RFD 318

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

March 24, 1959

British Financial Developments Over the Past Eighteen Months

19 pages

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NOT FOR PUBLICATION

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Summary

Over the past eighteen months, British monetary and fiscal policy has gone through two distinct phases. The first was the policy of severe restraint introduced in September 1957 to check an international speculative run on sterling and the growing erosion of domestic confidence in the ability of the British authorities to control inflation. The second phase developed during the spring of 1958 as official concern focused increasingly on the decline in domestic economic activity; the first time since the end of World War II in which excess demand pressures were fully dissipated. The abandonment of the credit squeeze in early July 1958 marked the beginning of a series of measures designed to stimulate expansion and the authorities have since dismantled most of the remaining direct controls on consumption and investment.

The British authorities, in September 1957, relied principally on financial measures to meet the external and internal crisis. They raised the Bank Rate from 5 to 7 per cent, a ceiling was placed on bank loans, government investment outlays were curtailed, and new capital issues were restricted. These measures coincided with a leveling off in the investment boom, a decline in inventory accumulation, and a reduction in foreign demand for British goods. However, a 10 per cent fall in the value of imports, reflecting lower import costs, enabled Britain to achieve the largest balance-of-payments surplus on current account in the postwar period. All these developments made possible the use of monetary and fiscal measures in the promotion of economic recovery.

In addition, the authorities in 1958 made extensive net sales of gilt-edged securities to the nonbank public in contrast to the demoralization of the gilt-edged market in the summer of 1957. Sales of bonds to the nonbank public in 1958 were large enough to enable the Treasury to meet the cash needs arising from the budget deficit, to refund the large amount of maturing bond issues, and to provide cash for the sizable inflow of foreign exchange, as well as to produce a surplus sufficient to reduce government debt held by the banking system. The Government's anti-inflation measures and declining interest rates made the British investor more receptive to holding government securities. Furthermore, the Government's willingness to "maintain a high long-term rate of interest" in the face of sharp falls in short-term interest rates in 1958 helped to channel savings into government bonds. For example, sales of National Savings Certificates and Defence Bonds increased markedly after their yields were increased in April.

The strong balance-of-payments position and the restoration of control over the banks through bond sales to nonbank holders enabled the authorities to encourage credit expansion and public investment in order to stimulate recovery. The signal for a major shift in official

policy took place on July 3 when the ceiling on bank loans was abolished and control of new capital issues was liberalized. At that time, the Bank of England announced a new Special Deposit scheme for restraining credit expansion to be called upon at some future date if needed.

Following this, the authorities encouraged a boom in installment credit. The banks, with official sanction, entered the hire-purchase field on a large scale by buying shares in existing finance companies and through the introduction of personal loan schemes. This movement led to a reduction in the cost of consumer credit and an increase in its availability. The basis was laid for a rapid growth in installment credit buying when the Government relaxed hire-purchase restrictions in September 1958 and then removed them altogether six weeks later. Installment credit sales of autos and other durables rose to record levels in subsequent months.

The Government also attempted to promote economic expansion by removing the ceiling on public expenditures in October and increased outlays were programmed for 1959-60. At the same time, local authorities were encouraged to undertake capital projects, such as housing, which could be completed within a year. In November 1958, the Government introduced direct Treasury loans to facilitate purchases of older homes. Early in 1959, the Government freed new private domestic capital issues from all controls; only foreign and local authority issues remained under control.

By the third quarter of 1958, the economy appears to have reached its lower turning point. Since then there have been increasing signs that inventory liquidation has ended and a modest expansion in output has occurred chiefly in consumer durables lines. However, basic industries are still lagging and unemployment remains high by postwar standards. With the record balance-of-payments surplus and the strong exchange rate, the policy of internal expansion has been accompanied by major relaxations in restrictions on foreign trade and payments. In September 1958, controls were removed on the import of a large variety of goods from the dollar area and in December Britain formally adopted current account convertibility for nonresidents.

British economy: the recession in 1958

Britain's recession in 1958 was marked by the ending of the investment boom following a period of growing excess capacity and inventory accumulation, a fall off in foreign demand, and the intensification of restrictions on capital and credit in September 1957. Consumer demand was a major sustaining factor. Since the third quarter of 1958, there has been a moderate revival in output, largely related to the consumer durable goods boom. By the end of the year, the decline in basic industries output appears to have ended and both exports and imports have almost recovered from earlier lows.

Britain's economy had been slowing down in real terms for several years prior to the 1958 downturn. In 1957, gross domestic product in real terms rose by only 1.5 per cent compared to a rise of 3.1 per cent in 1954 and industrial production was little higher in 1957 than in 1955.

The recession in industrial production was marked by a fall from the seasonally adjusted high of 109 (1954=100) in September 1957 to 105 in May 1958, where it remained until October. From November 1958 to January 1959, industrial production remained roughly stable at a level of 107. The principal declines during the recession were in the textile, iron and steel and coal mining sectors.

The sharpest falls occurred in inventory accumulation and in private investment. Inventories fell rapidly in the first half of 1958 but seem to have leveled out in the latter part of the year. Gross fixed capital formation reached a peak rate of increase in the third quarter of 1957 and declined steadily in year-to-year terms to an increase of only 1-1/2 per cent in real terms by the third quarter of 1958; the smallest quarterly rise in recent years. Public investment and housing were weakest while private capital expenditures, particularly in vehicles, failed to sustain earlier rates of increase. In the fourth quarter, private housing starts turned up, although new domestic machine tool orders were still low. Recent surveys indicate that expected declines in manufacturing investment in 1959 will be more than offset by rises in investment in distribution industries and by public investment. (See Table 1.)

Table 1

United Kingdom: Year-to-year Changes in Expenditures on the Gross Domestic Product and in Imports (at market prices)

Expenditure sectors	1957 3rd qtr.	1957 4th qtr.	1958 1st qtr.	1958 2nd qtr.	1958 3rd qtr.
Consumers' expenditures	+186	+223	+227	+176	+132
Current government expenditures	+ 1	--	+ 26	+ 30	+ 36
Gross fixed investment expenditures	+ 73	+ 68	+ 66	+ 52	+ 31
Inventory expenditures	+ 65	+ 5	-135	-110	- 80
Exports	+ 32	- 11	- 30	- 62	- 34
Imports	+ 86	- 36	-129	-107	- 76
Gross domestic product	+277	+290	+254	+178	+116

Source: Computed from Quarterly National Income and Expenditure Estimates, Monthly Digest of Statistics, January 1959. (H.M.S.O. London.)

Consumer expenditures were a major factor sustaining the level of internal demand in the past year. After rising in the last quarter of 1957 and first part of 1958, the rate of increase began to level off in the second and third quarters of 1958. In the last quarter of 1958 and through January 1959, the rise in installment credit sales caused retail sales to exceed year-earlier levels by 5 per cent. Throughout this period savings have remained high. Personal savings were some 10 per cent of disposable income in the first nine months of 1958, little changed from the same period in 1957.

An important element contributing to the fall in demand was the reduction in foreign demand for British exports. Exports fell from the fourth quarter of 1957 through the first quarter of 1958 and were still below year-earlier levels through mid-1958. While imports have risen slightly above year-earlier levels, exports in January and February 1959 were 3 per cent under the same months in 1958. As a result the January-February trade deficit, this year was almost double that of the same months of 1958. The sharper drop in the value of imports in the last year due to raw materials prices and to destocking at home, contributed significantly to the rise in the current account balance-of-payments surplus from £216 million in 1956-57 to £488 million in 1957-58.

During the recession, demand pressures in the labor market eased and wage and price increases were well below year-earlier levels. Unemployment rose from 1.5 per cent of the labor force in November 1957 to a postwar high of 2.8 per cent in January and February 1959, and in March fell more than seasonally to 2.5 per cent. From November 1957 to November 1958, the index of weekly wage rages rose by only 3.6 per cent as compared with a rise of 5.6 per cent in the year preceding November 1957. The index of retail prices which rose by almost 4 per cent during 1957 has risen by less than 2 per cent in the first 11 months of 1958.

Sharp fall in short rates, revival in gilt-edged prices and equities

In the last 18 months, the sharp fall in short-term rates has been reflected in the five cuts in Bank Rate from 7 per cent to 4 per cent. Both long- and short-term rates reached peaks on September 19, 1957 when Bank Rate went to 7 per cent. At that time, the Treasury bill rate jumped 2.4 per cent to 6.6 per cent and the longest dated bond yield rose by less than one-half of one per cent to 5.6 per cent. The yield gap was progressively narrowed from late 1957 through the spring of 1958 and long-term yields once again exceeded short-term yields in May 1958. Falling short term rates were influenced by easing internal demand pressures and the reflow of funds to London in the first part of the year. During this period, the decline in medium- and long-term rates was held in check by Bank of England sales of bonds of selected dates (1966, 1979, 1984).

In the second half of 1958, the Treasury bill rate continued to decline as official credit policy openly encouraged re-expansion and by January 30, 1959 the Treasury bill rate was 3.1 per cent, almost a full per cent below Bank Rate. However, this decline was checked in early February and a new cut in Bank Rate appears unlikely at the moment.

Shorter-term bond yields during the latter part of 1958 followed the sharp drops in Treasury bill yields but official bond sales slowed down the drop in long bond yields. (See Table 2.) Once again the longer bond yields are the highest part of the yield curve. For example, the yield on Consols is 1.6 per cent above the Treasury bill rate. There has recently been criticism of the policy of maintaining relatively high long-term interest rates for debt-management reasons at a time when private investment is lagging.

Table 2

Yields on Selected Government Bonds and on Equities

	Aug. 7, 1957	Sept. 25, 1957	May 21, 1958	Oct. 15, 1958	Jan. 28, 1959
Treasury bills	3.88	6.60	4.82	3.61	3.11
Bonds:					
1960 (2% Exchequer)	3.98	5.50	4.47	3.76	3.08
1964 (2-1/2% Exchequer)	4.46	5.44	4.70	4.43	4.02
1975 (3% Savings Bonds 1965-75)	5.54	5.88	5.63	5.37	5.19
3-1/2% War Loan	5.23	5.88	5.30	5.13	5.27
2-1/2% Consols	4.96	5.40	5.03	4.74	4.74
Equities:					
Industrial Ordinary Share Index (Economist)	5.36	5.83	6.57	5.31	5.26

Source: The Economist. Derived from the table "British Funds and Guaranteed Stocks" in various issues.

In the first eight months of 1957, stock prices rose by 10 per cent as fears of inflation and devaluation influenced buyers; the gap between the yields on industrial stocks and government bonds had virtually disappeared at the time of the restrictive measures in September. Thereafter, the prices of equities continued to decline and stock yields rose substantially above bond yields in early 1958. With industrial share prices rising on an index basis (1938 equals 100) from 160 to 213, between March 1958 and January 1959, the gap between stock yields and Consols narrowed from almost 2 per cent in late February 1958 to about one-half per cent in late January 1959.

New capital issues in the United Kingdom (excluding the British Government) totaled only £316 million in 1958 compared with £383 million in 1957 (Midland Bank figures). With favorable market conditions and Treasury approval, local authorities increased their borrowing from the market from £19 million in the first nine months of 1957 to £56 million in the same period of 1958. In 1958, there was a sharp fall in new issues to finance production. (See Table 3.)

Applications to the Capital Issues Committee for new issues, mainly by commercial and industrial firms fell in 1958. In the second half of 1958, applications were less than half those for the same period in 1957.

Table 3

New Domestic Capital Issues

(In millions of pounds)

	1958	1957	1956	1955
Public bodies	75.5	27.1	53.9	305.7
Production	143.0	250.3	158.4	165.5
Trade	10.7	7.0	16.6	13.4
Transportation	1.0	8.7	1.5	11.7
Finance	24.9	27.8	34.2	28.8
Total	255.0	320.9	264.6	525.1
Per cent of all issues	80.6	83.7	89.4	92.6

Source: "New Capital Issues," Midland Bank Ltd., January 1959.

New capital issues approved by the Capital Issues Committee dropped by 17 per cent between the first half of 1957 and the same period in 1958 but they showed an increase of 12 per cent over a year ago in the second half of 1958 following the July (1958) liberalizations in the Committee's instructions. In February 1959, Capital Issues control was abolished for private domestic issues and bank loans but retained on foreign flotations of over £50,000.

Successful debt management reduces liquidity of banking system

In 1958, the British authorities were able to make substantial net bond sales to the nonbank public in marked contrast to the summer of 1957 when "it seemed that the demand for gilt-edged securities had almost dried up . . . . "1/ In this period, bond sales were sufficiently large to cover the estimated 1958 budget deficit of £240 million, the sterling counterpart of the inflow of foreign exchange and withdrawal of foreign held sterling balances amounting to some £380 million, and maturing debt of some £1.3 billion (£676 million in June 1958 and £592 million in January 1959). In addition, the Treasury reduced its borrowing from the banks and discount houses by some £100 million in 1958.

The crisis measures of September 1957 were followed by a revival of confidence on the part of investors.2/ The easing of internal demand pressures and prospective reduction in short-term interest rates from the extraordinarily high levels of the fourth quarter of 1957 further enhanced the attractiveness of gilt-edged securities. Cuts in Bank Rate in early 1958 were viewed officially as technical adjustments to the improved external situation. At the time of the March reduction in Bank Rate, the Chancellor noted that the recent £310 million 5-1/2 per cent 25-year issue "indicated very clearly that we intend to maintain a high long-term rate of interest."3/

1/ Midland Bank Review, May 1958, page 10.

2/ An important part of the justification of the severe September measures was made in terms of the need to restore the gilt-edged market. During the October 1957 debate on the economic situation, the Chancellor said, "when gilt-edged and equities change hands; when there is in this country and among our own people a disorderly scramble from a foreseen and tolerated spoilation -- it is at this stage the whole machinery of public finance breaks down. We can finance for a time at the expense of holders of fixed interest stocks, but there comes a moment when a Government cannot raise further money either to finance investments or to repay debt and, at that moment, the mechanics of any policy, whether it is Conservative or Socialist, cease to exist." (Speech by Chancellor of the Exchequer, Mr. Peter Thorneycroft, Debate on the Economic Situation, House of Commons, October 29, 1957, reprinted in Hansard.)

3/ Speech by Chancellor of the Exchequer, Mr. Heathcoat Amory, at Bideford, March 21, 1958. Reprinted in The London Times, March 22, 1958.

Nonbank demand for bonds remained strong. The authorities kept bond price increases in check by feeding out bonds of selected dates over the entire range of government bond maturities, while at the same time engaging in the normal practice of buying up the next maturing issue with the proceeds of longer-term maturities.

In addition to sales of marketable debt, the authorities placed substantial nonmarketable debt with small savers principally by raising the return. Net sales of National Savings Certificates, Defence Bonds and Premium Bonds amounted to £223 million in 1958 compared with net sales of only £71 million in 1957. The principal rise in sales took place in National Savings Certificates and Defence Bonds after their terms were made more attractive in the budget of April 1958. Effective May 1, 1958 the maximum holdings of Savings Certificates were raised from £450 to £750. The interest on the issue is tax free and it yields 4-1/4 per cent if held for 7 years. At the same time, the coupon on the new issue of Defence Bonds was raised from 4-1/2 to 5 per cent and a 3 per cent tax-free bonus after 7 years was substituted for the 5 per cent bonus after 10 years of the former issue.

Bank credit expands with the end of the credit squeeze

From late 1957 through the first half of 1958, British commercial banks operated in an environment of direct control of the amounts and terms of bank lending. After July 1958 the situation changed to one of intense interbank competition, freedom in lending, and a return to effective central bank control of the level of bank liquid assets. The banks entered on a massive scale into the field of consumer credit. Their entry into this field laid the basis for a boom in hire-purchase credit in recent months.

In 1958, bank loans expanded by £378 million as compared with a contraction of £28 million in 1957. Advances to the nationalized industries showed almost no change on a year-to-year basis. The largest increase in advances through November 1958 was to the personal and professional sector. The clearing banks' ratio of liquid assets to gross deposits fell from 38.4 per cent in December 1957 to 34.6 per cent in December 1958 mainly as a result of a fall in Treasury bill holdings by £218 million in 1958 whereas they rose by £128 million in 1957. From September through December 1958, the banks sold £100 million in government bonds in order to restore their liquidity position. In January and February 1959, the clearing banks sold or asked for cash redemption of maturing bonds of some £140 million, and advances seasonally adjusted rose sharply further. (See Table 4.)

Table 4

London Clearing Banks: Change in net deposits and principal assets

(In millions of pounds)

	Jan. 1956 to Jan. 1957	Jan. 1957 to Jan. 1958	Jan. 1958 to Jan. 1959
1. Net deposits	+ 33	+169	+131
2. Private sector:			
Advances	+ 37	- 6	+410
Commercial bills	+ 17	- 26	+ 10
Total	+ 54	- 32	+420
3. Public sector:			
Short term 1/	- 1	+ 89	-145
Securities	- 24	+ 90	- 61
Total	- 25	+179	-206

1/ Includes Treasury bills and call money.
Source: Monthly Statements of the eleven London clearing banks.

The banks' liquidity problems reflected in part the end of the credit squeeze in July 1958.1/ The ceiling on bank loans (in effect in one form or another since July 1955) was removed effective July 31. At this time, the Bank of England announced the Special Deposits scheme for restraining bank credit expansion in the future, instead of relying on the use of official requests to restrict bank advances. The Governor of the Bank of England noted "the Special Deposits scheme commended itself to us as being the most flexible, the most obviously monetary in form and the least open to possible abuse as a method of inflationary borrowing by Government from the banking system."2/ The Bank announced that in the future, calls for Special Deposits from the clearing banks could be made as a supplementary credit instrument; it was in no sense "an alternative to the policy of funding the floating debt."

With the ending of the credit squeeze, ten of the eleven clearing banks moved into the installment credit field by purchasing either a minority or majority interest in finance houses. Governor Cobbold welcomed this development as a means of consolidating hire-purchase finance. Several U.K. banks, led by the Midland Bank, also introduced a new system of personal loans for personal and professional customers. These loans are repayable in installments; unlike hire-purchase financing, ~~and~~ the purchases being financed remain the property of the borrower. Other banks preferred to rely on expanding traditional methods of personal lending.

The consequences of these changes was to make installment credit available to consumers on better terms and in greater quantities. The abolition of all hire-purchase restrictions in September and October gave a further boost to the installment credit boom.

Hire-purchase record expansion in late 1958

During the last quarter of 1958 and the first part of 1959, the rise in hire-purchase credit was principally responsible for the sharp rise in consumer spending.

1/ The credit squeeze began in early 1955 and intensified in September 1957 when the Chancellor advised the banks to hold advances for the succeeding twelve months at the average of the previous twelve. Capital Issues Controls were made more restrictive, "in particular towards applications for large amounts." Financial Times, September 20, 1957.
2/ Speech by the Governor of the Bank of England, C. F. Cobbold, Esq., on October 16, 1958, at a dinner given by the Lord Mayor to the Bankers and Merchants of the City of London. Financial Times, October 17, 1958.

In 1958, the total volume of hire-purchase debt rose by £116 million to £604 million. The bulk of the increase -- £73 million -- took place from October to December. The total value of durable goods sold in 1958 is estimated to have been £870 million, of which some £350 million represented autos, £175 million furniture and £155 million other household goods. (See Table 5.) In January, hire-purchase debt rose by a further £16 million.

The various relaxations, after the credit squeeze was ended, sharply reduced the cost of consumer credit. The new personal loans normally carry interest rates of 5 per cent on the amount borrowed (9 per cent on the amount outstanding); the interest is tax-deductible whereas hire-purchase charges are not. Many retailers promptly reduced their charges for credit from over 7 per cent per annum on the amount borrowed to under 4 per cent, and some took off all charges. The maximum charge agreed by the finance houses was reduced from 8 per cent per annum in July to 7-1/2 per cent in October and was reported to have declined to between 5 and 6 per cent in late November. In this period, Bank Rate was reduced by only one per cent.

At the same time, installment credit controls were relaxed on September 16. They were removed from a wide range of industrial, agricultural and certain consumer durable goods (including furniture, bicycles, and motorcycles). In addition, downpayments on most household goods were reduced from 50 to 33-1/3 per cent; included in this group were refrigerators, radios, TV sets, washing machines, and other domestic electrical appliances. These measures resulted in only a modest rise in total hire-purchase debt (£12 million) although a sharp rise in sales of individual items on which controls were removed was recorded.

Six weeks later, on October 29, all hire-purchase restrictions were removed. Hire-purchase sales of automobiles in November and December were the highest ever recorded for these months, and substantial increases took place in credit sales of radios, TV sets, and furniture. Initially, one large dealer offered terms on autos of 5 per cent down and 50 months to pay but most dealers soon established downpayment requirements of from 10 to 20 per cent and a maximum of 36 months to pay. In late December, the nationalized gas and electricity boards asked the Treasury to remove the restriction imposed in 1956 on use of capital to finance hire-purchase sales of applicances in view of the demand they had experienced in installment credit, on which they offer a maximum 5-year repayment period.

The hire-purchase boom was extended into other fields when, in November, one finance house associated with a major bank announced a scheme to make industrial share ownership possible for

Table 5

New Credit Extended by Finance Houses

July 1957 = 100

Date	Total all goods	Private cars new	Private cars used	Commercial vehicles new and used	Industrial bldg. & plant	Furniture & furnishings	Radio TV	Domestic appliances
1957								
Aug.	81	61	87	77	90	107	117	64
Sept.	82	75	78	93	112	105	156	72
Oct.	85	79	78	94	121	129	206	84
Nov.	79	81	71	91	103	115	210	70
Dec.	70	78	60	72	87	120	216	65
1958								
Apr.	101	99	108	103	118	104	102	87
June	104	90	115	111	93	94	87	93
July	110	97	119	113	119	110	94	106
Aug.	87	58	95	79	86	98	96	95
Sept.	84	54	89	82	89	104	125	108
Oct.	98	58	89	107	142	175	201	127
Nov.	149	150	163	138	127	134	326	160
Dec.	130	115	129	129	125	230	406	139

Source: Board of Trade Journal, February 20, 1959. (H.M.S.O. London.)

lower income groups. The scheme involves installment loans covering up to 75 per cent of the value of the stock, repayable over a maximum period of 24 months. Interest of 5 per cent is charged on the amount borrowed.

Recently, thirty-three of the most important finance houses and hire-purchase houses announced that effective April 1, 1959, a generally agreed limit would be placed on minimum downpayments and repayments periods for new and used vehicles in the interests of "sound business." A minimum deposit of 20 per cent will be required by these houses on vehicles less than three years old and 25 per cent for those over three years of age. The maximum repayment period was set at 30 months.

Fiscal policy: from restraint to expansion

The limitation on the level of government spending was an integral part of the crisis program of September 1957. When the restraint phase was followed by an expansion phase in July 1958, increases in central and local government investment spending were delayed until late in the fall of 1958, after it had become evident that the recovery of private investment was lagging.

At the time of the September 1957 crisis measures, the Chancellor of the Exchequer announced that "we are no longer prepared to underwrite, through the banking system or through spending by the Government, the consequences of inflationary actions."1/ Planned increases in government investment expenditures were postponed and outlays for the succeeding two years were to be held to the level actually achieved in 1957. Chancellor Thorneycroft subsequently resigned on January 7, 1958 on the issue of an expected £50 million rise in expenditures in the budget for the 1958-59 fiscal year.

The budget in April 1958 involved no greater absorption of the national resources than the actual budget of 1957-58 and the over-all deficit was little changed. The Chancellor said that he "was determined to maintain the effort to meet Exchequer requirements without increasing the floating debt."2/ The budget did provide a modest stimulus with reduced excise taxes and accelerated depreciation allowances on private investment. Provision was also made for fostering investment in depressed areas. On June 18, 1958, the initial allowances granted on new investment in the April budget were doubled.

1/ Speech by Chancellor of the Exchequer, Mr. Peter Thorneycroft, debate on the economic situation, October 29, 1957, House of Commons, reprinted in Hansard.
2/ Speech by Chancellor of the Exchequer, Mr. Heathcoat Amory, on the budget April 15, 1958, House of Commons, reprinted in Hansard.

In late October, the Government removed the ceiling on public capital expenditure and local authorities were informed that projects such as houses that could be completed within a year would be given favorable consideration. In November, housing received a further direct stimulus in the form of the announcement of a system of direct Treasury loans up to £100 million to building societies to aid buyers of older homes.

Earlier, at the Commonwealth conference in September, the Chancellor offered increased assistance to the independent member of the Commonwealth in the form of Treasury loans under the Export Credits Guarantees Acts at the rate of interest at which the British Government borrowed plus one-fourth per cent. Provision was made for direct Exchequer loans to the Colonies at the same rate of interest.

From April to December 1958, the over-all Treasury deficit was only £938 million compared with £909 million in 1957, roughly as forecast in the budget. However, the budget had forecast a rise in nationalized industries expenditures for the full year 1958-59 of roughly half the £103 million which actually occurred in this period. (See Table 6.) This was partially offset by repayments of some £41 million in advances by the Public Works Loan Board to the Exchequer whereas new advances made by the Board in the nine-month period amounted to only £3.7 million. It is clear that local authorities relied almost entirely on the market for their financing in the last year. The rise in capital financing of the nationalized industries was due to increased capital outlays by the Transport Commission and to the Coal Board (where a reduction had been forecast in the budget).

Local authorities shift borrowing to market

Local authorities in 1958 found market conditions highly favorable for new capital issues. Over £60 million was raised on the London market in 1958, about double the volume raised in 1957. In May 1957, the Treasury placed a minimum of £3 million on new issues by local authorities in order to shorten the backlog of such borrowers waiting to enter the capital market.

Table 6

Budget Outcome April 1 to December 31, 1957 and 1958

(In millions of pounds)

	1958 April 1- Dec. 31	1957 April 1- Dec. 31
Current:		
Receipts	3,200	3,117
Expenditures	3,695	3,561
Deficit	-495	-444
Net capital:		
Local authorities	+ 37	- 37
Coal industry	-108	- 88
Transport (railway finances)	- 73	- 42
Other	-299	-298
Net deficit	-443	-465
Over-all deficit	-938	-909

Source: Exchequer statements.

The following table indicates the rapid fall in rates charged by the Treasury's Local Loan Funds in order to keep these in line with market rates.

Table 7

Local Loan Funds: Interest Rates

(Per cent)

	Sept. 28, 1957	Feb. 25, 1958	July 12, 1958	Aug. 23, 1958	Oct. 25, 1958
Up to 5 years	7-1/4	6-1/2	5-3/4	5-3/4	5-1/2
From 5 to 15 years	6-3/4	6-1/2	6-1/4	6	5-3/4
From 15 to 30 years	6-3/4	6-1/4	6-1/4	6	5-7/8
Over 30 years	6-3/4	6-1/4	6-1/4	6	5-3/4

Recent trends in market rates which local authorities have to pay for funds are indicated below:

	February	July	November
2-3 years	7 to 7-1/8	6-1/8	5-1/2 to 5-3/4
over 5 years	6-1/2 to 7	6 to 6-1/8	5-3/4 to 5-5/8

Building societies' funds increase with lower interest rates

The credit squeeze in late 1957 and the withdrawal of many local authorities from the housing mortgage field increased the demand for mortgages from private lenders at a time when high money rates reduced the flow of funds to these institutions. The result was a sharp cut in new mortgages issued in the last part of 1957 and in the first quarter of 1958. The flow of savings into the building societies began to improve after midyear as market rates of interest continued to fall.

Throughout the period when Bank Rate moved from 7 per cent to 4 per cent, the Building Societies Association continued to recommend a 6 per cent mortgage rate and 3-1/2 per cent (tax free) on shares. One major institution reduced lending rate to 5-1/2 per cent and its deposit rate to 3-1/4 per cent in December. Another society has since followed this lead. The mortgage market is currently described as being in an easy position in part because the banks are now reportedly granting mortgages below the 6 per cent rate to those with good references.

The reluctance of most societies to reduce rates in the face of declining market rates stems from the continued existence up till now of an excess demand for mortgages over the supply of loanable funds, and the fact that the rate on Government National Savings Certificates (with which the societies compete for savings) has not been reduced.

Chronology of Major Monetary and Fiscal Actions

1957

September 19: Bank Rate raised from 5 to 7 per cent, total volume of bank advances limited, ceiling put on public spending, tighter capital issues controls.

1958

March 20: Bank Rate cut from 7 to 6 per cent.

April 15: Budget presented. Small tax changes, initial allowances on new investment raised, terms liberalized on Defence Bonds and National Savings Certificates.

May 22: Bank Rate cut from 6 to 5-1/2 per cent.

June 18: Announcement that initial depreciation allowances on new investment would be doubled (retroactively) from level indicated in budget.

June 19: Bank Rate cut from 5-1/2 per cent to 5 per cent.

July 3: Credit squeeze ended. Limitation on volume of bank advances removed. Limit for exemption from CIC controls raised from £10,000 to £50,000. CIC instructions liberalized. New provisional system of special deposits instituted in case restriction of bank credit again necessary.

August 14: Bank Rate cut from 5 to 4-1/2 per cent.

September 19: Easing of hire-purchase controls on a wide variety of goods.

September 22: Increased credits offered to Commonwealth countries and to colonies at current rate of interest to Government borrowing plus one-fourth of one per cent.

October 1: Governor of Bank of England welcomes participation of banks in hire-purchase houses but notes the need for more comprehensive organization.

1958 (continued)

October 16: Chancellor removes ceiling on public investment and announced that public investment in 1959-60 would be from £125-150 million above the 1957-58 level. Minister of Housing informs local authorities that capital projects which could be completed within a year such as water, sewage and housing, would be given sympathetic consideration.

October 29: Remaining hire-purchase restrictions removed.

November 5: Government announced loans, not to exceed £100 million, to approved building societies to assist purchasers of older homes.

1959

February 5: Capital Issues Controls suspended for all private domestic borrowers. Local authorities and foreigners are still required to get approval for new issues on the London Market.