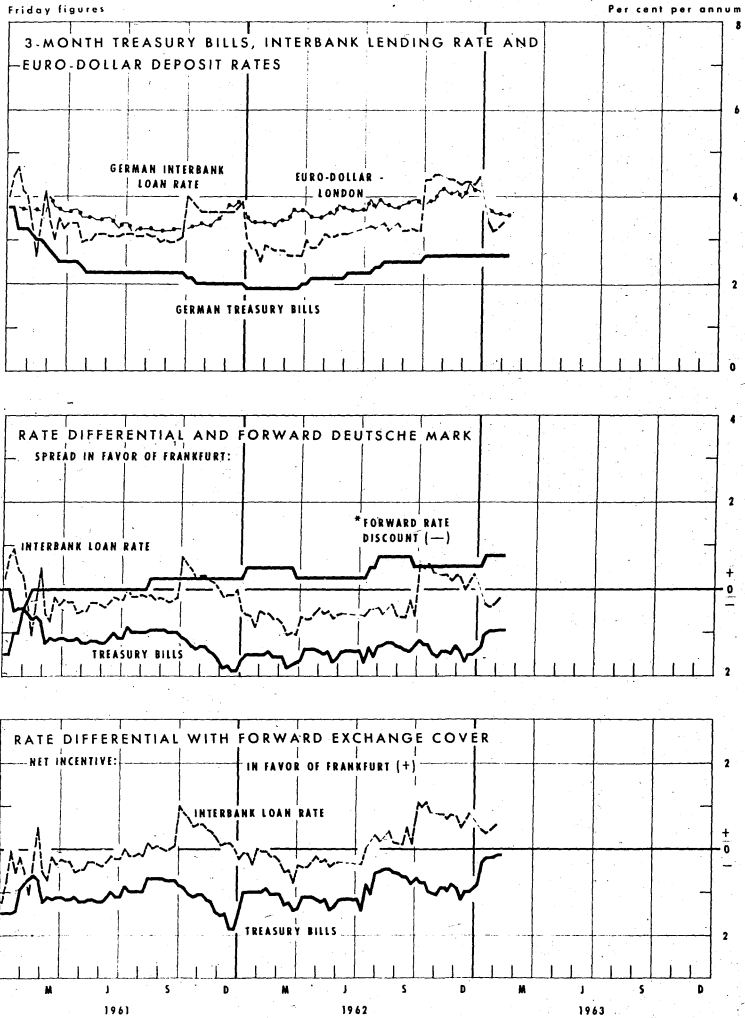


Chart 3

**INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS**



\*Note: Special forward rate available to German commercial banks.

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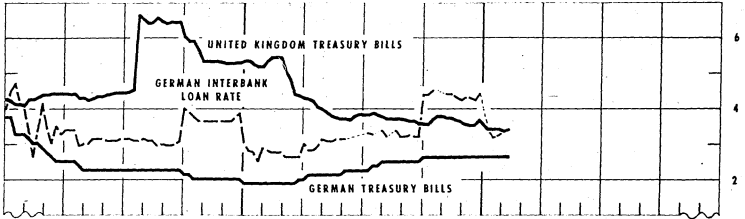
Chart 4

### INTEREST ARBITRAGE, FRANKFURT / LONDON

Friday figures

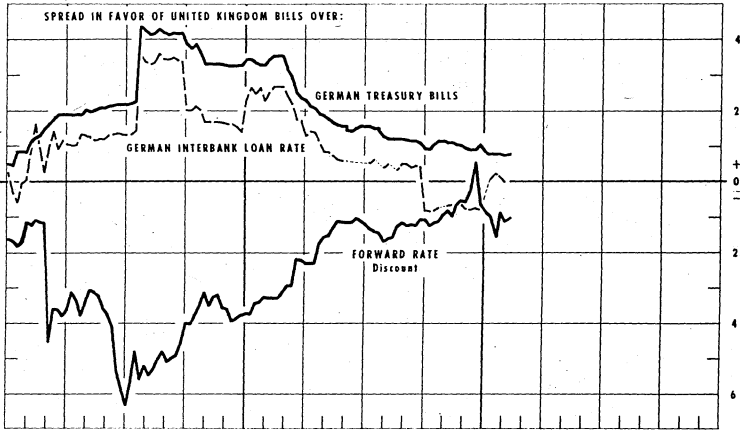
#### 3-MONTH TREASURY BILLS AND INTERBANK LENDING RATES

Per cent per annum



#### RATE DIFFERENTIAL AND 3-MONTH FORWARD STERLING

SPREAD IN FAVOR OF UNITED KINGDOM BILLS OVER:



#### RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

NET INCENTIVE OF UNITED KINGDOM OVER:

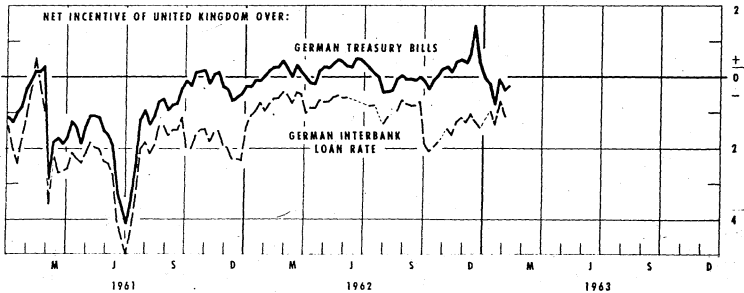
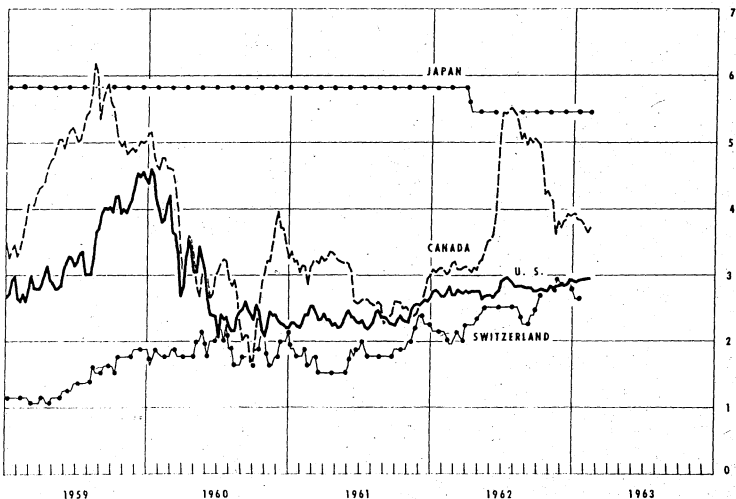
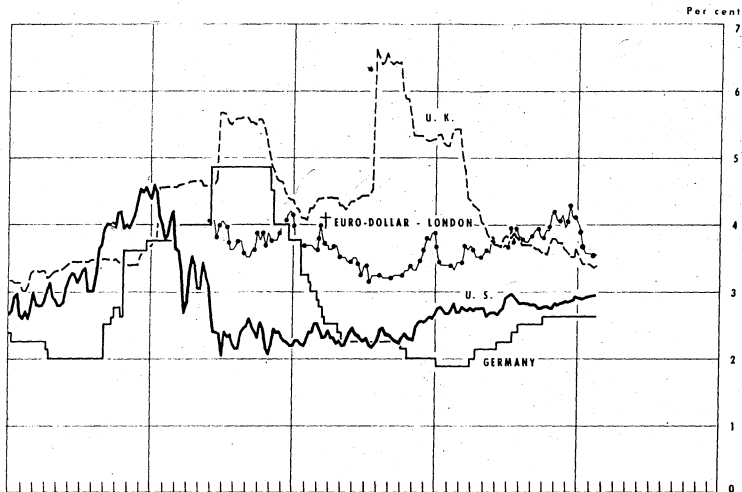


Chart 5  
SHORT-TERM INTEREST RATES \*



\* 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

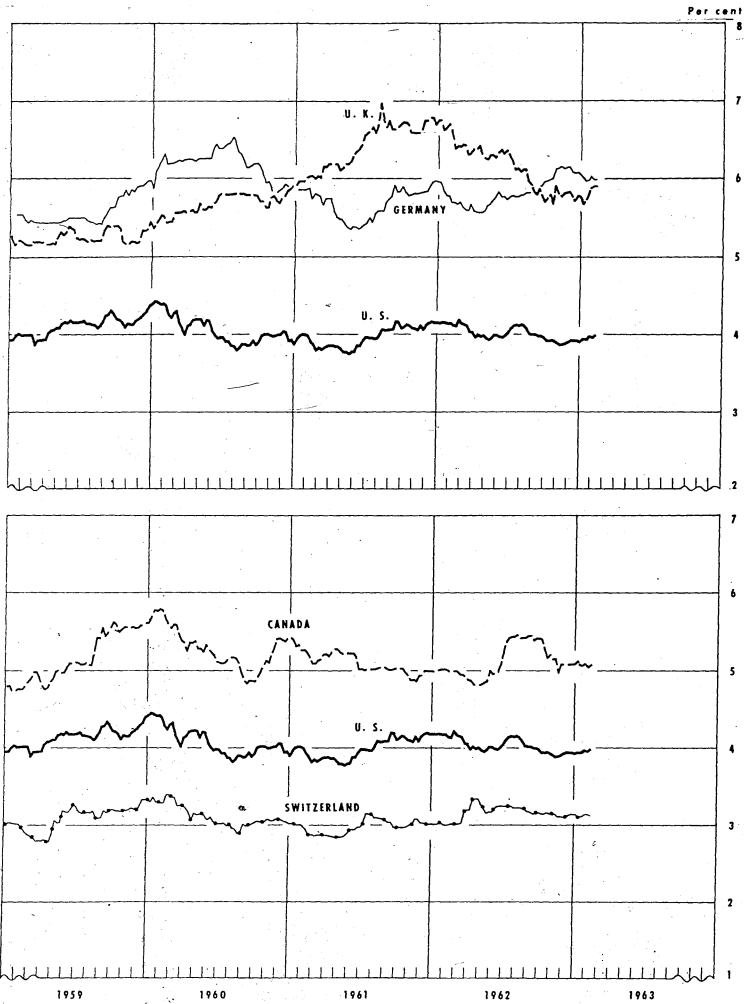
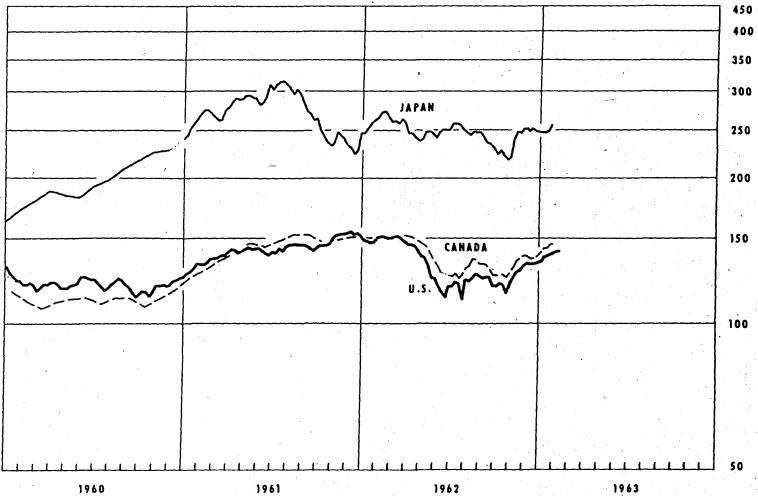
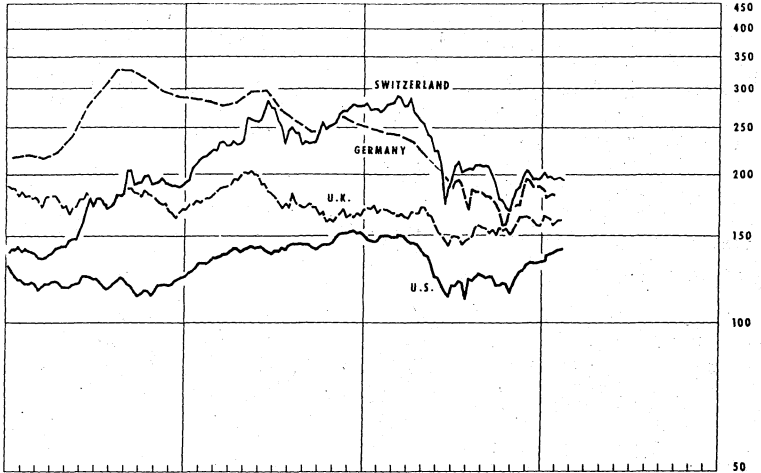


Chart 7

**INDUSTRIAL STOCK INDICES\***

1958 = 100

Ratio scale



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

Chart 8

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

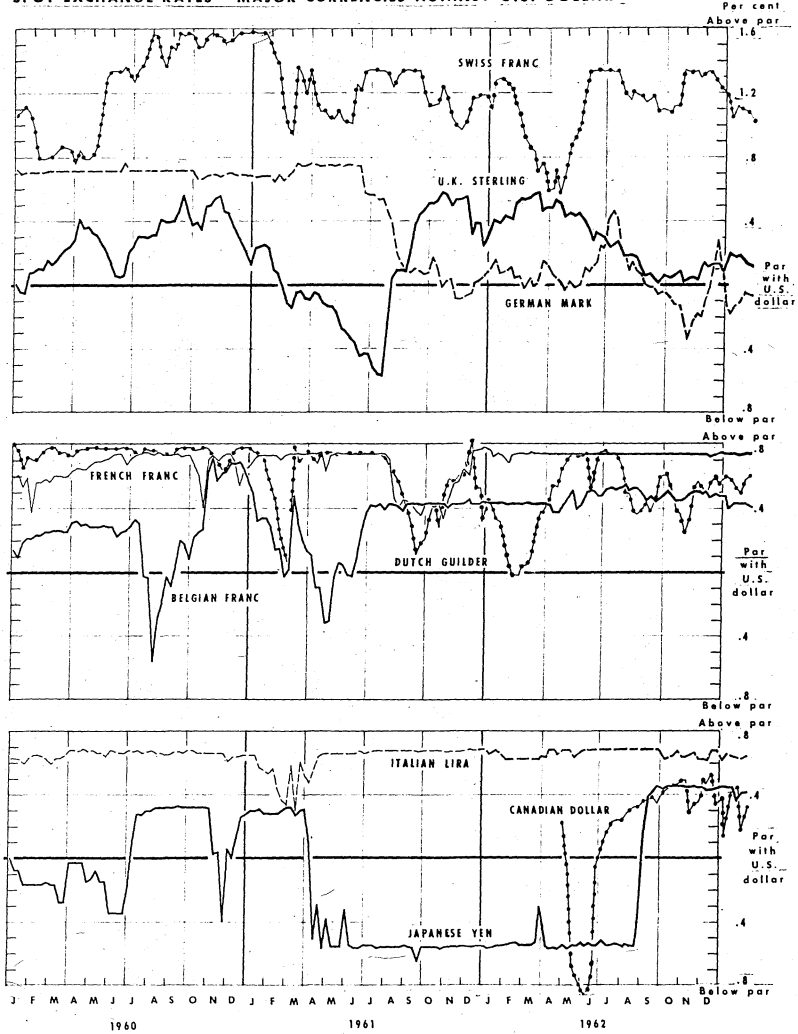




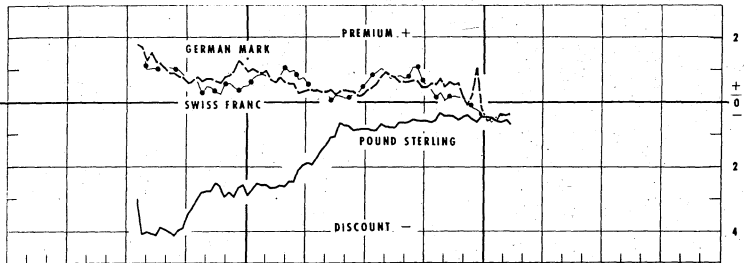
Chart 9

### 3-MONTH FORWARD EXCHANGE RATE

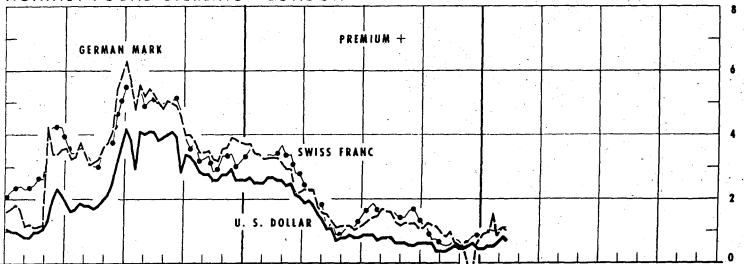
Friday figures

AGAINST U. S. DOLLARS

Per cent per annum



AGAINST POUND STERLING - LONDON



AGAINST POUND STERLING - LONDON

