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Recent Economic Developments in the United Kingdom, July through October 1963

16 pages

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Summary

The British economy has been expanding vigorously since mid-year, but a note of caution on the danger of too swift an expansion now is present in official statements. In early October some excess industrial capacity still remained, and the labor market exhibited moderate slack. On the external side, the pound has been stable since July, and modest reserves accruals took place in September and October.

Exports continued to rise through the third quarter, giving considerable impetus to employment and output. The rate of growth in exports thus far in 1963 has exceeded the 5.6 per cent per annum target calculated by the National Economic Development Council. Shipments to the outer sterling area and to Western Europe together explain the bulk of the export expansion. Imports rose somewhat faster than exports, moderately widening the trade gap between the second and third quarters. The greatest part of the increase was in imports of food, beverages, and tobacco. However, expansion-sensitive imports of fuels, basic materials, chemicals, and other semi-manufactures, which had remained at about £200 million per month from March through August, rose sharply to £218 million in September.

The stability of sterling may also have been bolstered by a substantial surplus of the outer-sterling countries in their transactions with the rest of the world. For the first half of 1963, the surplus amounted to £216 million, largely as a result of the heavy inflow of non-sterling long-term capital (£285 million) into these areas. (See Table 6, page 6b.)

On the domestic side, the business expansion gained momentum over the summer months. Retail sales are now rising, supported by the July 1 tax cut and good employment prospects. Private expenditures for plant and equipment may rise from the second quarter level for the balance of the year, and the increase in Government expenditure budgeted last April is now beginning to materialize.

Monetary actions are supporting the business expansion. As the increase in bank advances placed pressure on liquidity, the Bank of England announced that the traditional 30 per cent liquidity requirement will be reduced to 28 per cent through mid-April. In the capital markets, stock prices rose in August, sagged in September and rose to a 1963 peak in November. There was little activity in the Government bond market between July and October. The Chancellor has announced that local governments in Britain are to be required to limit their short-term borrowings and to obtain funds in substantial volume from the Treasury. The Treasury's flow of funds for this purpose may rise from about £200 million to £500 million annually and undoubtedly will have major implications for the gilt-edged market.

Thus far, the present British expansionary program, oriented in the light of short-term political considerations, has developed favorably. The broadening base of business expansion and the sustained increase in export sales have meant that economic developments in Britain during the course of 1963 have proceeded along the broad lines laid down by N.E.D.C. in its growth analysis.

At present, questions about the outlook for 1964 relate more to external considerations than to doubts about the momentum of the domestic recovery. Even though it was at a record level in August, industrial output was only 4 per cent above the preceding peak of July 1961. However, one financial review has suggested that measures to slow down the momentum may be required as early as next spring when the new budget is prepared.

The primary area of concern for the British economic outlook for 1964 lies in uncertainties about how the balance of payments will be affected by the domestic boom. Heavy purchases of imported materials are expected to take place as the domestic expansion proceeds. For this reason, the trend in exports is clearly one key to the course of economic growth in Britain. From a balance-of-payments point of view, the improved prospects for primary products may produce payments surpluses within the outer sterling area. A rise in sterling-area balances in London could lend support to the pound rate. In addition, recent developments in the grain situation which have prompted a sharp rise in tramp freight rates should augment earnings on shipping account and help Britain's production and sales abroad of new ships. 1/

The stability of sterling

Exchange rates and reserves. Sterling was relatively stable during the third quarter. (See Table 1, page 3a.) Moderate strength was exhibited in July and September and moderate weakness in August, when sterling fell below par and reserves declined. From mid-September

1/ See "New orders Halt Decline in U.K. Shipyard Work," The Financial Times, (London), October 26, 1963, page 10.

Table 1. Sterling-Dollar Spot Exchange Rate, Jan.-Sept. 1963
(In cents per U.K. pound)

MONTHLY AVERAGES

Jan.	280.48	Apr.	280.07	July	280.08
Feb.	280.34	May	279.96	Aug.	279.96
Mar.	280.06	June	280.02	Sept.	279.77

SELECTED FRIDAYS: JULY-SEPTEMBER

July 5	280.12	Aug. 16	279.97	Sept. 20	279.74
19	280.02	30	279.80	Oct. 4	279.76
Aug. 2	280.04	Sept. 6	279.78	11	279.77
9	280.07	13	279.73	18	279.77
				24	279.78
				Nov. 6	279.76

Source: Certified noon buying rates in New York for cable transfers.

Table 2. United Kingdom: Gold and Convertible Foreign Exchange Reserves, January-September 1963
(In millions of U.S. dollars)

	Changes: 1st Qtr.	2nd Qtr.	3rd Qtr.	July	Aug.	Sept.	Outstanding, Sept. 30, 1963
ACTUAL CHANGE	+ 8	-101	+22	+20	-20	+22	2,735
Less:							
Central bank loans a/	+250	-250	--	--	--	--	
Adjustments for U.S. official foreign exchange operations b/	+ 33	+ 18	-17	-25	+ 8	--	
ADJUSTED CHANGE	-275	+131	+39	+45	-28	+22	

a/ Loans received (+) from four Continental central banks in February and March and repaid (-) in June.

b/ See: Federal Reserve Bulletin, September 1963, pp. 1219-20.

through October, the pound remained very close to 279.77 U.S. cents. Gold and foreign exchange reserves increased somewhat in September and in October, a seasonally weak month, after substantial losses in the first quarter and moderate gains in the second quarter. (See Table 2, page 3a.)

Exports. Exports expanded between the second quarter and third quarter, contributing to the stability of sterling and to the rapid expansion of domestic output. The growth in the first nine months of this year has been well above the National Economic Development Council (NEDC) target figure of 5.6 per cent per annum.

The sterling area has accounted for 42 per cent and Western Europe for 50 per cent of the export expansion between the third quarter of 1962 and the third quarter of 1963. (See Table 3, page 4a.) Sales to the Common Market, France in particular, have expanded rapidly as the result of domestic inflationary pressures and liberalizations of imports controls.

In the remainder of 1963, exports are expected to continue expanding in response to further growth of demand in major British export markets. However, the rapid rate of growth experienced in the second quarter may not continue; in the third quarter, the rate of export expansion slowed down perceptibly. For the immediate future, the growth of new foreign orders for engineering goods gives some basis for optimism: the index for July-August 1963 was 17 per cent above the comparable period of 1962.

Imports. In the second quarter, imports rose more rapidly than exports, shifting the seasonally adjusted trade balance from a surplus of £18 million to a deficit of £9 million (on an f.o.b. basis--See Table 5, page 6a.) Trade returns suggest that the trade deficit (on a "payments"

Table 3. United Kingdom Exports: 1957, 1962, 1963

	Monthly Averages						Share in Growth	
		1962		1963			1957 to 1963 a/	1962 to 1963 b/
	1957	Year	3rd Qtr.	2nd Qtr.	3rd Qtr.	Aug.-Sept.		
	(Seasonally adjusted; £ mns; f.o.b.)						(per cent)	
Sterling Area	120	112	112	119	123	123	4	42
Western Europe	75	113	117	126	130	132	78	50
of which:								
EEC	(28)	(60)	(62)	(69)	(71)	(72)	(61)	(35)
EFTA	(38)	(43)	(43)	(45)	(47)	(48)	(13)	(15)
U.S. and Canada	37	43	44	41	45	45	11	4
Other	43	48	47	49	48	50	7	4
Total	275	316	320	335	346	350	100	100

a/ Growth between 1957 and June-August 1963 monthly average.
b/ Growth between third quarter 1962 and third quarter 1963 monthly average.

Table 4. United Kingdom Imports in Two Economic Cycles; 1958-60 vs. 1962-63 Revival 1/
(In millions of pounds, seasonally adjusted monthly averages)

	1958	1960 3rd Qtr.	1962	1963 2nd Qtr.	1963 3rd Qtr.	Growth 1958-60 3rd Qtr.	Growth 1962-63 3rd Qtr.
Food, beverages and tobacco	124	129	131	140	148	4%	13%
Fuels and industrial materials	162	210	191	201	209	30%	9%
Finished manufactures	25	44	51	55	55	76%	8%
Total	312	384	374	395	412	23%	10%

1/ Details may not add to totals due to rounding.

Source: Board of Trade, Report on Overseas Trade, September 1963.

basis) might have enlarged during the third quarter, although estimates are clouded by the problem of valuing sugar imports.1/

The major problem for the British balance of payments in coming months is whether imports of fuel and industrial materials will rise sharply in connection with continued growth of domestic output and with possible inventory accumulations. In September fuel and industrial materials imports rose to £218 million per month after having remained at £200 million per month from March through August.

In the previous expansion (mid-1957 to mid-1961), imports did not begin rising rapidly until early 1959. They reached a peak in the third quarter of 1960--a full year before the upper turning point of July 1961. (See Table 4, page 4a.) In the period from early 1959 to third quarter 1960, there was a 30 per cent growth in fuel and industrial materials imports. In September 1963, this expansion-sensitive category of imports rose sharply to 14 per cent above the low-level plateau persisting through 1962. Imports of finished manufactures, while relatively small, expanded by 76 per cent from 1958 through the third quarter of 1960. Part of this import growth was a spill-over of inflated domestic demand; but part was a consequence of removing import controls. This cause of additional imports is not likely to be repeated.

1/ The Economist (November 2, 1963, page 494), estimates the third quarter trade deficit (on an f.o.b. basis) at £30 million, compared with the deficit of £9 million in the third quarter. (See Table 5, page 6a.)

<u>Balance of payments: second quarter</u>. The full balance of payments figures for the second quarter reveal a reversal of the short-term capital outflow which took place in the first quarter. (See Table 5, page 6a.) The detailed figures also reveal two features of the second quarter which had not been known previously: (1) The balance of goods, services and transfer payments remained in surplus despite a deterioration of the trade balance; and (2) central banks of non-sterling countries drew down their sterling holdings. This adverse effect on reserves was completely offset by a substantial surplus of outer sterling area countries with the rest of the world, amounting to £123 million in the second quarter and to £216 million in the first half of 1963 as a whole (see Table 6, page 6b)--a figure comparable to that for entire year 1961 and 1962. Whether this surplus has continued into the third quarter is not known, but available reserve data for July and August suggest that it is quite possible. Non-sterling long-term investment in the outer sterling area seems to be an important support to the current stability of the pound.

<u>Short-term interest differentials</u>. The U.S. balance of payments measures taken in July have reduced the interest differentials in favor of the United Kingdom. The rise in the U.S. bill rate has lowered the uncovered 3-month Treasury bill differential from 0.68 per cent per annum in favor of the United Kingdom on May 17 to 0.18 per cent per annum on October 25. (See Table 7, page 6c.) However, a steady decline in the forward discount on sterling brought a small covered advantage in favor of the U.S. bill in October.

Table 5. United Kingdom: Balance of Payments, Semi-Annually 1961-June 1963
(in millions of pounds)

	1961		1962		1963		
	Jan.-June	July-Dec.	Jan.-June	July-Dec.	Jan.-June	1st Qtr.	2nd Qtr.
A. GOODS, SERVICES AND TRANSFER PAYMENTS							
Seasonally adjusted:							
Exports, f.o.b.	1940	1943	1981	2010	2086	1029	1057
Imports, f.o.b.	2058	1955	1999	2060	2077	1011	1066
Trade balance	-118	- 12	- 18	- 50	9	18	- 9
Services and transfer payments	52	44	77	65	80	46	34
Total, seasonally adjusted	- 66	32	59	15	89	64	25
Seasonal influences	32	-32	39	- 39	55	11	44
Total	- 34	--	98	- 24	144	75	69
B. LONG-TERM CAPITAL	a/- 61	a/25	6	b/- 66	c/- 85	- 67	- 18
C. PRIVATE SHORT-TERM CAPITAL							
Sterling liabilities to foreign private:							
Sterling area	51	34	51	34	28	- 1	29
Other	a/-454	a/ 23	- 36	12	- 81	- 95	14
Miscellaneous	a/- 49	a/-13	84	31	- 22	d/- 5	d/- 17
Total	-452	44	99	77	- 75	-101	26
D. NET ERRORS AND OMISSIONS	- 8	16	78	37	- 21	12	- 33
SURPLUS OR DEFICIT (-)	-555	85	259	24	- 37	- 81	44
E. EXTRAORDINARY AID RECEIVED	a/368	a/-278	--	--	--	d/89	d/- 89
F. STERLING LIABILITIES TO FOREIGN OFFICIAL							
Sterling area	68	--	1	- 42	c/ 87	42	45
Other	a/-31	a/- 1	- 38	- 9	c/- 85	- 47	- 39
G. RESERVE MOVEMENTS (INCREASE -)							
Drawing Rights at IMF	-15	389	-181	-198	2	--	3
Gold and foreign exchange	165	-195	- 41	225	33	- 3	36
Total	555	- 85	-259	- 24	37	81	44

Source: U.K. Central Statistical Office, *Economic Trends*, September 1963. Data have been rearranged by Federal Reserve Board staff. No sign indicates credit; minus sign debit.

a/ Basle aid transactions included in Extraordinary Aid (see: Bank of England, *Quarterly Bulletin*, September 1961). See also note b. b/ Long-term capital in the second half of 1961 and 1962 includes subscription to IDA (-9) net of increases in sterling liabilities to IDA (8). c/ Figures are not entirely comparable with those for earlier periods mainly because some long-term securities have been re-classified from sterling liabilities to long-term capital. d/ Assistance received from continental central banks is classified here as Extraordinary Aid.

Table 6. Overseas Sterling Area Consolidated Balance of Payments
1960 - June 1963
(In millions of pounds)

	1960	1961	1962	Jan. - June 1962	Jan. - June 1963
A. TRANSACTIONS WITH THE UNITED KINGDOM					
Current balance	-359	-285	-217	-92	-134
Long-term capital (net)	221	208	166	103	112
Errors and omissions	-126	23	42	6	- 11
Short-term capital	- 6	31	- 4	- 5	10
Total	-270	- 23	- 13	12	- 23
B. TRANSACTIONS WITH NON-STERLING AREAS					
Current balance	-373	-157	-171	- 1	- 53
Long-term capital	416	350	421	182	285
Other capital	15	- 4	- 12	- 24	- 16
Total	58	189	238	157	216
C. SURPLUS OR DEFICIT(-)	-212	166	225	169	193
D. RESERVE MOVEMENTS (Increase-)					
Drawing rights at IMF	- 32	104	- 67	- 74	- 20
Sterling assets	226	-153	- 44	- 52	-115
Gold and non-sterling assets	18	-117	-114	- 43	- 58
Total	212	-166	-225	-169	-193

Source: U.K. Central Statistical Office, Economic Trends, September 1963. Data have been rearranged by Federal Reserve Board Staff to facilitate analysis.

Table 7. Short-term U.S. and U.K. Yield Spreads, May-October 1963

(in per cent per annum)

	May 17	July 19	Aug. 16	Sept. 20	October 11	October 25	Nov. 7
TREASURY BILLS (3-mo.)							
United Kingdom	3.56	3.64	3.57	3.62	3.48	3.61	3.63
United States	2.88	2.15	3.31	3.38	3.42	3.43	3.51
Favor U.K.	0.68	0.49	0.26	0.24	0.06	+0.18	+0.12
3-mo. £ discount (-)	-0.68	-0.28	-0.22	-0.05	-0.35	-0.24	-0.18
Net incentive	--	0.21	0.04	0.19	-0.29	-0.06	-0.06
TIME DEPOSITS (3-mo.) *							
Euro-dollar (London)	3.94	4.19	4.12	4.06	4.06	4.12	4.12
C/D (New York) a/	3.16	3.42	3.54	3.70	3.74	3.83	3.83
Favor U.K.	0.78	0.77	0.58	0.36	0.32	0.29	0.29
Local authorities (London), fully hedged	3.75	4.01	3.95	4.01	3.77	3.95	n.a.

* Data for previous Wednesdays.

a/ Prime negotiable certificates of time deposits.

The Bank of England has resisted market pressures to lower the British bill rate. The discount houses were forced to borrow heavily from the Bank in the week following auctions in which they bid down the bill rate.

The differential between Euro-dollar deposits over yields on 3-month negotiable certificates of time deposits in New York has been steadily eroded, as the C/D rate has climbed continuously while the Euro-dollar rate has remained close to 4 per cent per annum. (See Table 7, page 6c.) Also, in mid-October, the C/D rate has risen close to the local authorities deposit yield (adjusted for forward cover).

<u>Domestic demand bouyant</u>

Industrial production rose at a quickening pace in the summer months. The average rate of increase expressed at an annual growth rate from the previous economic cycle peak of mid-1961 has been accelerating. Steel production in October was about 88 per cent of capacity. Labor market conditions remain relatively easy, even after the number of workers on short-time had been reduced to a level usually associated with full employment. The ratio of unemployed workers to unfilled vacancies, which stood at 0.96 at the peak of the previous economic cycle (mid-1961), had been reduced from 4.38 in the first quarter of 1963 to only 2.79 in September, the same ratio that existed in August 1962; the ratio fell to 2.58[1/] in October, probably reflecting a further rise in industrial production in September. (See Table 8, page 7a.)

While exports continue to spark demand, the basis of the expansion in output has broadened. Personal consumption expenditure is growing: the retail sales value index jumped three points in August to 110, and it remained at this level in September. (Commentators had thought that the jump in August sales would be at least in part at the

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1/ Seasonal adjustment estimated.

Table 8. United Kingdom: Recent Economic Indicators
(Month or monthly average)

		1961 July-Sept.	1962 July-Sept.	1963 Jan.-Mar.	1963 Apr.-June	1963 June	1963 July	1963 Aug.	1963 Sept.
LABOR MARKET									
Workers on short-time (ths)	a/	46	81	153	86	68	40	40	
Ratio unemployed to unfilled vacancies*	a/	1.13	2.69	4.38	3.19	3.14	3.02	2.98	2.79
PRODUCTION AND DEMAND									
Industrial production* (1958=100)		115	116	113	117	118	120	121	
Steel production* (th.tons, wkly av.)	b/	370	405	398	413	415	428	461	465
Retail sales* (1961=100)		101	105	105	106	105	107	110	110
Exports* (£ mn.)		309	320	326	335	345	339	351	348
NEW ORDERS									
Engineering industries (1958=100)									
Export		116	118	122	144	132	139	139	
Domestic		110	113	136	137	142	122	126	
Industrial building authorizations (mn. sq. ft.)		12.2	9.0	9.1	9.9		→	9.4	←
FINANCE									
London clearing banks									
Net advances* (monthly chg.; £ mn.)		-29	+38	+40	+30	--	+32	+63	c/ +30
Liquidity ratio		33.4	33.3	32.2	30.9	31.6	31.4	31.4	32.1
New installment credit (1957=100)									
Household goods shops		109	115	97	109	111	122	114	
Finance houses		160	146	132	182	169	189	162	

*Seasonally adjusted data.

a/ At the industrial production peak in June-July 1961 the ratio of unemployed workers to unfilled vacancies was .96; number of workers on short-time was 35,000.

b/ Not seasonally adjusted; comparable figure for the third quarter 1962: 365.

c/ Estimated by *The Economist*.

expense of September.) Government expenditure, which had remained steady for the first half of this year, began to show the effect of the budgeted increases in late summer. Private fixed capital formation turned up in the second quarter of the year and is expected to continue rising into 1964. The September survey of industrial trends conducted by the Federation of British Industries suggests, for the first time since June 1960, that the number of respondents expecting to authorize more expenditure in the coming year outnumber those expecting to authorize less.

Table 9. United Kingdom: Prices and Wages

	Weekly Wage Rates	Retail Prices	Wholesale Prices: Home Mkt. Sales	Export Prices	Import Prices	Terms of Trade
	(1958=100)			(1961=100)		
1960-Dec.	107	103	103	a/ 100	a/ 101	a/ 99
1961-Dec.	111	107	106	101	100	102
1962-Mar.	112	108	107	101	99	102
June	113	111	107	101	100	101
Sept.	115	109	107	102	100	102
Dec.	116	110	108	104	100	102
1963-Jan.	116	111	108	102	101	101
Feb.	116	112	108	103	102	101
Mar.	116	112	108	103	102	101
Apr.	117	112	108	103	102	101
May	117	112	108	103	103	100
June	118	112	108	104	104	99
July	118	111	108	104	103	101
Aug.	118	111	108	104	103	102
Sept.	n. a.	n. a.	108	n. a.	n. a.	n. a.

a/ January 1961.

As of September, there was still some margin of idle capacity available for servicing further additional increases in demand, according to the September survey. The percentage of firms reporting an increase in output rose only from 17 to 29 per cent between the June and September surveys. The main limitation to further expansion of output is still lack of orders (as contrasted with shortages of skilled labor) according to 65 per cent of the respondents to the survey.

Wholesale prices continued unchanged since the end of 1962 (see Table 9). The retail prices index and the import price index fell in the summer, reflecting a reduction in the cost of food, which had been responsible for a one point rise in the index earlier this year. Britain has been insulated from the rise in world sugar prices, as the bulk of British sugar imports are purchased under long-term contract under the Commonwealth Sugar Agreement. A slight rise in export prices has moved the terms of trade fractionally in Britain's favor.

Continued ease in monetary policy

The banking system has been under some pressure for liquidity after advances increased substantially during the summer months. to finance business and consumption spending. The Bank of England has informed the banks that until April 1964 they need to maintain a liquidity ratio of only 28 per cent instead of the customary 30 per cent. This will permit an additional expansion of loans of roughly £350 million. The liquidity requirement had been reduced to 29 per cent in the early spring months when the banks experienced unexpectedly heavy demands for loans--partly due to the bad winter. Lord Cromer indicated that the banks will be permitted to move towards a normal liquidity ratio of less than 30 per cent, but it is believed unlikely that the liquidity requirement will be reduced to 25 per cent as has been rumored in the financial press.

Interest rates on government bonds have, on the whole, changed very little from early July through mid-October. There was some decline in medium-dated yields, but long-term rates were held up by the surge during July and early October. The Financial Times' industrial common stock price index, which had sagged in September, rose rapidly in the first half of October to 344.8 in response to the encouraging economic news, only 6 per cent below the all-time high of 365.7 reached on May 15, 1961.

As was expected, the Treasury announced that local governments are being requested to restrict their short-term borrowing: loans for one year or less may not exceed 20 per cent of a local authority's total indebtedness, and loans for three months or less may not exceed 15 per cent. In turn, local governments will be permitted to borrow once again from the Public Works Loan Board. Ultimately, they will be able to secure half of their long-term capital requirements through the Public Works Loan Board. This move will limit the growth of the parallel money market, which has been beyond the control of the monetary authorities,1/ but the national government's total borrowing requirements will be increased from about £200 million to around £500 million per year. Difficulty in raising such large sums several years ago had prompted the Treasury to restrict the local authorities' access to the Public Works Loan Board.

1/In March 1962, when the Bank of England reduced bank rate from 5 to 4-1/2 per cent in an effort to reduce the inflow of foreign short-term capital, 3-month local authorities deposits continued to yield a substantial fully-hedged premium over Euro-dollar deposits.