

H. 13
No. 185

March 3, 1965.

CAPITAL MARKET DEVELOPMENTS ABROAD

- I. United Kingdom
 II. Nine Charts on Financial Markets Abroad
 III. Latest Figures Plotted in H.13 Chart Series

I. United Kingdom: Money and Capital Markets
December 1964 to February 1965

Between December and February, British financial markets experienced three distinct periods of relative weakness and an intervening period (mid-January to mid-February) of relative strength. During the first half of December deteriorating conditions culminated in an especially sharp fall in bond and stock prices in the second week of the month. On December 18, the Government Broker announced buying prices for all listed government bonds to halt the selling pressure in that market. Bond prices held fairly steady, but the volume of trading remained small until mid-January, when the announcement of improved trade figures for December initiated a month-long easing of market yields. In mid-February, yields began to rise once again, after the announcement of adverse trade figures for January. During the period under review, the foreign exchange market for sterling experienced identical periods of alternating weakness and strength. (See Table 1.)

Table 1. United Kingdom: Selected Financial Market Indicators
December 1964 to February 1965

	<u>Change from previous date to:</u>					<u>Actual</u>	
	<u>Dec.</u> <u>4</u>	<u>Dec.</u> <u>17</u>	<u>Jan.</u> <u>15</u>	<u>Feb.</u> <u>12</u>	<u>Feb.</u> <u>19</u>	<u>Feb.</u> <u>19</u>	<u>Feb.</u> <u>26</u>
Interest rates (per cent per annum)							
Treasury bill (maximum tender)	6.63	0.00	0.00	-0.10	0.00	6.53	6.45
Government bonds ^{a/}							
5% 1967	6.05	+0.35	+0.12	-0.17	+0.07	6.42	6.42
5% 1971	6.07	+0.36	+0.07	-0.25	+0.15	6.40	6.38
3-1/2% 1979-81	6.17	+0.20	0.00	-0.05	+0.05	6.37	6.37
5-1/2% 2008-12	6.30	+0.10	+0.07	-0.07	+0.02	6.42	6.42
3-1/2% War Loan	6.33	+0.13	+0.04	-0.06	+0.03	6.47	6.46
Stock index ^{a/b/}	338.2	-14.8	+10.4	+17.7	+1.7	353.1	341.1
	<u>Actual Values</u>						
Exchange rates							
Spot (U.S. cents)	279.15	279.08	279.07	279.56	279.54	--	279.43
Forward (percent per annum)	-2.54	-2.68	-2.71	-2.52	-2.81	--	-2.82

^{a/} Previous Thursday.

^{b/} Financial Times 30 Industrials.

Thursday--two-day quote for the spot rate.

OFFICIAL USE ONLY

(Decontrolled after six months)

There was a generally stronger tone in financial markets between mid-January and mid-February. In the gilt-edged market, supplies of the short- and long-dated "tap issues" which anchor the yield curve were exhausted. At the short end, the 4 per cent Exchequer 1968 "tap" was replaced by a £450 million tranche of 5 per cent Exchequer 1967. At the long end, the 5-3/4 per cent "tap" was not officially replaced, perhaps in deference to the existing level of long-term yields. In addition, several local authority issues were very favorably received and oversubscribed. Two important ones, issued by the London City Council, were priced at par bearing a coupon of 6-3/4 per cent. Rumors of a decrease in Bank rate as well as improved trade returns for December contributed to these improved conditions.

By contrast with the gilt-edged market, conditions in the money market generally remained tight for the entire period under review. On some occasions in January and February, the discount houses were forced to borrow at Bank rate.

There were signs that the higher Bank rate and shortage of funds were affecting other credit markets. The financial press reported that these two factors were causing a slowdown in construction activity; and in January the Agricultural Mortgage Corporation announced an increase in its mortgage rate from 6-3/4 per cent to 7-1/4 per cent, following an average increase in the building societies' loan rate of 1/2 per cent to 6-1/2 per cent.

Money market remains tight. During the period under review, there was no general easing of the tight credit conditions that have prevailed since the initial stages of the sterling crisis. With the exception of the Treasury bill yield, money rates tended to rise during January and February after a slight drop-off around the turn of the year. (See Table 2.)

Table 2. United Kingdom: Selected Money Market Rates
December 1964 - February 1965
(per cent per annum)

	December		January		February		
	11	31	8	22	15	19	26
Call money ^{a/}	6.38	5.38	6.38	6.44	6.50	6.50	6.44
90-day deposits							
Local authority ^{a/}	7.50	7.56	7.18	7.25	7.31	7.44	7.63
Euro-£	4.68	4.62	4.50	4.46	4.50	4.56	4.56
Treasury bill							
90-day market rate ^{b/}	6.41	6.41	6.44	6.41	6.32	6.32	6.29

^{a/} Median of a range of rates quoted in the Financial Times.

^{b/} Adjusted to a U.S. basis.

With the exception of a few days, call money has been in short supply. In December, the Bank of England periodically provided enough assistance to the discount market so as to eliminate the necessity of borrowing at Bank rate. However, at the end of December the usual semi-annual borrowing did occur. During the first three weeks of January, the Bank of England again bought enough bills, when the occasion demanded, to alleviate the need to borrow at Bank rate, although not enough to keep the yield on Treasury bills from inching up from 6.41 per cent to 6.44 per cent (adjusted to a U.S. basis).

On January 22, the discount houses raised their buying price for Treasury bills at the weekly tender for the first time since the increase in Bank rate on November 23. Further increases followed on January 29 and February 5. As a result, the market yield drifted down from 6.44 per cent to 6.32 per cent. During this period the assistance provided by the Bank of England was on a somewhat smaller scale than before, forcing the houses to borrow at Bank rate upon a few occasions. Partly in response to this, the bid was lowered slightly on February 12 with no perceptible impact on the market rate. For a period of two weeks thereafter enough assistance was provided to avoid the need for new borrowings at Bank rate. Then on February 26, the bid was raised again, and the market yield eased to 6.29.

In the 90-day deposit market, conditions changed very little. There was a noticeable easing of rates at the turn of the year, but since then they have fluctuated around a gently rising trend. Because of these tight conditions, local authorities had turned to the Public Works Loan Board. By mid-January, total borrowing reached an estimated £203 million--£3 million more than was anticipated for the entire fiscal year ending March 31.

London clearing banks improve their liquidity positions in January. During the fourth quarter of 1964 the liquidity ratios of the London clearing banks (the ratio of liquid assets to gross deposits) fluctuated just above 30.00 per cent. Although this was two percentage points above the set minimum ratio, it did not provide a comfortable working margin in light of the cash drain the banks face in the early part of 1965 when government tax receipts are seasonally at a peak. (See Table 3.)

In a major effort to improve their liquidity positions, the banks between mid-December and mid-January increased their holdings of liquid assets, largely at the expense of advances. The decline in advances brought with it a decline in deposits, and together with the rise in liquid assets pushed the average liquidity ratio up to 32.10 per cent by mid-January.

The drive for improved liquidity positions served to intensify the general credit squeeze mentioned earlier. The decrease in advances of £66 million (£40 million on a seasonally adjusted basis) was, in the view of the Bank of England, "the first significant check in the growth of advances since September 1961". At this time it seems that the fall can be attributed both to the central bank's December call for a selective credit squeeze and to the desire of the banks to improve their liquidity positions.

Table 3. United Kingdom: London Clearing Banks; Selected Assets and Liabilities
October 1964 - January 1965
(millions of pounds)

	Change from previous month to:				Outstanding January 20	
	October	November	December	January		
Net Assets ^{1/}						
Cash reserves	+ 3.2	-13.3	+64.2	-65.4	701.8	
Other liquid assets	+87.0	-34.1	+41.7	+163.3	2,150.0	
Advances	+62.7	+11.5	+25.7	-66.5	4,471.6	
Other assets	- .6	+ 2.8	- 7.7	+ 9.1	1,932.2	
Total	+152.5	-33.1	+123.9	+40.5	9,255.6	
Net Liabilities ^{1/}						
Deposits	+154.8	-36.2	+96.7	-14.8	8,211.1	
Other	- 2.3	+ 3.1	+27.2	+55.3	1,044.5	
Total	+152.5	-33.1	+123.9	+40.5	9,255.6	
		Actual Values				
Liquidity ratio ^{2/}	30.57	30.15	30.61	32.10	--	
Cash reserve ratio ^{3/}	8.12	8.00	8.53	7.91	--	

^{1/} Excludes "float" and inter-bank balances.

^{2/} Ratio of cash to gross deposits.

^{3/} Ratio of total liquid assets to gross deposits.

Source: Bank of England.

Gilt-edged yields rise once again. Government bond yields moved up in mid-February, after nearly a month of slow, but steady, decline. However, this recent break in prices did not push yields to the levels recorded in the mid-December shake-out. In addition, this new reversal did not immediately carry over into the stock market, and prices there tended to remain firm. (See Table 1.)

In late February, however, bond yields firmed, but stock prices fell off sharply after the government's announcement on February 22 that its "above the line" expenditures for the next fiscal year were estimated to be 8.9 per cent (in money terms) greater than the original estimates for similar expenditures for the current fiscal year. (See Table 1.)

Trade deficit narrows in December but widens in January. Through November of 1964 there was no basic change in the monthly trade returns: imports tended to grow while exports remained stagnant. In December exports picked up noticeably bringing about a significant reduction in the monthly deficit. However, in January, exports fell off, imports remained at a high level and the deficit widened by £16 million. (See Table 4.)

Table 4. United Kingdom: Foreign Trade, 1964-1965
(millions of pounds)

	1964 ^{a/}				December	1965
	I	II	III	IV		January
Imports (c.i.f.)	469	477	476	478	476	465
Exports (f.o.b.)	367	365	363	377	396	368
Re-exports (f.o.b.)	12	13	14	13	13	14
Balance	-90	-99	-99	-88	-67	-83
Trade balance ^{b/}	-42	-48	-52	-42	-19	-34

^{a/} Monthly average; revised data based on coverage changes effective January 1965.

^{b/} Estimated on a balance of payments basis.

Foreign exchange holdings rise in February. Official holdings of gold and foreign exchange rose by about \$64 million in February, after a \$17 million fall in January. This is the first monthly increase in reserve holdings since May 1964. At the end of February, reserves totaled about \$2.36 billion. British officials have not as yet disclosed the amount of central bank assistance utilized in the fourth quarter of 1964 or the amount of repayments made in February. As a result, monthly changes in foreign exchange holdings indicate only the direction of movement in Britain's reserve position and suggest, perhaps, whether gains or losses were greater in one month as opposed to any other month.

Foreign exchange markets show alternating periods of weakness and strength. Changes in conditions in the foreign exchange markets were generally parallel to those in domestic financial markets during the period under review. From December through mid-January spot sterling remained close to 279.00 (U.S. cents) and the forward discount fluctuated between -2.60 and -2.71 per cent per annum. In mid-January conditions began to improve and by February 5 the spot rate had climbed to 279.48 (U.S. cents) and the forward discount had narrowed to -2.55 per cent per annum. This improvement was sustained through the following week, but on February 15 sterling came under selling pressure: the spot rate fell, and the forward discount widened. Through the end of February, there were no signs of a sustained rebound from this latest setback. On February 26, spot sterling was quoted at 279.43 (U.S. cents) and the forward discount at -2.81 per cent per annum. (See Table 5.)

There were no substantial changes in the covered differentials on comparable U.S./U.K. obligations from early December to mid-February. During this interval, arbitrage incentives for Treasury bills favored New York by 12 basis points or less; those for local authority--Euro-dollar deposits favored the local authorities by between 10 to 20 basis points; and those for Euro-dollar deposits--New York certificates of deposit favored Euro-dollar deposits by between .33 and 62 basis points. With the widening of the forward discount

after mid-February, the covered differential on Treasury bills (in favor of New York) increased to 45 basis points by February 19 and 50 basis points on February 26. The covered differential on local authority--Euro-dollar deposits narrowed significantly then widened as local authority rates rose. (See Table 5.)

Table 5. United Kingdom: U.K./U.S. Exchange Rates and Arbitrage Calculations
December 1964 - February 1965

	December		January			February		
	<u>11</u>	<u>31</u>	<u>8</u>	<u>22</u>	<u>29</u>	<u>5</u>	<u>19</u>	<u>26</u>
Exchange rates								
Spot (U.S. cents)	279.04	279.01	278.97	279.12	279.25	279.48	279.54	279.43
Forward (per cent per annum)	-2.68	-2.72	-2.61	-2.61	-2.65	-2.55	-2.81	-2.82
Security sterling (U.S. cents)	278.15	278.16	278.00	278.40	278.75	279.25	279.39	279.38
3-month yields and yield differentials								
Treasury bills								
U.K. (covered)	3.73	3.69	3.83	3.80	3.73	3.77	3.49	3.47
U.S.	3.80	3.80	3.77	3.81	3.83	3.89	3.94	3.97
Differential	-0.07	-0.11	+0.06	-0.01	-0.10	-0.12	-0.45	-0.50
Deposit rates								
Local authority (covered)	4.82	4.84	4.57	4.65	4.60	4.70	4.59	4.81
Euro-\$	4.68	4.62	4.50	4.46	4.50	4.50	4.56	4.56
Differential	+0.14	+0.22	+0.07	+0.19	+0.10	+0.20	+0.03	+0.25
Euro-\$ ^{a/}								
New York C/D ^{a/b/}	4.75	4.62	4.56	4.44	4.44	4.50	4.50	4.63
Differential	+0.62	+0.48	+0.43	+0.33	+0.34	+0.36	+0.30	+0.38

a/ Previous Wednesday.

b/ Secondary offering rates for New York negotiable certificates of time deposits.

Demand for gold rises as French convert dollar reserves. The demand for gold which had intensified in early December stabilized in the latter part of that month and the London fixing price ranged in the neighborhood of \$35.120 per fine ounce. At the turn of the year reports in the British and continental press began to speculate on the possible conversion of dollars for gold by the French authorities. During the first week of January the demand for gold increased substantially and on Friday, January 8, the London fixing price reached \$35.150 per fine ounce. That afternoon the U.S. Treasury announced that it regarded the figure of \$35.00 per ounce as immovable. The demand for gold then eased off and on February 5 the fixing price was \$35.125.

Statements by French authorities on the gold policy of the Bank of France and the role of gold as the major means of international exchange in February generated renewed demands for gold. By February 26 the price at the fixing had climbed to \$35.1686 per fine ounce. (See Table 6.)

Table 6. United Kingdom: London Fixing Price for Gold
December 1964 - February 1965

	December		January			February		
	11	31	8	22	29	5	12	26
Price per fine ounce (U.S. dollars)	35.122	35.123	35.150	35.125	35.131	35.125	35.147	35.1686

Europe and British Commonwealth Section

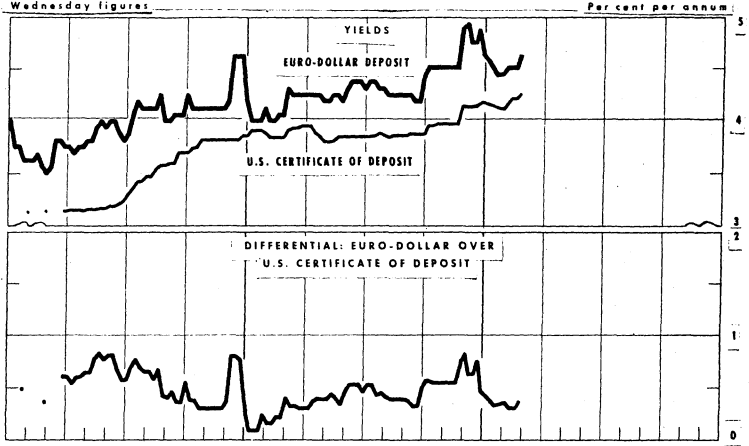
II. Nine Charts on Financial Markets Abroad

- Chart 1 - International Money Market Yields on U.S. Dollar Investors
- Chart 2 - Interest Arbitrage, United States/Canada
- Chart 3 - Interest Arbitrage, New York/London
- Chart 4 - Interest Arbitrage for German Commercial Banks
- 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

Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

3-MONTH EURO-DOLLAR DEPOSIT VS. CERTIFICATE OF DEPOSIT
Wednesday figures



NEW YORK OFFER RATES ON SELECTED 3-MONTH INVESTMENTS

Friday figures

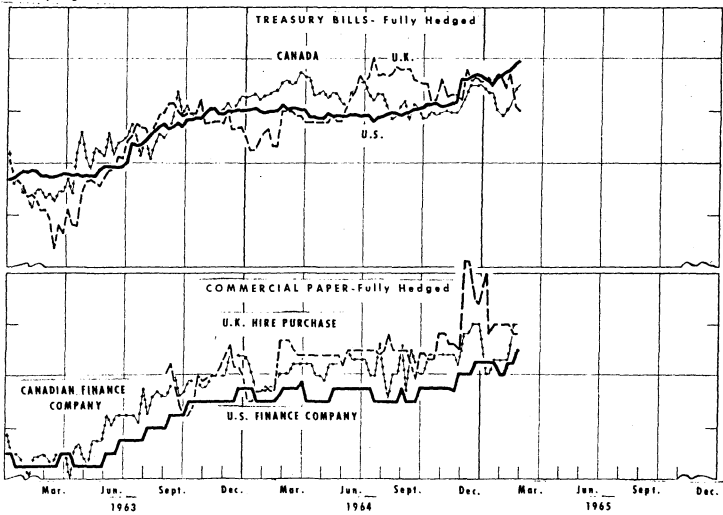
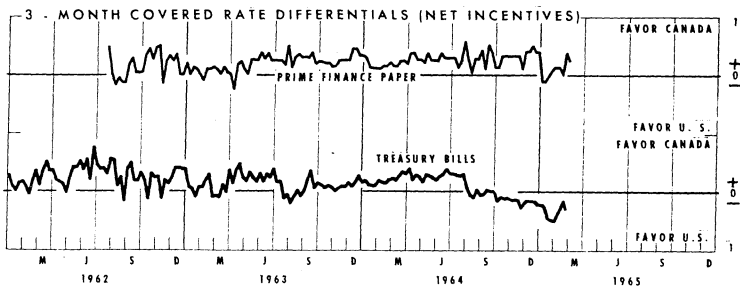
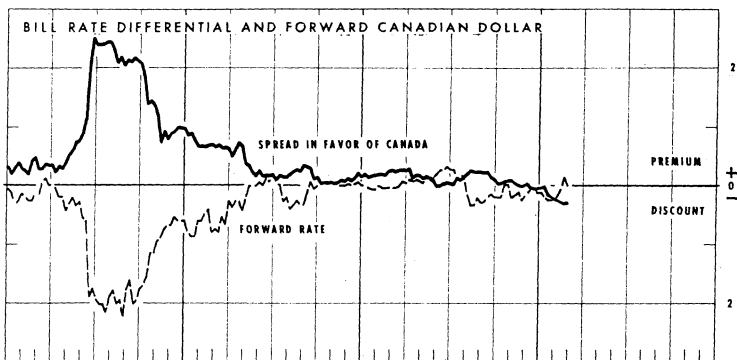
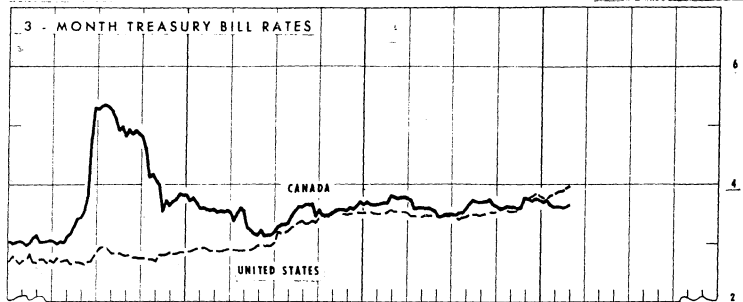


Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Friday figures*

Per cent per annum



* Thursday figures 1962; Friday thereafter.

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

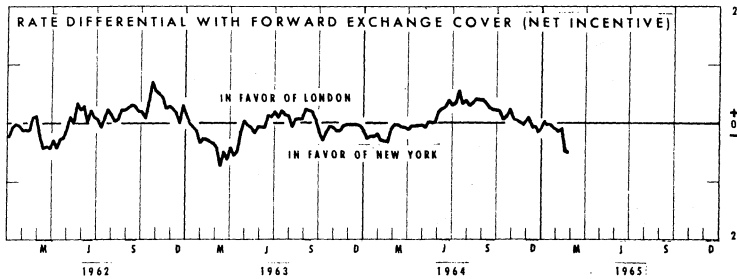
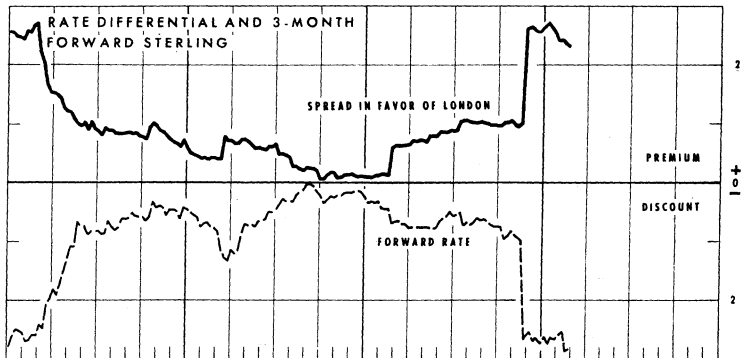
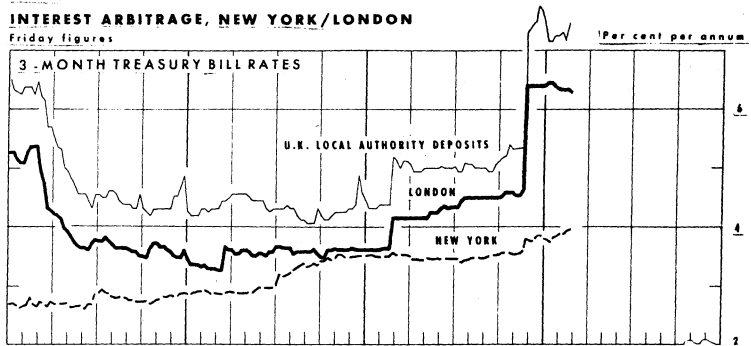


Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

Per cent per annum

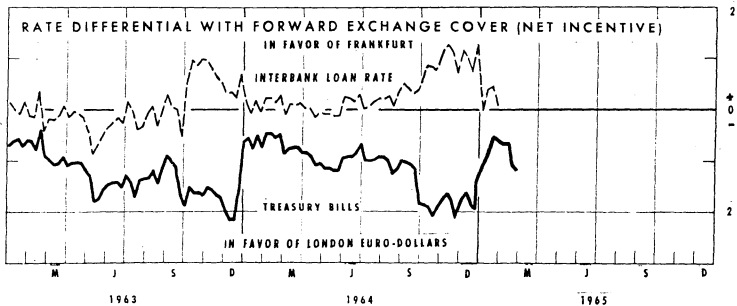
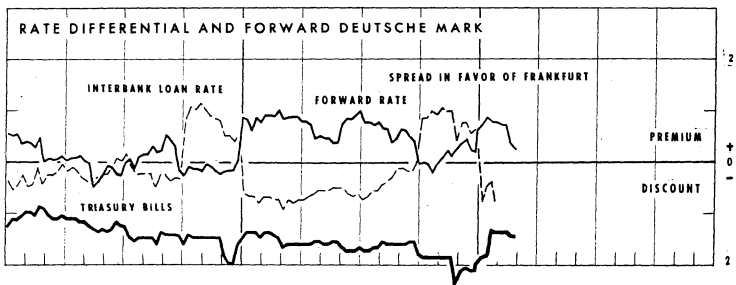
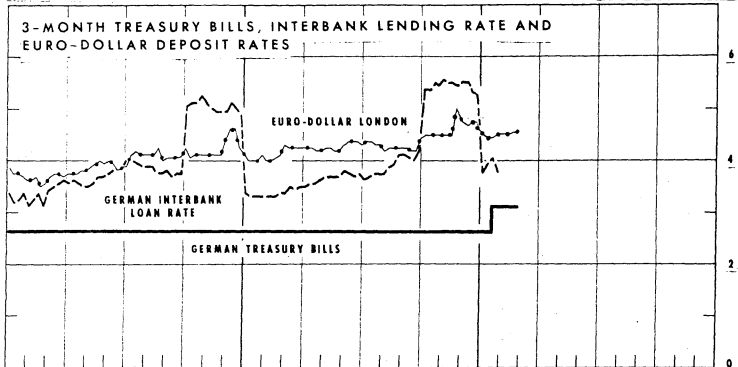
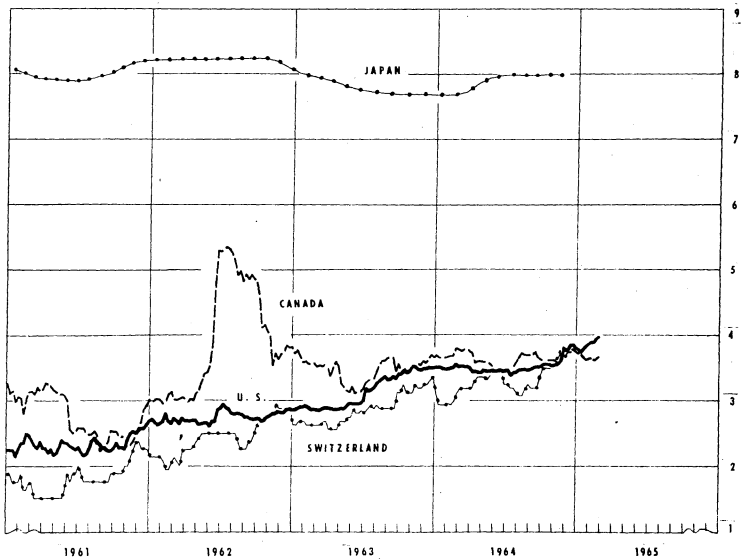
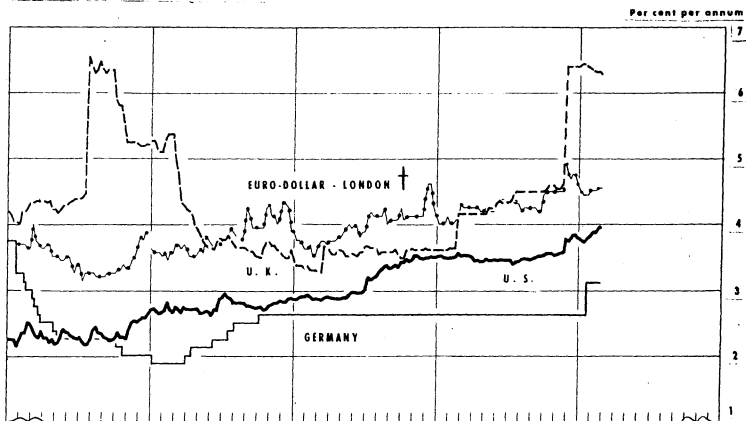


Chart 5
SHORT-TERM INTEREST RATES*

12



* 3 month treasury bill rates for all countries except Japan (Average rate on bank loans and discounts) and Switzerland (3 month deposit rate)

† 3 month rate for U.S. dollar deposits in London

Chart 6
LONG-TERM BOND YIELDS

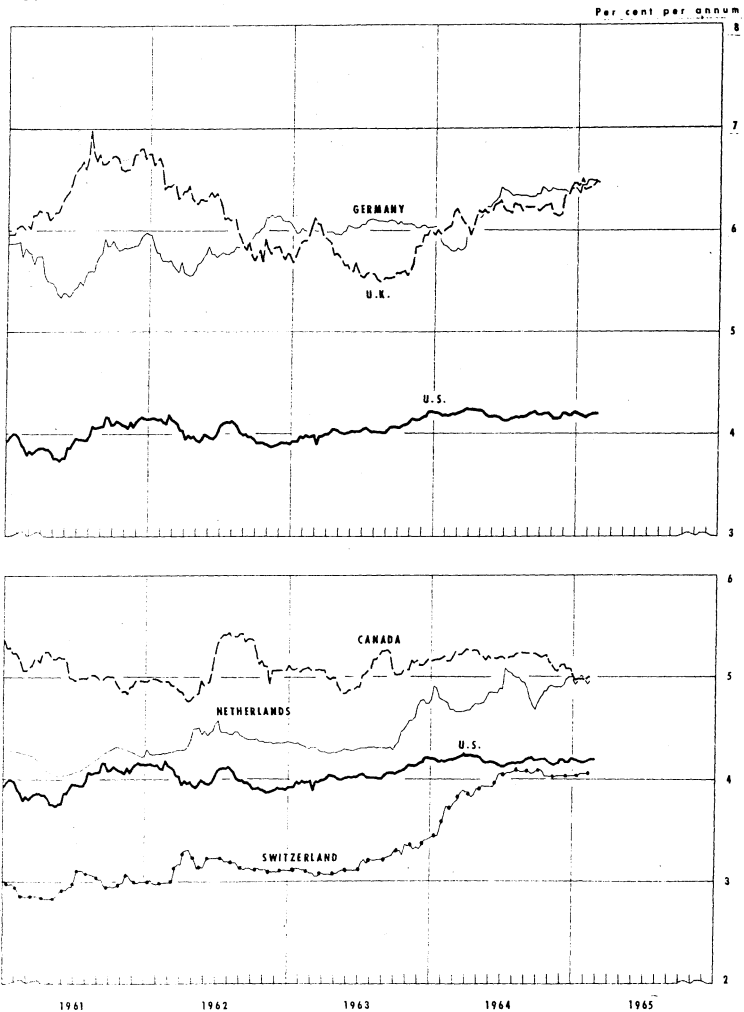
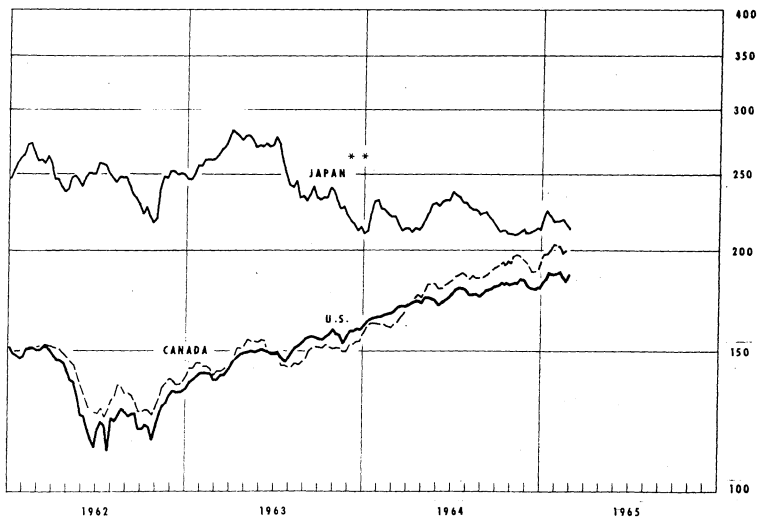
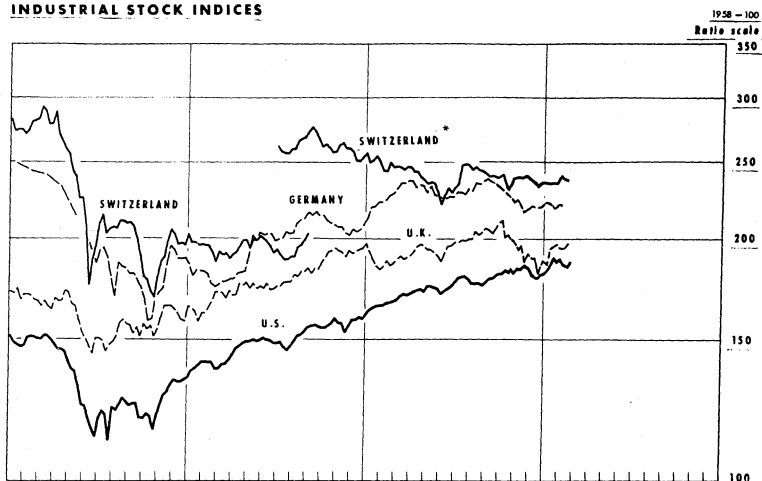


Chart 7
INDUSTRIAL STOCK INDICES



* New series Swiss Bank Corporation industrial stock

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

Chart 8

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

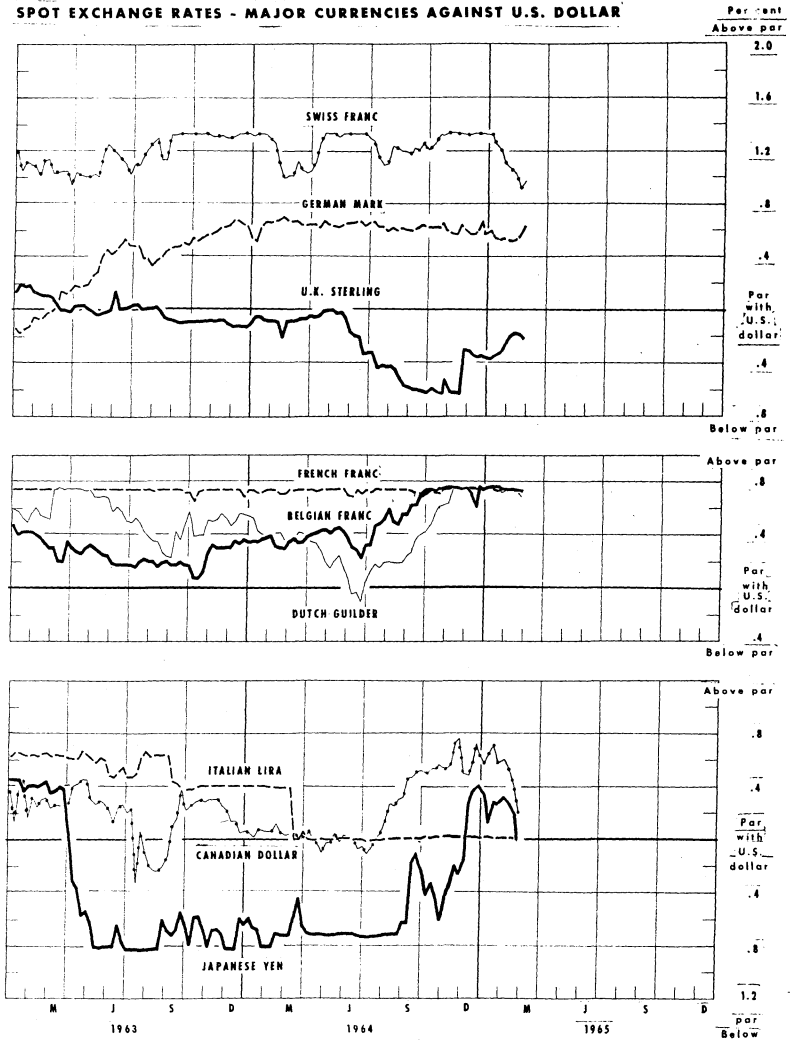
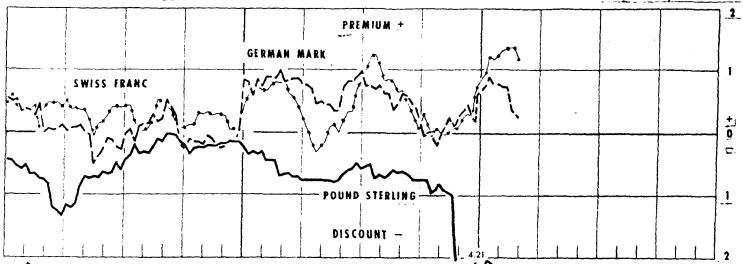


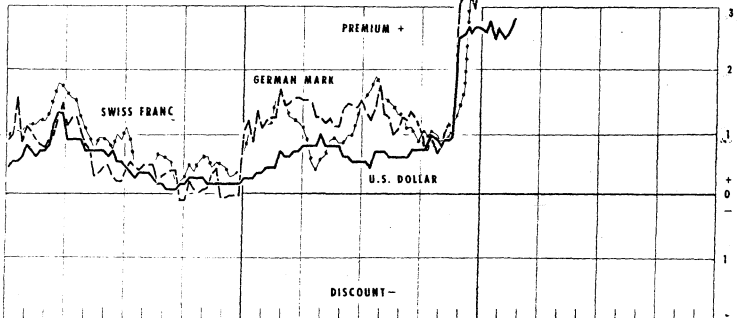
Chart 9
3-MONTH FORWARD EXCHANGE RATES

Friday figures

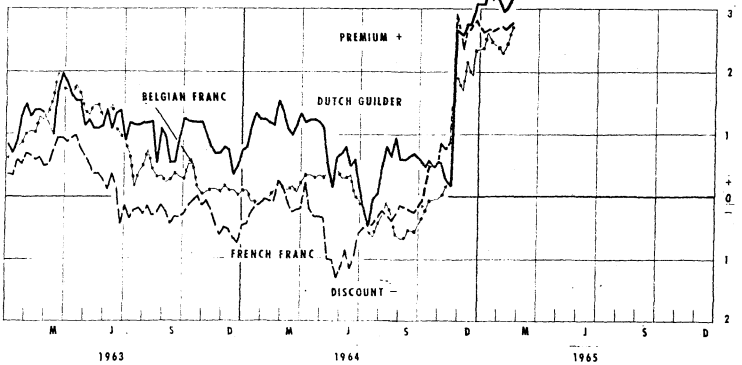
AGAINST U.S. DOLLARS



AGAINST POUND STERLING - LONDON



AGAINST POUND STERLING - LONDON



III, Latest Figures Plotted In H.13 Chart Series, 1965

<u>Chart 1</u>	<u>Per cent per annum</u>	<u>Chart 5</u>	<u>Per cent per annum</u>
<u>Upper panel</u>		<u>(Friday, Feb. 26, except as noted)</u>	
<u>(Wednesday, Feb. 24)</u>		<u>Treasury bills:</u>	
Euro-\$ deposit	<u>4.62</u>	U.S.	<u>3.97</u>
U.S. certif. of deposit	<u>4.25</u>	U.K.	<u>6.29</u>
<u>Lower panels</u>		Germany	<u>3.12</u>
<u>(Friday, Feb. 26)</u>		Canada	<u>3.67</u>
Treasury bills: U.S.	<u>3.97</u>	Swiss 3-month deposits (Date: <u>Jan. 15</u>)	<u>3.25</u>
U.K.	<u>3.42</u>	Euro-\$ deposit (London)	<u>4.56</u>
Canada	<u>3.74</u>	Japan: composite rate (Date: <u>Nov. 27</u>)	<u>7.990</u>
Finance Co. paper: U.S.	<u>4.25</u>	<u>Chart 6</u>	
Canada	<u>4.50</u>	<u>Bonds:</u>	
Hire-purchase paper, U.K.	<u>4.40</u>	U.S. govt. (Wed., <u>Feb. 24</u>)	<u>4.19</u>
<u>Chart 2</u>		U.K. war loan (Thurs., <u>Feb. 25</u>)	<u>6.46</u>
<u>(Friday, Feb. 26)</u>		German Fed. Railway (Fri., <u>Feb. 19</u>)	<u>6.49</u>
Treasury bills: Canada	<u>3.67</u>	Swiss Confederation (Fri., <u>Feb. 12</u>)	<u>4.04</u>
U.S.	<u>3.97</u>	Canadian govt. (Wed., <u>Feb. 10</u>)	<u>5.01</u>
Spread favor Canada	<u>-0.30</u>	Netherlands government perpetual (Fri., <u>Feb. 19</u>)	<u>4.98</u>
Forward Canadian dollar	<u>0.00</u>		
Net incentive (Canada +)	<u>-0.30</u>		
<u>Chart 3</u>			
<u>(Friday, Feb. 26)</u>			
Treasury bills: U.K.	<u>6.29</u>		
U.S.	<u>3.97</u>		
Spread favor U.K.	<u>+2.32</u>		
Forward pound	<u>-2.82</u>		
Net incentive (U.K. +)	<u>-0.50</u>		