DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

H. 13
No. 113

July 17, 1963

CAPITAL MARKET DEVELOPMENTS ABROAD

I. United Kingdom: Money and Capital Markets in June

Financial markets were somewhat easier in the United Kingdom in the early part of June, but the market for short-term funds tightened towards the end of the month. As a result, the Treasury bill rate moved up late in June but medium and long-term bond yields continued on the downward trend which began in mid-March. (See Table 1.) The Profumo political controversy had a significant but momentary impact on stock prices and on bond yields; bond prices had recovered their lost ground late in June and stock prices by early July. On the foreign exchange market, the pound continued strong.

Table 1. United Kingdom: Selected Securities Prices and Yields, June-July

	June				July
	6	10	17	27	4
Security Price Indices a/					
Industrial stocks	311.0	302.6	307.1	307.3	311.6
Bonds	93.6	93.1	93.5	94.0	94.1
Yields (per cent per annum)					
Industrial stocks	5.02	5.16	5.05	5.08	5.01
Government securities					
Treasury bill (3-month)	3.56	3.59	3.59	3.63	b/3.72
4-1/2% Conversion 1964	3.67	3.63	3.60	3.56	3.65
3% Savings bonds 1965-75	5.03	5.08	5.05	5.01	5.00
5-1/2% Treasury bonds 2008-12	5.52	5.58	5.55	5.50	5.50
2-1/2% Consols	5.41	5.48	5.45	5.39	5.39

a/ Financial Times.
b/ July 5. Tender rate was 3.76 per cent.

Bank loans advanced no more than seasonally in the month ending June 19 and the clearing banks materially eased their liquidity position with purchases of Treasury bills. The failure of bank advances to rise further is attributed by the financial press to the apparent sluggish pace of business expansion. This interpretation may in part be related to the disappointing business indicators released during the period under review, which revealed that industrial output was unchanged in April. However, installment credit

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expanded appreciably in May. This credit contributed to the sharp increase in retail sales of consumer goods and to the continued high sales of automobiles reported in May. The May expansion in consumer spending suggests that business activity is again slowly moving ahead.

There is a good deal of press speculation at the moment that British financial institutions are about to introduce negotiable certificates of deposits in the London market. (See, in particular, The Economist, July 6, 1963, p. 63.) Money market operators in London apparently expect that outstanding certificates might (as an outside limit) total as much as £800 million or roughly about 10 per cent of outstanding deposits of the London clearing banks. These estimates seem to be based on the assumption that sterling-currency certificates will be issued and imply that the London clearing banks will be primary factors in the market. If dollar-currency certificates were to be issued, the smaller financial institutions now active in the Euro-dollar market would presumably be chiefly involved. During June and early July, rates on Euro-dollar deposits in London rose as both U.K. and U.S. Treasury bill rates moved up.

The strength of sterling continued to be manifested primarily in June (as in April and May) by a further narrowing of the forward discount. Between May 31 and July 5, the 3-month discount fell from 0.64 per cent per annum to 0.49 per cent per annum. This decline, along with a small increase in the U.K. Treasury bill rate during the latter part of June, brought about a covered interest differential in favor of U.K. over U.S. bills for the first time since early January. (See Table 8 and Chart 2.) In June, Britain repaid the $250 million acquired in February and March from Continental central banks. Reserves would have increased by $34 million in the absence of these repayments. The fixing price for gold bullion was slightly up during the month.

The financial press has reported that two investment trusts (British Assets Trust and Scottish United Investors) have completed arrangements for borrowing dollars in the United States to invest in dollar securities. They are both borrowing from the New York Life Insurance Company at 5 per cent, estimated to be about 1/2 to 3/4 per cent cheaper than they would be able to borrow in London. One loan is for $10 million for 18 years and the second for $5 million repayable in two equal installments in 1977 and 1979. (See The Economist, July 13, 1963, p. 175.)

Money market. Money market conditions were easy in mid-June. Funds were shifted out of the unsettled securities markets and funds were also available with the pay-off for two maturing government bond issues. The Treasury bill offering on June 14 was subscribed twice over. The after-tender market rate on that day was 3.56 per cent as contrasted with 3.61 per cent on May 31. (See Table 8 and Chart 2.) At the end of the month, however, a shortage of funds developed, apparently because the banks attempted to increase their cash position. The Bank of England made some purchases of Treasury bills, but on June 29 almost all the discount houses had to borrow substantial sums from the Bank at Bank rate. Thereupon, on July 5 and again on July 12, the Treasury bill tender rate rose to 3.76 per cent; this was the highest level since March 21 when the Bank of England forced the discount houses to borrow at 1/2 per cent above Bank rate. The higher British tender rate in July came at a time when the U.S. Treasury bill rate was also rising.

The covered interest differential in favor of U.K. over U.S. Treasury bills widened slightly in late June, (See Table 8 and Chart 2) despite the rise in the U.S. bill rate but the differential remained small, nonetheless.

In the local authorities funds market, Treasurer's borrowing requirements continued to be low in June as tax receipts continued to flow in. The tax receipts and the ample supply of funds to the money-market mid-month caused rates to move down. The 3-month rate fell to 4.25 per cent on June 21 from 4.44 per cent on June 7. At the end of June, the market for temporary funds became firmer as the availability of domestic funds fell and also because some foreign money was withdrawn. The supply of mortgage funds, which were forthcoming in May only at rates above the Public Works Loan Board's 5-3/4 per cent rate, were more easily available in June as gilt-edged yields declined.

Tight money market conditions on the Continent, particularly in Germany, Switzerland, and the Netherlands, helped maintain the high level of Euro-dollar rates in June which had prevailed in May. However, the Euro-dollar deposit rate in London eased in mid-June, reflecting the tone of the U.K. short-term money market at that time, but moved up again in early July. (See Table 2 and Chart 3.)

Table 2. United Kingdom: Rates on U.S. Dollar Deposits By Maturity, Selected Dates, 1963
(in per cent per annum)

	April	May	June				July	
	26	31	7	14	21	28	5	12
Euro-dollar deposits:								
Call	3.50	3.63	3.63	3.50	3.43	3.50	3.50	3.50
7-days	3.63	3.63	3.69	3.56	3.50	3.50	3.50	3.56
30 days	3.69	3.88	3.88	3.81	3.69	3.75	3.81	3.88
90 days	3.81	3.94	4.00	3.94	3.81	3.88	3.94	4.06
180 days	3.88	4.00	4.06	4.00	3.94	4.00	4.06	4.13
U.K. Treasury bill	3.66	3.61	3.59	3.56	3.63	3.63	3.72	3.72
U.S. Treasury bill	2.87	2.97	2.97	2.97	2.96	2.97	3.01	3.19

Bond market. The rise in bond prices which began in mid-March continued through June except for a temporary relapse between June 10 through June 17 when the political implications of the Profumo affair upset the market. By mid-June the market for bonds had recovered sufficiently to enable a £25 million London County Council issue to be floated successfully. Viewing the month as a whole, yields fell moderately throughout the medium and long-dated range of issues. (See Table 9.) Early in July, the War Loan reached a new peak price for the year, and there was also a strong demand for the 5 per cent Exchequer Stock of 1976/78.

Stock market. In contrast to the generally upward movement of bond prices in recent months, the stock prices have changed little since the latter part of April. Some commentators in the British financial press suggest that the mid-February to mid-April rise in stock prices had already discounted the higher rate of corporate profits expected from the general business expansion now being awaited.

With relatively subdued buying activity in the market early in June, the stock market was particularly vulnerable to the political uncertainty created by the Profumo scandal. On June 10, The Financial Times' industrial stock index fell seven points, which was the largest single-day decline since the Cuban crisis. Bargain-hunting on the following day brought the index up by 4.6 points, but the market remained very unsettled until June 17. (See Table 1 and Chart 7.) Stock prices did not make good the June 10 losses until July 3, whereas bond prices had recovered fully by June 17. The Financial Times attributes the sluggish nature of the stock market in part to the impending reduction of the stamp duty on stock transfers from 2 to 1 per cent.

London clearing banks. Bank advances to the private sector levelled off in June. (See Table 3.) The increase of £17 million represented in part the semi-annual debiting of interest charges. Bank liquidity, which had been at a critically low level since February, eased in the month ending June 19 when the banks added £99 million to their Treasury bills and call loans. The liquidity ratio rose to 31.6 on June 19 as contrasted with just over 30 per cent for the previous four months.

Table 3. United Kingdom: London Clearing Banks, Net Deposits and Selected Assets
(in millions of pounds)

	Changes						Outstanding
			1963				
	1961-62 a/	1962-63 a/	Mar.	Apr.	May	June	June 19, 1963
NET DEPOSITS	+106	+258	+ 11	-94	+149	+104	6,668
SELECTED ASSETS							
1. Claims on Public Sector	+ 33	+ 30	-151	-20	+ 2	+ 83	2,677
Government securities	- 90	+137	- 35	-33	+ 3	- 2	1,089
Treasury bills and call loans	b/+120	-118	-105	+28	- 4	+ 99	1,538
Loans to nationalized industries	+ 3	+ 11	- 11	-15	+ 3	- 14	50
2. Claims on Private Sector	+117	+491	+146	+31	+ 41	+ 22	4,280
Advances (net)	b/ 58	+453	+117	+28	+ 42	+ 17	3,850
Other	59	+ 38	+ 29	+ 3	- 1	+ 5	430
3. Special Deposits at Bank of England	+ 77	-220	--	--	--	--	--
LIQUIDITY RATIO	c/33.6	c/33.0	30.5	30.5	30.7	31.6	31.6

a/ Fiscal years ending mid-March. Bank balance sheets are normally prepared for the third Wednesday of each month.
b/ Adjusted for the reclassification of £40 million from advances to money on call in October 1961.
c/ Monthly averages.

Installment credit. The unique feature of installment credit in May was the sharp rise in new credit extended by household goods shops, reflecting expanding retail sales of durable goods. (See Table 4.) At the same time, new credit extended by finance houses in May rose substantially for the third consecutive month. This was mainly due to the continued expansion of automobile sales. Installment credit outstanding in May rose by £14 million.

Table 4. United Kingdom: Installment Credit

	1962	1963 Jan.-Mar.	Feb.	Mar.	Apr.	May	Outstanding May 31, 1963
New Credit Extended, Index of value (1957=100)							
Household goods shops	111	97	93	99	101	114	--
Finance houses	140	132	116	164	177	201	--
Credit Outstanding (£ mns.)							
Household goods shops	+ 9	- 8	- 3	- 2	- 3	+ 3	311
Finance houses	-49	- 5	- 3	+ 4	+10	+11	584
Total	-40	-13	- 6	+ 2	+ 7	+14	895

Foreign trade. The average trade deficit for April and May was about equal to that of the second half of 1962. While exports in this period averaged 3 per cent above the third quarter of 1962 (the higher quarter for 1962), imports rose only 2 per cent above that level. (See Table 5.)

Table 5. United Kingdom: Foreign Trade
(In millions of pounds, seasonally-adjusted monthly averages)

	1962 Jan.-Mar.	1962 Apr.-June	1962 July-Sept.	1962 Oct.-Dec.	1963 Jan.-Mar.	1963 Apr.-May	1963 Apr.	1963 May
Imports c.i.f.	-365	-373	-385	-374	-375	-391	-389	-394
Exports f.o.b.	306	319	320	318	326	330	320	341
Re-exports f.o.b.	12	14	12	14	12	13	13	13
Balance	- 47	- 40	- 53	- 42	- 37	- 48	- 56	- 40

Foreign exchange. Sterling was firm in June, with the spot rate gradually rising from 280.01 cents per pound on May 31 to 280.12 cents on July 5. The 3-month forward discount continued to fall in June, going from 0.64 per cent per annum on May 31 to 0.49 per cent per annum on July 5. (See Table 8 and Charts 8 and 9.)

Reserve movements. In June, after adjustment for repayment of $250 million of loans received in February and March from Continental central banks, gold and foreign exchange reserves rose by $34 million. After the repayment, however, the level of published reserves at the end of June at $2,713 million was the lowest since 1957. Britain's drawing rights at the IMF were unchanged in May, remaining at $2,445 million. (See Table 6.)

Table 6. United Kingdom: Reserve Position, 1963
(In millions of U.S. dollars)

	Changes Jan.-Mar.	Apr.-June	Mar.	Apr.	May	June	Outstanding June 30, 1963
A. Gold and convertible currency	+ 8	-101	+17	+34	+81	-216	2,713
Less Central bank loans	250	-250	200	--	--	-250	--
Adjusted reserves	-242	149	-183	+34	+81	+ 34	2,713
B. Drawing rights on IMF	--	n.a.	--	- 8	--	n.a.	a/2,445
Total	-242	n.a.	-183	+22	+81	n.a.	5,158

a/ As of May 31, 1963.

Bullion market. The London gold market was relatively quiet in June and early July, although the fixing price edged up from the low level reached at the end of May. (See Table 7.) Demand on June 19 and on July 10 was reported to have been heavier than on other days in the period under review.

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

April 19	35.091	May 17	35.083	June 14	35.084
26	35.082	24	35.079	21	35.082
May 3	35.076	31	35.073	28	35.083
10	35.076	June 7	35.078	July 5	35.089

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 8. United Kingdom: Treasury Bill Yields and Exchange Rates

		3-mo. Treasury bill arbitrage calculation					Spot pound (U.S. cents) b/	London deposit rates	
		U.K.	U.S.	Difference	3-mo. pound a/	In favor U.K. bill		U.S. dollar (3-mo.)	Local authority
1962 -	High	3.78	2.73	1.05	-0.31	0.74	281.75	4.13	4.87
	Low	4.25	2.74	1.51	-1.92	-0.41	279.97	3.44	4.19
April	5	3.66	2.89	0.77	-1.09	-0.32	280.09	3.69	4.56
	11	3.59	2.88	0.71	-1.19	-0.48	280.07	3.69	4.56
	19	3.59	2.87	0.72	-1.13	-0.41	280.10	3.66	4.56
	26	3.66	2.87	0.79	-0.89	-0.10	280.06	3.72	4.56
May	3	3.66	2.87	0.79	-0.73	-0.06	280.97	3.73	4.56
	10	3.63	2.89	0.74	-0.74	--	280.90	3.81	4.50
	17	3.56	2.88	0.68	-0.69	--	280.94	3.84	4.44
	24	3.56	2.93	0.73	-0.73	--	279.97	3.91	4.44
	31	3.61	2.97	0.64	-0.64	--	280.01	3.84	4.44
June	7	3.59	2.97	0.62	-0.67	-0.05	280.04	3.91	4.44
	14	3.56	2.97	0.59	-0.64	-0.05	280.00	3.84	4.31
	21	3.63	2.96	0.67	-0.56	+0.11	280.04	3.78	4.25
	28	3.63	2.97	0.66	-0.53	+0.13	280.06	3.84	4.31
July	5	3.72	3.01	0.71	-0.49	+0.22	280.12	3.91	4.31
	12	3.72	3.19	0.53	-0.43	+0.10	280.11	3.94	--

a/ Market quotation for Friday. The 1963 figures, assembled for arbitrage calculations, are the premiums on the U.S. dollar. b/ Noon buying rate in New York.

Table 9. United Kingdom: Selected Capital Market Yields

		U.K. Government bond yields					Share yield a/	Yield gap b/	Share prices a/
		4-1/2% 1964	3% 1965-75	5-1/2% 2008-12	3-1/2% War Loan	2-1/2% 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	5.78	-0.27	261.3
April	4	4.01	5.32	5.85	5.90	5.76	5.03	0.73	303.3
	10	3.87	5.27	5.83	5.87	5.72	5.09	0.63	304.3
	18	3.80	5.21	5.70	5.75	5.60	4.93	0.67	311.3
	25	3.75	5.27	5.73	5.77	5.62	4.91	0.71	313.1
May	2	3.65	5.25	5.73	5.74	5.59	4.89	0.70	314.2
	9	3.72	5.23	5.68	5.70	5.56	4.95	0.61	310.5
	16	3.70	5.15	5.63	5.65	5.46	4.94	0.52	314.1
	23	3.72	5.14	5.60	5.66	5.50	4.99	0.51	311.0
	30	3.67	5.06	5.55	5.60	5.42	4.99	0.43	311.0
June	6	3.65	5.03	5.52	5.59	5.41	5.02	0.39	311.0
	13	3.67	5.13	5.57	5.68	5.54	5.14	0.40	303.7
	20	3.65	5.03	5.53	5.60	5.44	5.06	0.38	308.7
	27	3.56	5.01	5.50	5.54	5.39	5.08	0.31	307.3
July	4	3.65	5.00	5.50	5.53	5.39	5.01	0.38	311.6
	11	3.75	5.00	5.50	5.57	5.43	5.00	0.43	312.3

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

Chart 1

INTEREST ARBITRAGE, UNITED STATES/CANADA

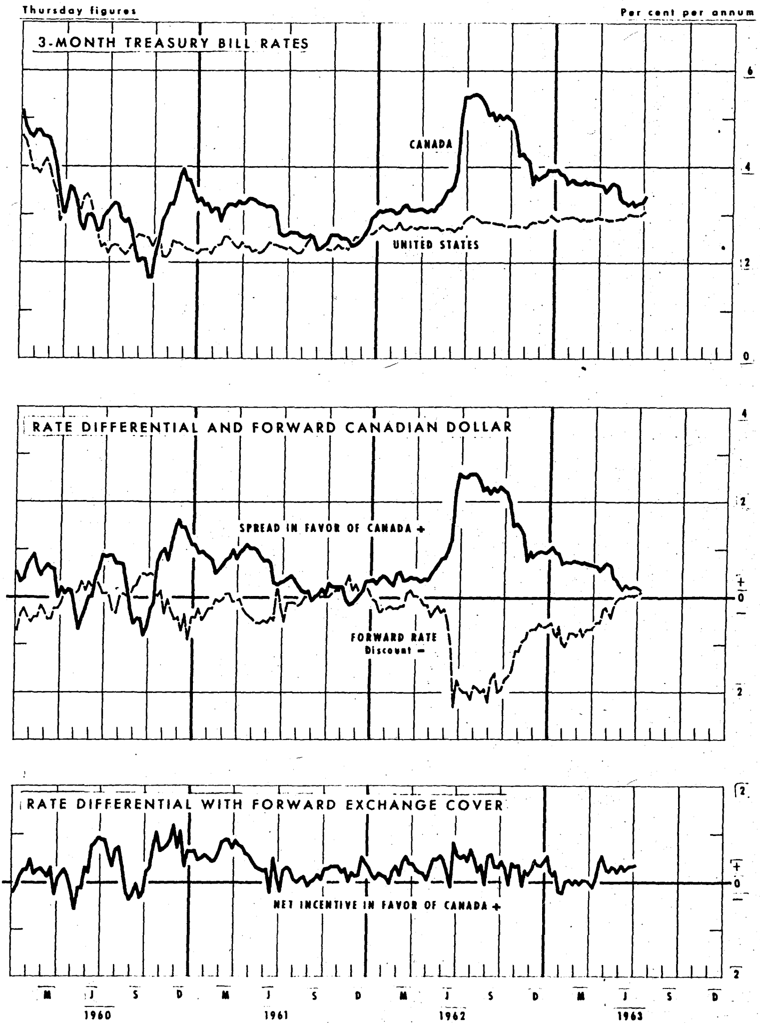

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Chart 2

INTEREST ARBITRAGE, NEW YORK/LONDON

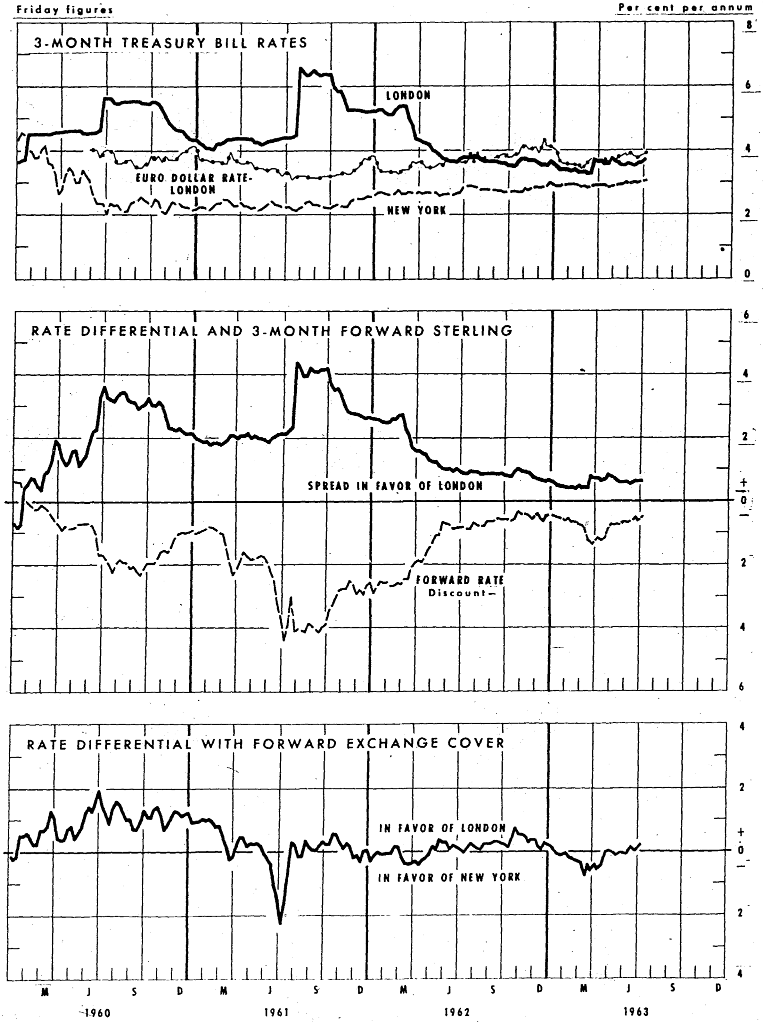
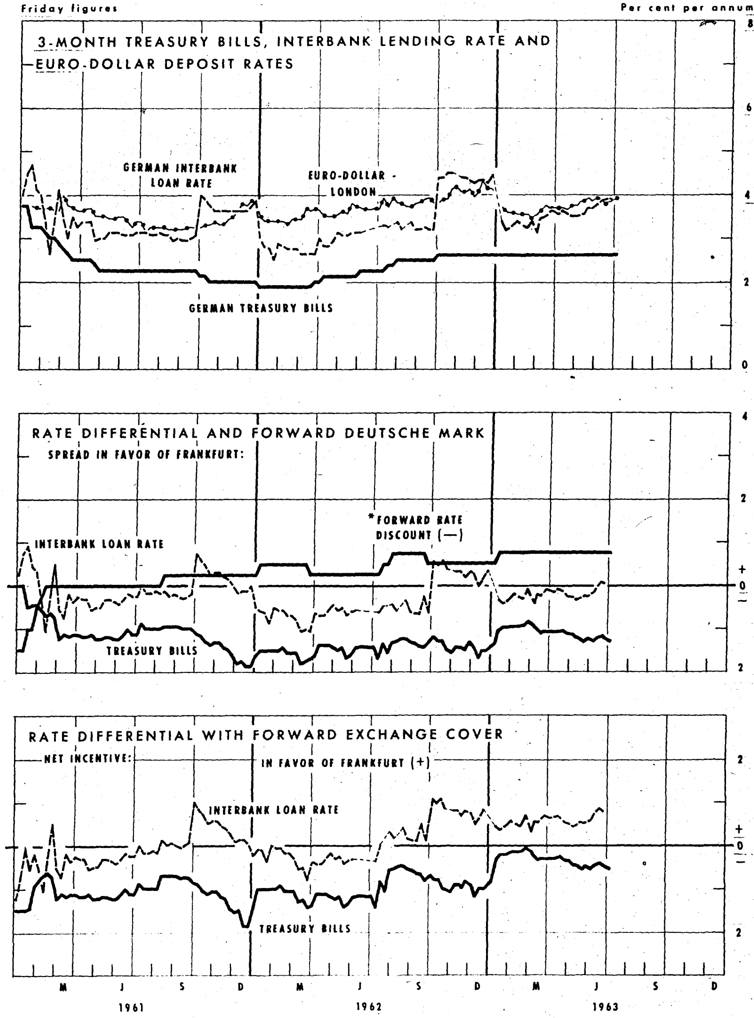


Chart 3

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS



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

Chart 4

INTEREST ARBITRAGE, FRANKFURT / LONDON

Friday figures

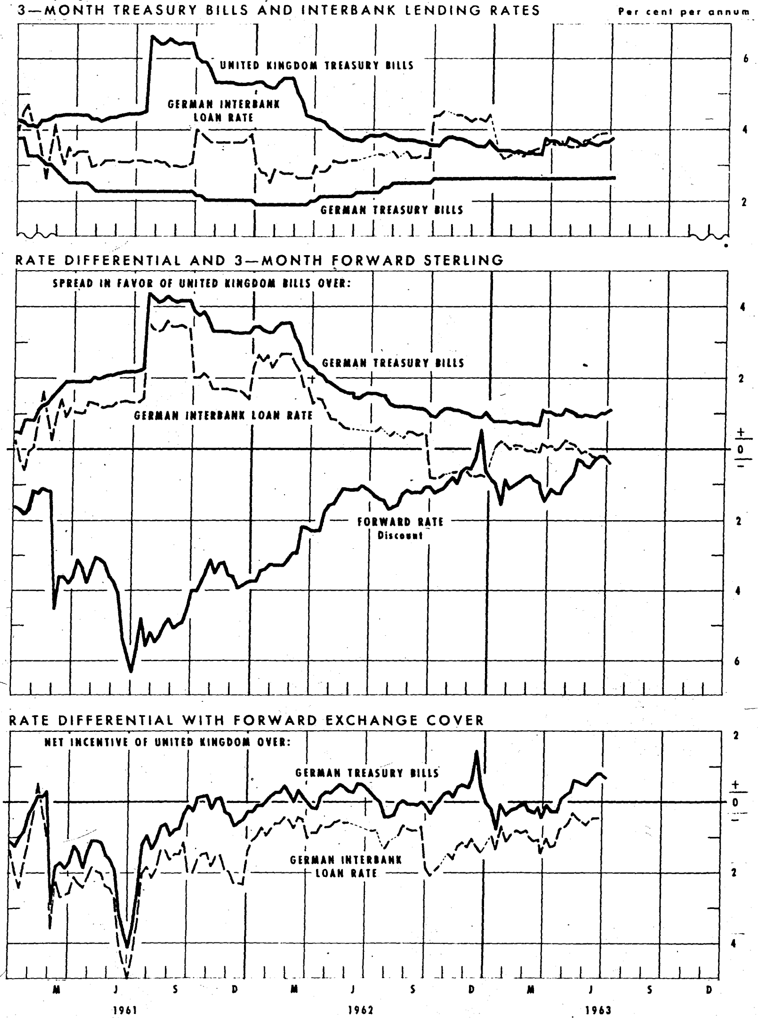
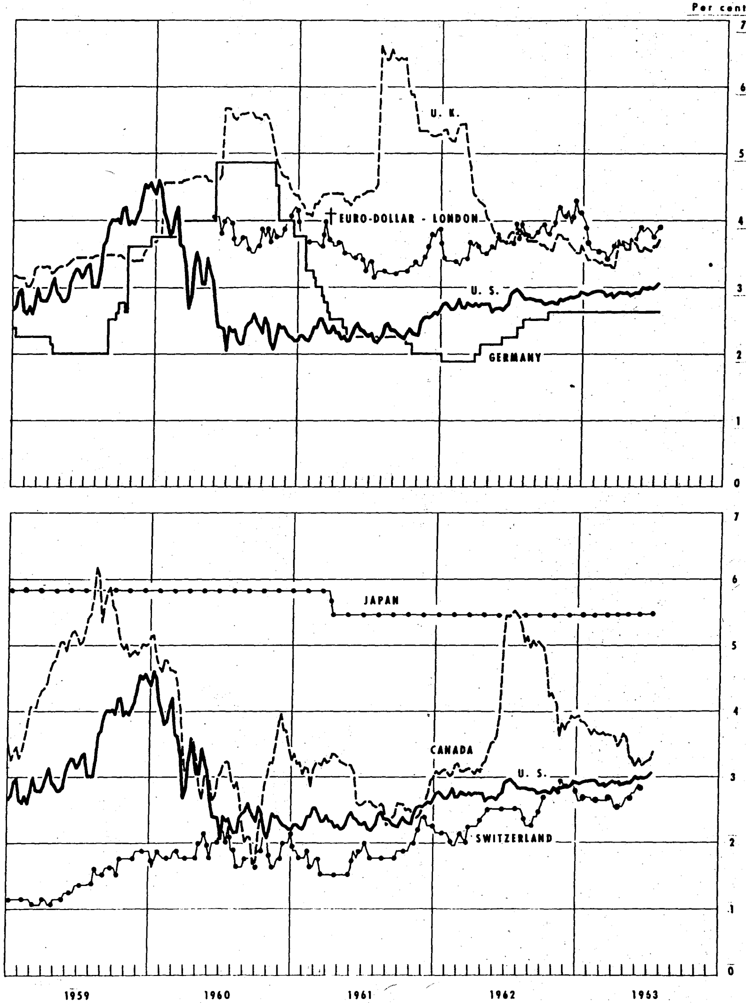


Chart 5
SHORT-TERM INTEREST RATES *



* 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

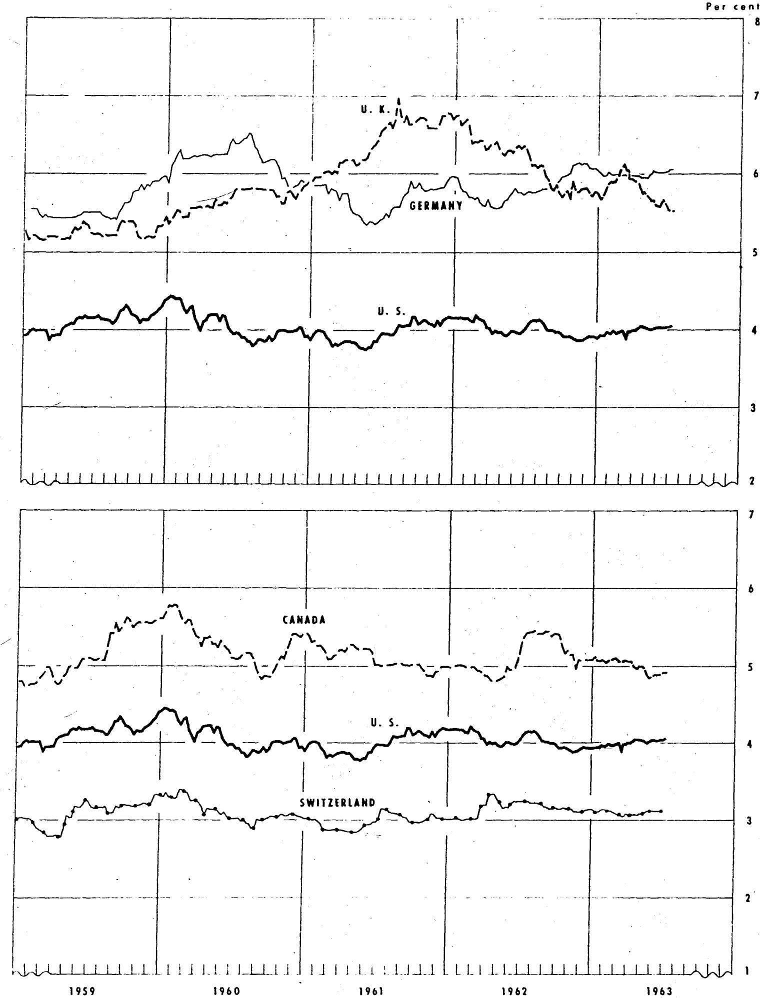
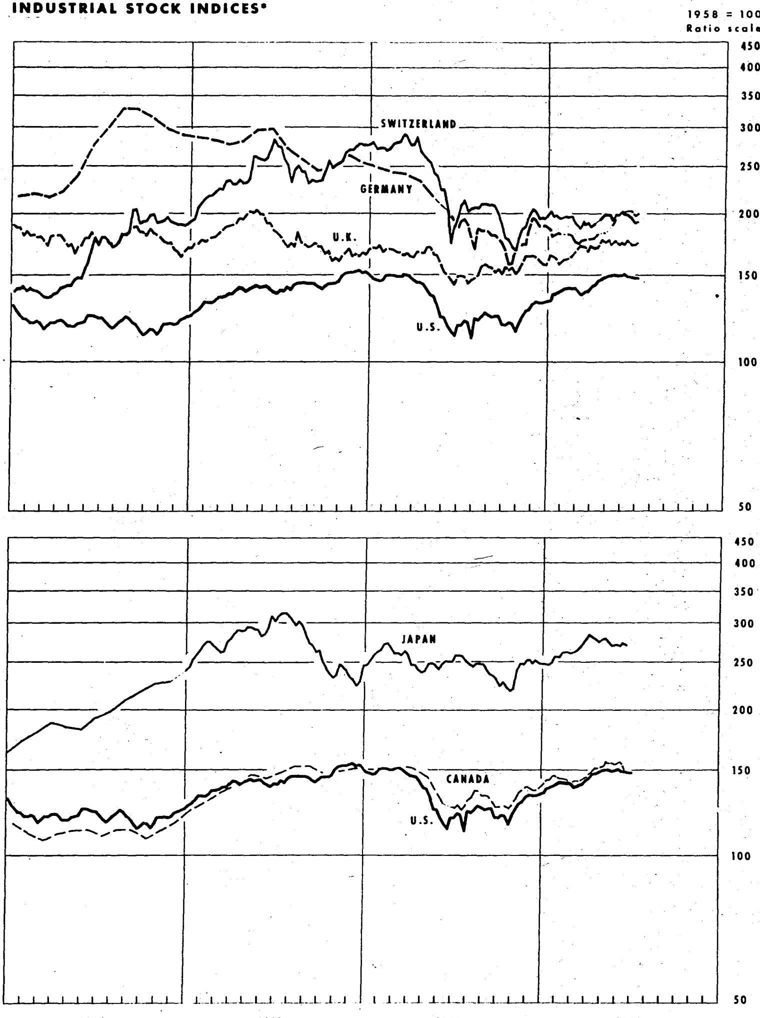


Chart 7

INDUSTRIAL STOCK INDICES*



*Note: Japan: index of 225 industrial and other stocks traded on the Tokyo exchange.

Chart B

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

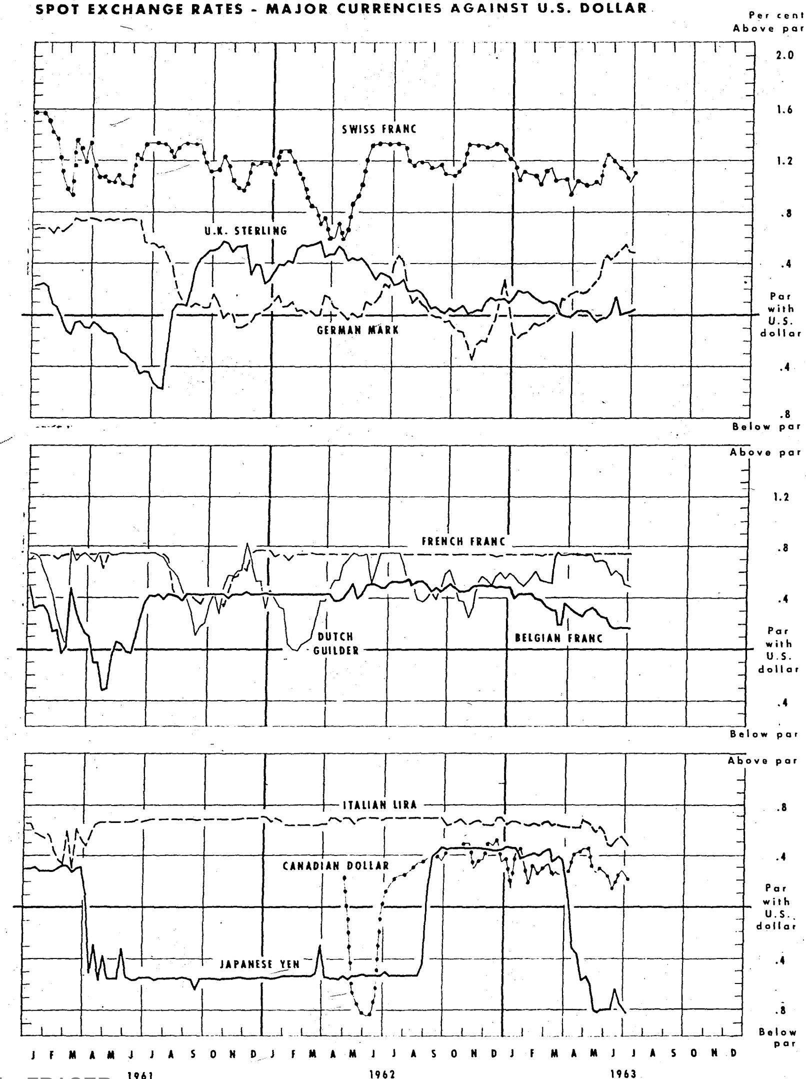


Chart 9

3-MONTH FORWARD EXCHANGE RATE

Friday figures