

H. 13

No. 192

April 21, 1965

CAPITAL MARKET DEVELOPMENTS ABROAD

- I. United Kingdom
- II. Nine Charts on Financial Markets Abroad
- III. Latest Figures Plotted in H.13 Chart Series, 1965

I. United Kingdom Money and Capital Markets, February-April 1965

The British budget for 1965-66, which was presented to Parliament on April 6, had a dominant influence on British financial markets during the period under review. The primary intent of the budget is to strengthen the pound by curbing the growth of consumer demand with new taxes and by curtailing long-term capital flows by £100 million a year through new exchange controls. The new taxes are intended to reinforce the restrictive influence of the measures announced last autumn--the 7 per cent Bank rate and increases in some tax rates. Despite the new tax levies, however, the Treasury's borrowing requirement for 1965-66 is estimated to be nearly twice the actual borrowings for last year. (See Table 1.) The nationalized industries will require additional funds this year; in addition, under plans announced a year ago, some local authority borrowing is to be shifted from the gilt-edged market to the Treasury.

Table 1. The British Budget, 1964-65 and 1965-66
(£ million)

	1964 - 1965		1965 - 1966	
	Estimates	Outturn	Estimates before tax changes ^{a/}	Estimates after tax changes
Current transactions:				
Total revenue	7,880	8,157	8,862	9,026
Total expenditures	7,792	7,713	8,482	8,842
Surplus or deficit	+ 67	+ 420	+ 356	+ 520
Adjustment for special transactions	+ 21	+ 24	+ 24	+ 24
Total surplus or deficit	+ 88	+ 444	+ 380	+ 544
Below-the-line transactions:				
Net expenditures	837	830	1,228	1,268
Overall surplus or deficit	- 749	- 386	- 848	- 724

^{a/} Includes revenue and expenditure changes resulting from measures announced in November, 1964 budget.

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British financial markets gave the budget a mixed reception. In the month before the budget, financial markets had displayed a growing weakness: spot sterling declined and the forward discount widened; government bond yields rose; and stock prices eased slightly. In the first few days after the budget, sterling strengthened steadily; the spot rate rose and the forward discount narrowed. Stock prices, after falling initially, later firmed and then began to rise. Government bond yields showed little change. (See Table 2.)

Table 2. United Kingdom: Selected Financial Market Indicators
February - April, 1965

	Actual Feb. 26	Changes from previous date to				Actual	
		March 5	April		April		
			2	9	9	16	
Interest rates (per cent per annum)							
Treasury bill							
(maximum tender)	6.45	-0.03	+0.15	-0.07	6.50	6.45	
Government bonds ^{a/}							
5% 1967	6.42	-0.05	+0.20	0.00	6.57	6.65	
5% 1971	6.38	+0.01	+0.20	+0.06	6.65	6.82	
3-1/2% 1979-81	6.37	-0.02	+0.15	+0.05	6.55	6.67	
5-1/2% 2008-12	6.42	0.00	+0.10	0.00	6.52	6.60	
3-1/2% War Loan	6.46	-0.01	+0.09	0.00	6.54	6.65	
Stocks							
Price index ^{a/b/}	108.27	-0.81	-0.78	+0.43	107.11	104.67	
Share yield ^{a/b/}	5.29	+0.06	+0.16	+0.01	5.52	5.66	
<u>Actual Values</u>							
Exchange rates							
Spot (U.S. cents)	279.43	279.43	279.09	279.51		279.72	
Forward (per cent per annum)	-2.82	-2.78	-3.02	-2.97		-2.55	
<u>a/</u>	Previous Thursday.						
<u>b/</u>	<u>Financial Times</u> 500 industrials.						

During the following week, however, adverse trade returns for March intensified the weakness in the gilt-edged market and brought a reversal in the trend of equity prices. But spot sterling continued to exhibit strength. (See Table 2.)

To reduce the balance of payments deficit--£745 million on current and long-term capital account in 1964--the government introduced six new exchange control measures that covered a wide range of international transactions. The most important one was the requirement that 25 per cent of the proceeds from the sale of foreign securities and direct investments be converted into sterling at the official rate. This step alone is expected to benefit the balance of payments by £50 million a year. The remaining five are to contribute the other £50 million.

The budget did not contain any additional aids to exporters. However, on April 9, new financial incentives were announced:

- (1) an increase from 85 to 90 per cent in the standard minimum percentage of insurance cover provided by the Export Credits Guarantee Department;
- (2) a reduction from three to two years in the minimum period for guaranteed bank loans for exporters carrying a fixed interest rate of 5-1/2 per cent;
- (3) a 50 per cent reduction in the charge for the bank guarantee; and
- (4) an increase in the proportion of total credit normally covered by the bank guarantee from 90 to 100 per cent.

On April 9, the authorities also announced the criteria to be employed by the Prices and Incomes Review Board. The general norm agreed to by representatives of labor and management is that prices and money incomes should not be allowed to increase by more than 3-1/2 per cent a year.

The favorable reception given to the budget by the equity and foreign exchange markets ended a month-long period of weakness in British financial markets. Between March 5 and April 2, spot sterling fell 34 points to 279.09 (U.S. cents) and the forward discount widened out to over 3 per cent. In the government bond market, yields rose from 9 to 20 basis points. The stock market did not display the same degree of weakness and the Financial Times 500 industrials index lost less than a point.

Throughout the entire period under review money market conditions remained very tight. Most rates drifted upward and shortages of funds were reported to be impinging upon the rate of new loans made by the building societies and the local authorities.

Money markets still tight. There was no general easing of money market conditions during the period under review. Rates, for the most part, remained quite high. (See Table 3 and Charts 1, 3 and 5.)

In the short-term deposit market, rates on both Euro-dollar and local authority deposits rose appreciably in early March. By March 10, the 90-day Euro-dollar deposit rate had risen to a new peak of 5.12 per cent, and by March 12 the local authority rate reached 7.81 per cent. Thereafter, Euro-dollar rates eased somewhat, but local authority rates continued to show an upward tendency as the forward discount continued to widen. (See Table 3 and Charts 1 and 3.)

Table 3. United Kingdom: Selected Money Market Rates
(per cent per annum)

	Feb.	March	March	April	April	April
	<u>12</u>	<u>12</u>	<u>19</u>	<u>2</u>	<u>9</u>	<u>16</u>
Call money ^{a/}	6.50	6.44	6.50	6.31	6.44	n.a.
Deposit rates						
Less than 3-days						
Local authority ^{a/b/}	7.12	7.68	7.56	7.87	8.31	n.a.
Euro- $\$$ ^{b/}	<u>d/4.06</u>	<u>e/4.18</u>	4.12	4.12	4.12	n.a.
90-day						
Local authority	7.18	7.81	7.68	7.62	7.75	n.a.
Euro- $\$$	<u>d/4.50</u>	<u>e/5.12</u>	4.88	4.75	4.75	n.a.
Treasury bill ^{c/}	6.32	6.20	6.35	6.35	6.32	6.29

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

^{b/} Two-day deposits for local authorities; call for Euro- $\$$.

^{c/} Adjusted to U.S. basis.

^{d/} February 10, 1965.

^{e/} March 10, 1965.

In the Treasury bill market, special circumstances continued to keep downward pressure on the rate. Recurrent rumors of a decrease in Bank rate and the relatively small issues of Treasury bills led the discount houses to raise their bidding price at the weekly tender once in March and twice in April. By forcing the discount houses to borrow at the penalty rate in March as it had in February, the Bank of England succeeded in pushing the rate up to 6.35 per cent by March 19 from 6.20 per cent. However, in mid-April the rate slipped back to 6.29 per cent. (See Table 3 and Charts 1 and 5.)

Capital markets weaken in April. The announcement at mid-April of a trade deficit for March brought about substantial selling pressure in the equity and government bond markets. Gilt-edged yields rose 10 to 17 basis points and the Financial Times industrials index lost about 2.5 points over week-earlier levels. (See Table 2 and Chart 6.)

This new development occurred at a time when financial markets were still assessing the April budget. Stock prices, after an initial set-back, had begun to rise, but bond yields were either unchanged or up slightly. (See Table 2.) The comparatively weaker tone of the government bond market was partly associated with the announcement that "gilts" would be covered by the capital gains tax. There had been some doubts about this earlier.

Some easing in the rate of new borrowing by the private sector.

During the first quarter of 1965, there was some easing in the rate of new borrowing by the private sector relative to the fourth quarter of 1964. Additions to instalment credit and advances by the building societies were much smaller in the January-March period than in the previous three months and bank advances (seasonally adjusted) actually declined. New issues by U.K. corporations rose slightly. (See Table 4.)

Table 4. United Kingdom: New Borrowing by the Private Sector 1964-65
(£ million)

	1964		1965		
	I	IV	Jan.	Feb.	March
Bank advances <u>a/</u>	80	190	-50	-40	+65
Instalment credit <u>b/</u>	31	31	- 2	+10	n. a.
New issues (net)					
U.K. corporations	175	71	21	26	40
Advances by building societies	227	273	83	67	84

a/ London clearing banks; seasonally adjusted.

b/ Debt owed to finance companies and department stores.

The diminution in the rate of new borrowing appears to have been more than seasonal. Changes in the rate of instalment credit and new issues were smaller in the first quarter of 1965 than in the similar period one year ago. Although the increase in advances by the building societies was greater in the first three months of 1965 than during the first quarter of 1964, the prospects for further increases are limited. The inflow of new deposits is easing and mortgage demand is being checked by the currently high interest rates.

At the same time, the local authorities are under pressure to reduce the volume of new loans they extend for house-buying purposes. In some instances, they are paying more for borrowed funds than they receive on loans. For example, the Glasgow City Council is paying 9 per cent but charging only 6-3/4; rather than raise loan rates, it chose to suspend new home loans for the time being.

Trade position shows modest improvement. Returns through the first quarter of 1965 show a modest but sustained improvement in Britain's foreign trade position. On a balance of payments basis, the seasonally-adjusted current-account deficit has fallen from £127 million for the fourth quarter of 1964 to £44 million for the first three months of 1965. (See Table 5.)

This improvement is due to a fall in imports, and a rise in exports. However, February imports were reduced to some extent by the U.S. dock strike.

Table 5. United Kingdom: Foreign Trade, October 1964 - March 1965
(£ million)

	1964			1965		
	Oct.	Nov.	Dec.	Jan.	Feb.	March
Imports (c.i.f.)	472	487	476	465	440	468
Exports (f.c.b.)	365	369	396	368	390	389
Re-exports (f.c.b.)	12	14	13	14	14	13
Difference	-95	-104	67	-83	-36	-68
Trade balance a/	-52	-56	-19	-34	+11	-19

a/ Balance of payments basis.

Sterling strengthens in response to budget

Sterling has strengthened noticeably in the post-budget period. Between April 2 and April 15, the spot rate climbed 63 points to 279.72 (U.S. cents) and the forward discount fell 47 basis points to 2.55 per cent. As a result, the covered differential on Treasury bills favored New York by only 17 basis points on April 15, and as early as April 9, the covered differential on deposit rates once again favored local authorities over Euro-dollars. (See Table 6 and Charts 8 and 9.)

Between March 23 and March 26, sterling weakened steadily in response to repeated rumors on the continent of a possible devaluation of the pound. The spot rate fell 47 points to 278.94 (U.S. cents) and the forward discount widened by 43 basis points to 3.25 per cent. However, in early April, prior to the presentation of the budget, sterling showed some strength and the spot rate rose, although the forward discount remained quite wide. (See Table 6.)

The widening of the forward discount during this period raised the covered differential of Treasury bills from 45 basis points in favor of New York on March 23 to 76 basis points on March 26. At the same time, the covered differential between local authority and Euro-dollar deposits swung in favor of the latter for the first time this year. Throughout the entire January-April period, the rate paid on Euro-dollars remained significantly higher than that for New York C.D.'s. (See Table 6.)

Demand for gold rises in mid-April. During the middle two weeks of April the demand for gold intensified and the fixing price rose from \$35.1490 on April 2 to \$35.1713 on April 15. This latest rise followed a month-long period of relative quiet, during which the price fluctuated around a downward trend. (See Table 7.)

Table 6. United Kingdom: Exchange Rates and Arbitrage Calculations
February - April, 1965

	Feb.	March			April		
	26	5	19	26	2	9	15
Exchange rates							
Spot (U.S. cents)	279.43	279.43	279.09	278.96	279.09	279.51	279.72
Forward (per cent per annum)	-2.82	-2.78	-2.74	-3.25	-3.02	-2.97	-2.55
3-month yields and yield spreads							
Treasury bills							
U.K. (covered)	3.47	3.48	3.61	3.13	3.33	3.35	3.74
U.S.	3.97	3.93	3.90	3.89	3.91	3.90	3.91
Difference	-0.50	-0.45	-0.29	-0.76	-0.58	-0.55	-0.17
Deposit rates							
Local authority (covered)	4.81	5.02	4.94	4.57	4.60	4.78	n.a.
Euro-\$	4.56	4.75	4.88	4.88	4.75	4.75	n.a.
Difference	+0.25	+0.27	+0.06	-0.31	-0.15	+0.03	
Euro-\$ <u>a/</u>	4.63	4.68	5.00	4.88	4.75	4.75	4.81
New York C/D's <u>a/b/</u>	4.25	4.25	4.28	4.26	4.26	4.28	4.27
Difference	+0.38	+0.33	+0.72	+0.62	+0.49	+0.47	+0.54

a/ Previous Wednesday.

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

Table 7. United Kingdom: London Fixing Price for Gold
February - April, 1965

	Feb.	March		April		
	26	5	19	2	9	15
Price per fine ounce (U.S. dollars)	35.1686	35.1777	35.1449	35.1490	35.1562	35.1713

Europe and British Commonwealth Section.

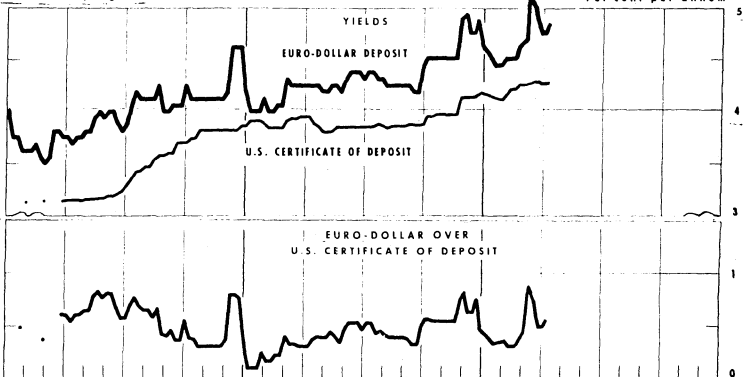
Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

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

Wednesday figures

Per cent per annum



SELECTED INTERNATIONAL MONEY RATES

Friday figures

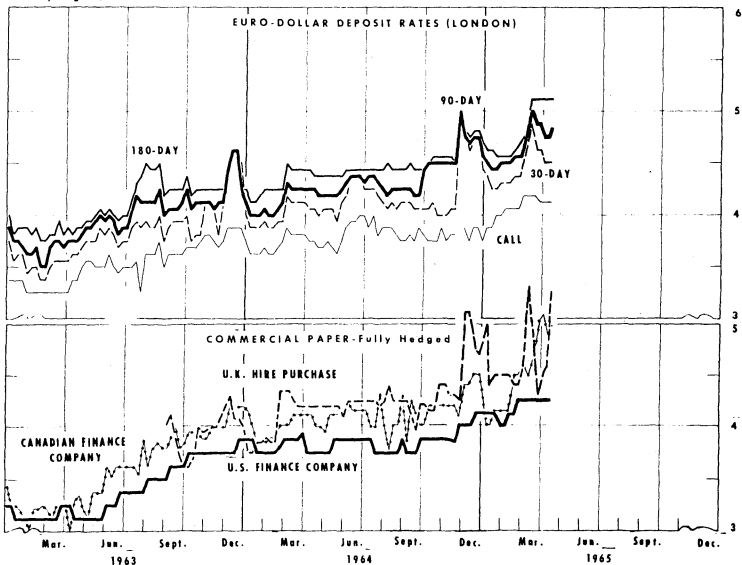
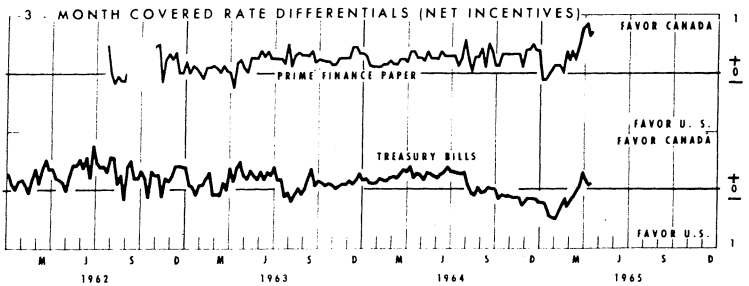
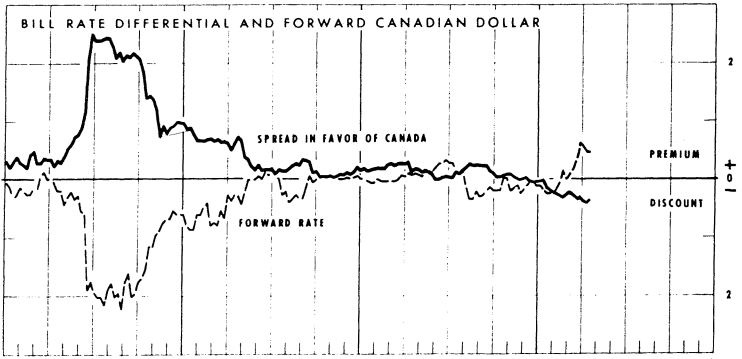
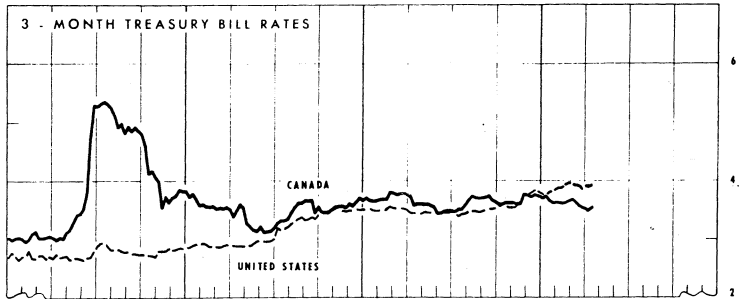


Chart 2

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

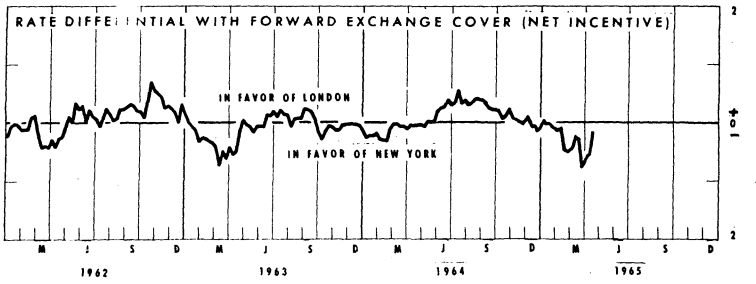
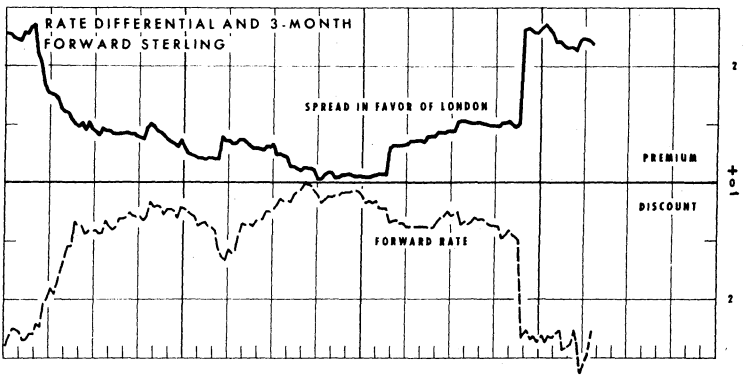
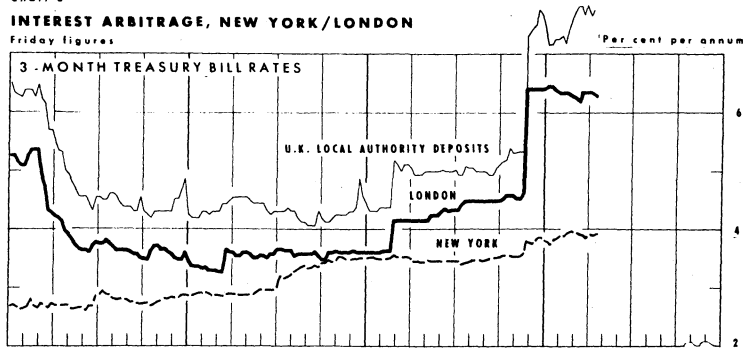


Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

Per cent per annum

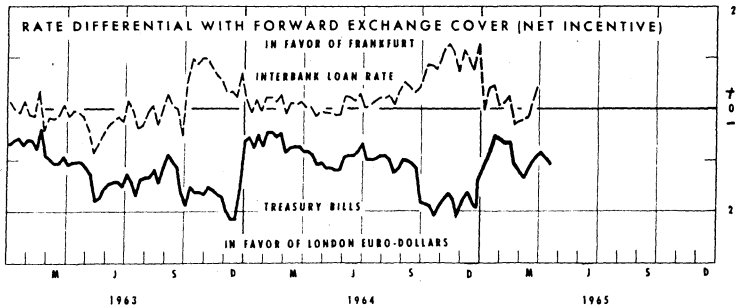
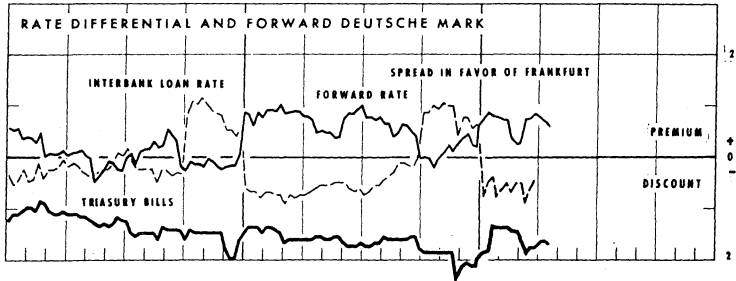
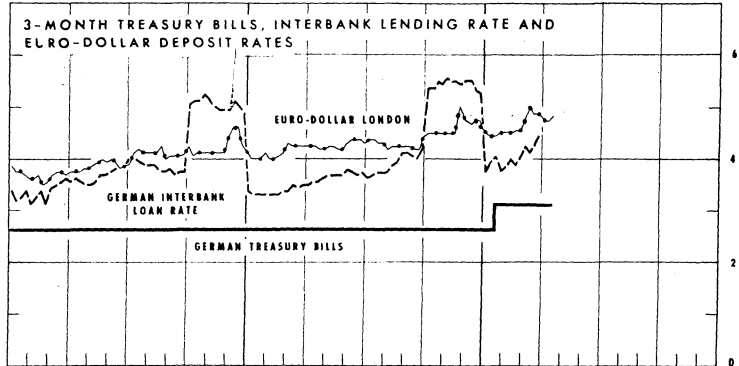
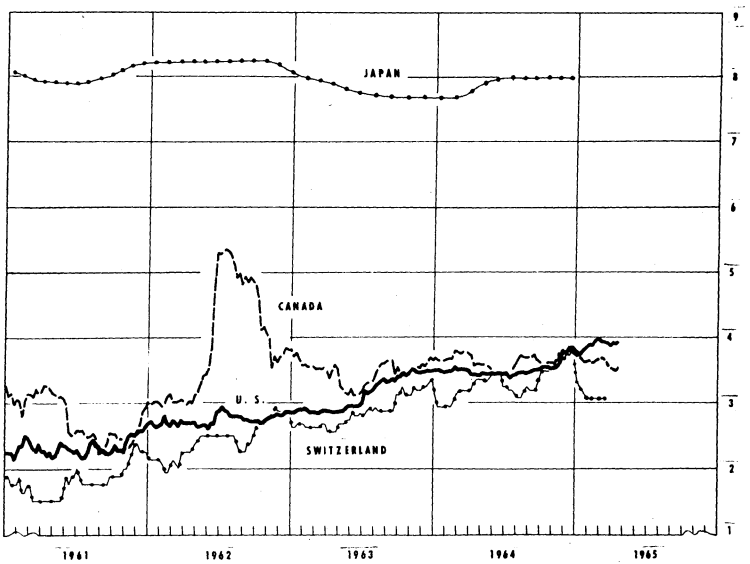
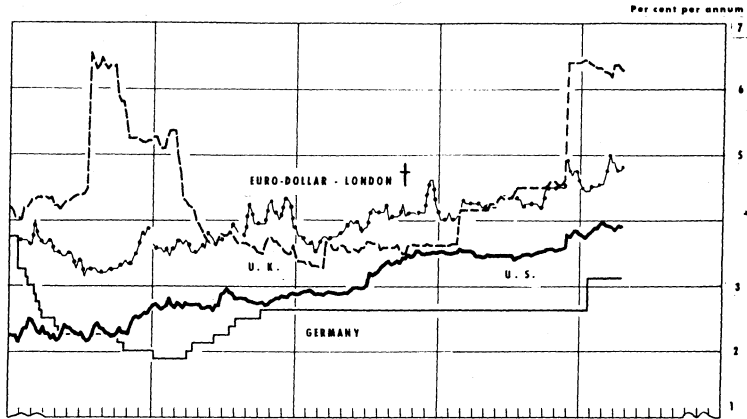


Chart 5
SHORT TERM INTEREST RATES*



* 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 4
LONG-TERM BOND YIELDS

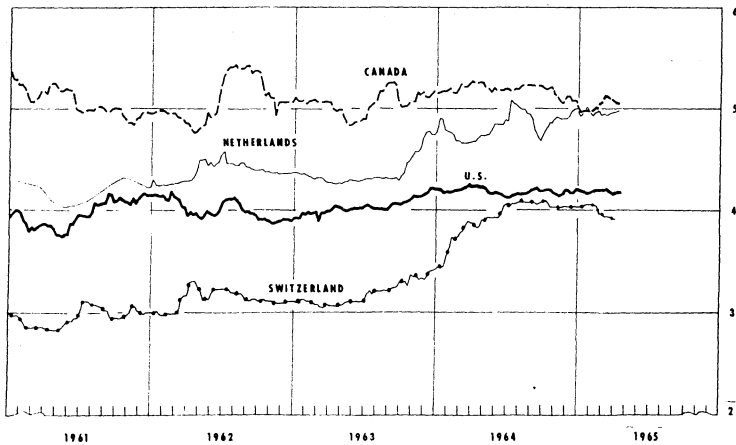
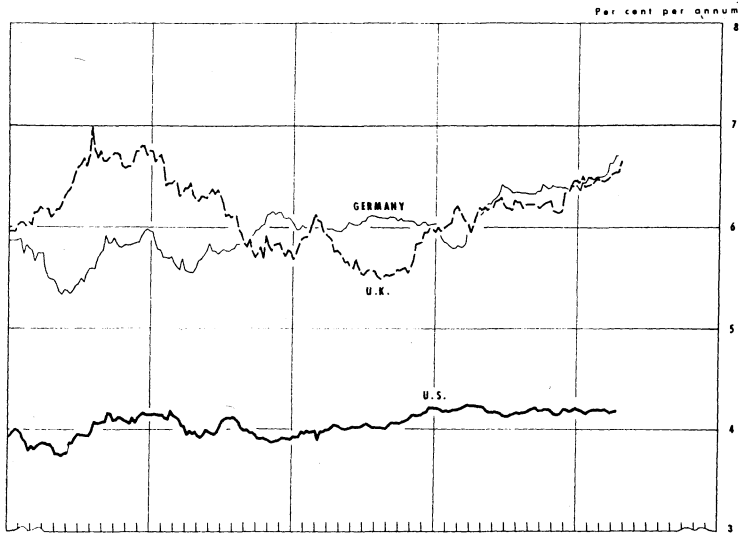
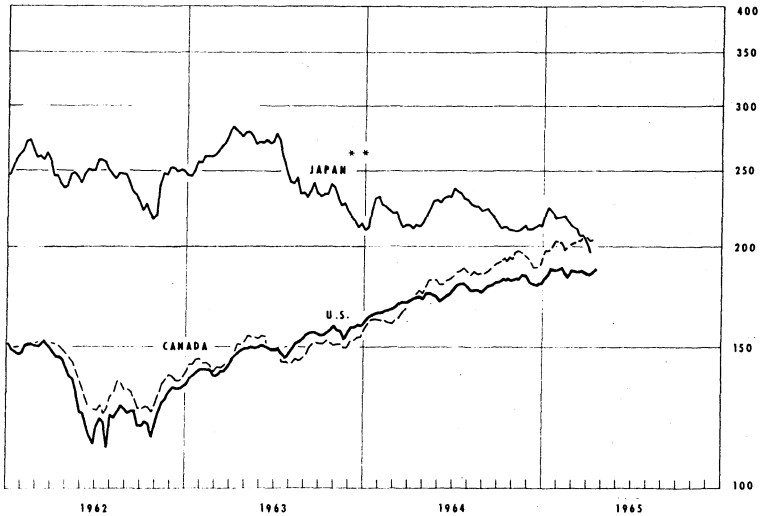
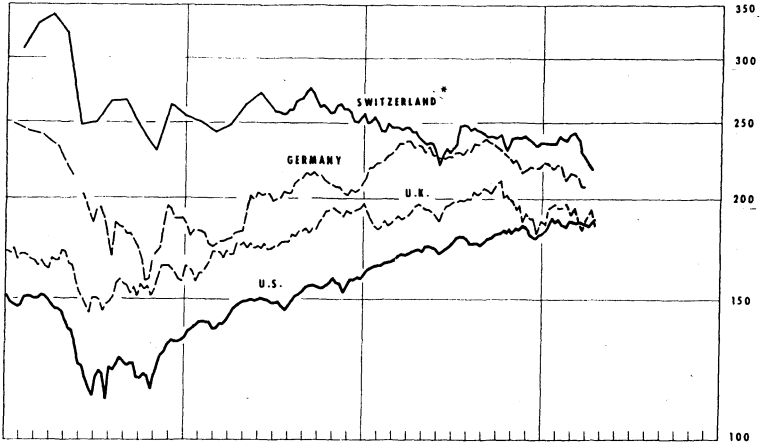


Chart 7
INDUSTRIAL STOCK INDICES

1958=100
Ratio scale



* Swiss bank Corporation industrial stock.

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

15

Chart 8
SPOT EXCHANGE RATES - MAJOR CURRENCIES AGAINST U.S. DOLLAR

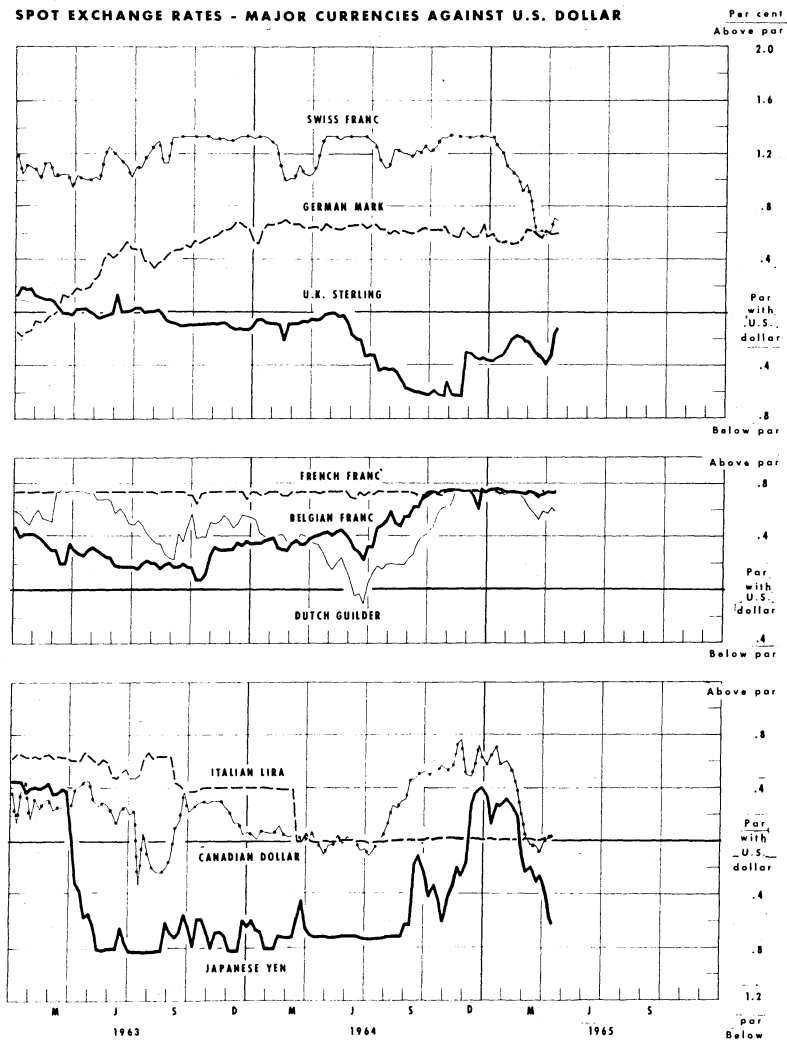
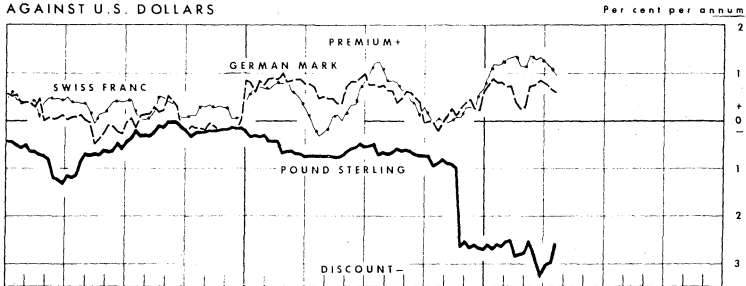
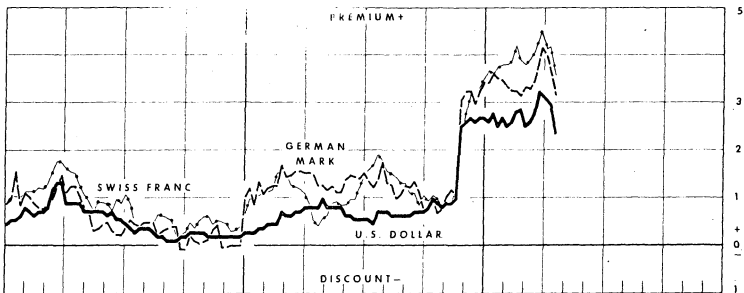


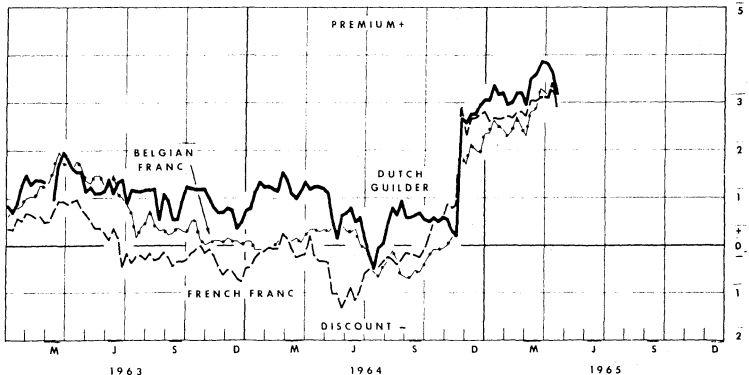
Chart 9
3-MONTH FORWARD EXCHANGE RATES
Friday figures
AGAINST U.S. DOLLARS



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, April 16 , except as noted)</u>	
<u>(Wednesday, April 14)</u>		<u>Treasury bills:</u>	
Euro-\$ deposit	<u>4.82</u>	U. S.	<u>3.91</u>
U. S. certif. of deposit	<u>4.27</u>	U. K.	<u>6.29</u>
<u>Lower panels</u>		Germany	<u>3.12</u>
<u>(Friday, April 16)</u>		Canada	<u>3.54</u>
Euro-dollars: Call	<u>4.12</u>	Swiss 3-month deposits (Date: <u>March 15</u>)	<u>3.06</u>
7-day	<u>4.31</u>	Euro-\$ deposit (London)	<u>4.82</u>
30-day	<u>4.50</u>	Japan: composite rate (Date: <u>Dec. 31</u>)	<u>7.990</u>
90-day	<u>4.82</u>	<u>Chart 6</u>	
180-day	<u>5.12</u>	<u>Bonds:</u>	
Finance Co. paper: U. S.	<u>4.25</u>	U. S. govt. (<u>Wed., April 14</u>)	<u>4.17</u>
Canada	<u>4.97</u>	U. K. war loan (<u>Thurs., April 15</u>)	<u>6.65</u>
Hire-purchase paper, U. K.	<u>5.32</u>	German Fed. Railway (<u>Fri., April 16</u>)	<u>6.72</u>
<u>Chart 2</u>		Swiss Confederation (<u>Fri., April 9</u>)	<u>3.88</u>
<u>(Friday, April 16)</u>		Canadian govt. (<u>Wed., April 7</u>)	<u>5.05</u>
Treasury bills: Canada	<u>3.54</u>	Netherlands government perpetual (<u>Fri., April 2</u>)	<u>4.97</u>
U. S.	<u>3.91</u>	(<u>April 9</u>)	<u>4.98</u>
Spread favor Canada	<u>-0.37</u>		
Forward Canadian dollar	<u>+0.47</u>		
Net incentive (Canada +)	<u>+0.10</u>		
<u>Chart 3</u>			
<u>(Friday, April 16)</u>			
Treasury bills: U. K.	<u>6.29</u>		
U. S.	<u>3.91</u>		
Spread favor U. K.	<u>2.38</u>		
Forward pound	<u>-2.55</u>		
Net incentive (U. K. +)	<u>-0.17</u>		