L.5.2 RFD 537

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

April 20, 1965

Recent Economic Developments in the United Kingdom:
January-April 1965

25 pages

David G. Hayes

April 20, 1965

David G. Hayes

Recent Economic Developments in the United Kingdom: January-April 1965

Summary

During the last quarter of 1964 and the early months of 1965, business activity in the United Kingdom rose sharply.[1/] An upturn in exports and consumer spending provided the stimulus for renewed expansion: in addition, total fixed capital spending continued to rise and inventory investment remained at a high level. Between September (1964) and January, industrial output rose nearly 5 per cent. The increase in domestic demand was not met with heavier purchases from abroad; in fact, there was some improvement in the trade balance. However, there was still a substantial deficit on current and long-term capital account for the fourth quarter of 1964; for much of the period under review, the pound remained weak in foreign exchange markets.

Against the background of rising domestic spending and weakness in the foreign exchange market, the budget for fiscal 1965/66, presented on April 6, was designed to strengthen Britain's external position. Its main features may be grouped under three headings:

(1) measures to restrict consumer spending;

(2) measures to reform corporate taxation; and

(3) measures to reduce the outflow of capital.

Full details of the budget are set forth in Appendix I on page 23.

1/ For a review of earlier developments, see "Recent Economic Developments in the United Kingdom: October 1964 to January 1965" dated January 19, 1965.

The budget program was greeted with conflicting criticism: some argued it was too tight; others, that it was too lax. Those who argued that the budget was overly restrictive point out that the November (1964) and April budgets combined will withdraw £450 million directly from domestic spending: £213 million due to the income and petrol tax increases announced last November; £164 million due to the April tax measures; £32 million due to an increase in postal charges; and £35 million due to the government's cancellation of the TSR-2 airplane contract.

By contrast, those who argue the budget is not tight enough note that, despite a projected "above-the-line" surplus of £544 million, the overall deficit is £724 million--nearly twice last year's actual outturn. (See Table 1.) Part of the large increase in the financing requirement reflects the government's intention to transfer some of the borrowing by local authorities from the market to the Treasury (the Public Works Loan Board). But in addition, a large increase in loans to the nationalized industries is to take place over the next twelve months.

All of the restrictive fiscal actions taken thus far are intended to reinforce the deflationary monetary measures adopted earlier by the British authorities--the 7 per cent Bank rate and the credit squeeze. The fiscal measures are particularly designed to reduce consumer rather than investment spending. Last year a more limited set of similar steps was directed to this objective.

Table 1. The British Budget: 1964-65; 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 expenditure	7,792	7,713	8,482	8,482
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 the measures announced in November, 1964 budget.

The slowdown in business activity during the major part of 1964 reflected in part the increased taxes on alcoholic beverages and tobacco provided in the budget for fiscal 1964/65. The growth of consumer spending was checked during the second and to some extent the third quarters of 1964 while spending in fixed capital continued to rise. Throughout 1964, in fact, fixed capital expenditures was the only element in domestic demand that rose continuously.

Aggregate output still rising

During the last quarter of 1964, there was a sharp increase in the rate of industrial output in the United Kingdom which carried over into the early months of 1965. Between September 1964 and February 1965, the index of industrial production increased sharply from 127 to 132. (See Table 2.) This new rise is in marked contrast to the first nine months of 1964 when the index remained static at 127.

Expansion in the rate of output in the last quarter of 1964 was widespread among industrial sub-groups. During the January-September period, only a very few industries (food, chemicals, bricks, and construction) showed output gains; for the others, output was either unchanged or slightly downward. In the fourth quarter, by contrast, all major industrial groups registered output gains with the exception of textiles. (See Table 3.)

Two factors appear to be responsible for this fourth quarter increase in industrial activity: (1) an increase in aggregate demand; and (2) a breakthrough in some supply bottlenecks. On the demand side,

Table 2. United Kingdom: Selected Economic Indicators, 1964-1965
(monthly average or monthly)

	1964 I	1964 II	1964 III	1964 IV	1964 Nov.	1964 Dec.	1965 Jan.	1965 Feb.
Index of industrial production	127	127	127	131	131	132	133	132
Volume index of retail trade	105	105	106	107	107	106	108	108
Export volume index	113	111	109	113	111	119	111	118
Import volume index	117	120	120	119	121	120	116	110
Gross fixed capital expenditures a/ (£ million)	1264	1294	1329	1372	--	--	--	--
Inventory investment a/ (£ million)	88	153	119	123	--	--	--	--
Consumer spending a/	4682	4617	4676	4732	--	--	--	--
G.D.P. (£ million) a/	6126	6156	6190	6326	--	--	--	--
Unemployment rate	2.1	1.5	1.5	1.5	1.5	1.5	1.6	1.6

a/ Quarterly data in 1958 prices. (Gross fixed capital adjusted for transfer costs.)
Sources: Monthly Digest of Statistics and Economic Report 1964.
Note: All series seasonally adjusted except unemployment rate.

Table 3. United Kingdom: Seasonally-Adjusted Indices of Industrial Output, 1964
(1958=100; monthly or monthly averages)

	I	II	III	IV	Oct.	Nov.	Dec.
Total: all industries	127	127	127	131	129	131	132
Mining	97	95	95	96	94	95	97
Manufacturing	128	128	128	133	130	132	133
Food	116	116	119	n.a.	119	121	n.a.
Chemicals and allied industries	133	133	135	139	138	145	136
Engineering and allied industries	126	127	125	132	130	131	134
Metals	124	129	125	131	131	132	130
Textiles	120	118	118	118	120	118	117
Bricks	144	145	152	154	152	152	158
Timber	130	125	123	131	123	131	140
Paper, etc.	140	137	139	137	139	139	135
Other	135	134	137	n.a.	n.a.	n.a.	n.a.
Construction	133	135	136	n.a.	n.a.	n.a.	n.a.
Gas, electricity and water	134	132	133	141	142	139	141

Note: All series seasonally adjusted.

Source: Monthly Digest of Statistics.

spending for fixed capital continued to rise and remained the main expansionary force in the economy throughout the entire year. In addition, there was a sharp increase in inventory investment and consumer spending. (See Table 2.) On the supply side, there was a noticeable increase in average productivity, a decrease in total working days lost due to industrial stoppages and an increase in the number of overtime hours worked. (See Table 4.)

Exports also expanded in the fourth quarter: the volume index rose from 109 for the third quarter to 113 for the last three months of the year. There is some reason to believe that this represented an increase in foreign demand as well as the completion of complex types of equipment for export delivery. During the first nine months of 1964, output in the engineering and allied industries sector declined slightly as did the export volume of similar goods (machinery and transport goods). But, during the fourth quarter, output in the engineering industries expanded sharply (about 7 per cent) as did the export volume of machinery and transport goods (about 8 per cent). There has been no appreciable quarter-to-quarter change in the ratio of export deliveries to home deliveries for the engineering industries: it fluctuated narrowly around 1.00.

The fourth quarter rise in aggregate demand did not bring about a further rise in imports. In fact, the import volume index fell slightly in the last three months of the year, and continued to fall in January and February 1965. (See Table 2.) This fall might well have meant a substitution of domestic for foreign goods, in response to the

15 per cent import surcharge, as well as a drawing down of existing inventories. However, the New York dock strike undoubtedly contributed to the February fall.

The downward trend in imports may in part reflect the import surcharge, but is not uniquely tied to it. For example, comparing the first quarter of 1965 with the last quarter of 1964 there was an average 7 per cent reduction in the importation of chemicals, semi-manufactured and fully-manufactured goods--items covered by the surcharge. On the other hand, there were similar declines in food and beverages--goods not covered by the surcharge.

Some of the economic trends established in the last quarter of 1964 continued into the early months of 1965. On the domestic side, output and sales volume continued to grow, Comparing January-February with the last quarter of 1964, industrial production rose 0.8 per cent and retail trade volume 0.9 per cent. On the external side, for the same time period, export volume rose 1 per cent and import volume fell 5 per cent. (See Table 2.)

Labor markets remain tight and other resources hard pressed

Labor shortages, which were prevalent during much of 1964, continued through the first quarter of 1965. In particular, total unemployed as a percentage of the work force (seasonally unadjusted) averaged 1.6 per cent in the first three months of 1965. This compares with 2.1 per cent for the first quarter of 1964 and 1.5 per cent for the last three quarters of that year. Also, there was still only slightly more than one unemployed for each vacancy in the January-March period. (See Table 4.)

Table 4. United Kingdom: Labor Market Indicators, 1964-1965
(monthly or monthly averages)

	1964				1965		
	I	II	III	IV	Jan.	Feb.	March
Total unemployed	465	367	342	348	376	367	372
Actual change a/	-11.3	-32.6	0	- 5.6	+25.7	- 7.4	-14.2
Seasonal change a/	+ 8.0	-25.0	+ 2.0	+15.0	+40.7	+ 2.1	-18.8
Employment vacancies	258	334	357	318	311	326	358
Actual change	+27.8	+23.8	-10.0	- 9.0	- 0.3	+14.0	+32.5
Seasonal change	+ 1.9	+18.6	- 8.3	-12.3	-12.0	- 0.4	+18.4
Ratio of unemployed to vacancies	1.69	1.08	0.95	1.09	1.21	1.12	1.03
Unemployment rate (%)	2.1	1.5	1.5	1.5	1.6	1.6	1.6
Number of overtime hours worked in manufacturing	15.9	16.5	15.9	17.7	--	--	--
Total working days lost due to industrial stoppages (all industries and services)	246	215	169	129	--	--	--
Productivity index	128.5	128.0	127.5	132.0	--	--	--

a/ Excludes school leavers.
Sources: Monthly Digest of Statistics and Economic Report 1964.
Note: All series in thousands except total working days lost. Not seasonally adjusted.

There is reason to believe that the current low levels of unemployment and high levels of vacancies are more than a seasonal phenomenon. In the first quarter of 1965 the actual rise in employment (excluding "school leavers") was much less and the rise in vacancies much more than was to be expected on seasonal grounds. (See Table 4.)

Other evidence of resource shortages comes from the Federation of British Industries' survey of industrial and export trends published in February. It revealed no appreciable easing of the acute shortage of skilled labor. It also indicated that "more firms than ever before are working at full capacity"--59 per cent of 1,067 respondents--and that "shortages of plant capacity and of materials and components . . . are likely to limit output during the next four months" (e.g., at least through May).

Prices and wages still rising

The expansion of aggregate money demand in the fourth quarter of 1964 stimulated further increases in basic price indices. As a result, between end-1963 and end-1964 retail prices rose 4.8 per cent; wholesale prices of manufactures 4.5 per cent; and wage rates 3.8 per cent. During the first two months of 1965, there was no appreciable slackening in the rate of price advances. (See Table 5.)

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

Table 5. United Kingdom: Basic Price Indices, 1963 - 1965

	1963	1964				(%) change	1965	
	Dec.	March	June	Sept.	Dec.	Dec.'63-Dec.'64	Jan.	Feb.
Retail prices	104.2	105.2	107.4	107.8	109.2	4.8	109.5	109.5
Wholesale prices								
Manufactured goods, home market sales	121.0	122.3	124.4	125.5	126.5	4.5	127.3	127.6
Basic materials	106.3	106.3	106.1	107.2	107.9	1.5	107.7	108.3
Wage rates (weekly average)	137.6	138.6	140.0	141.6	142.9	3.8	143.8	144.0
Export prices	105.0	105.0	106.0	107.0	107.0	1.9	107.0	108.0
Import prices	106.0	107.0	106.0	106.0	107.0	.9	108.0	107.0

Source: Monthly Digest of Statistics.

Table 6. United Kingdom: New Borrowing by the Private Sector, 1964 - 1965
(£ million)

	1964				1965			Total outstanding
	I	II	III	IV	Jan.	Feb.	March	March 1965
Bank advances a/	80	95	195	190	-50	-40	+45	4,580
Instalment credit b/	31	57	41	+31	- 2	+10	n.a.	c/1,123
New issues (net) U.K. corporations	175	137	126	71	21	26	40	--
Advances by building societies	227	272	285	273	83	67	64	--

a/ London clearing banks; seasonally adjusted.
b/ Debt owned to finance houses and department stores; not seasonally adjusted.
e/ End February, 1965.

Source: Financial Statistics.

quarter of 1964. Additions to instalment credit and advances by the building societies were 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 6.)

Apart from the change in bank advances, it would appear that this diminution in the rate of new borrowing is more than seasonal. Changes in the rate of instalment credit and new issues were smaller in the first quarter of 1965 than in the first quarter of 1964. Although the increase in advances by the building societies was greater in the first three months of 1965 than during the same period one year ago, the prospects for further increases are limited. Press reports indicate that this latest increase was made by drawing on liquid funds and that these funds could not be reduced further. Further increases will have to be met out of increases in deposits and repayment of the principal on outstanding mortgages.

Money market remains tight

Between January and early April, most money market rates fluctuated around a rising trend, suggesting a continuation of the tight conditions that have prevailed since the early stages of last year's sterling crisis. The only exception is the Treasury bill rate which has trended downward over this period because of special circumstances. (See Table 7.)

The rise in London deposit market rates between February and March owed much to the President's balance of payments message of

Table 7. United Kingdom: Selected Money Market Rates
January - April 1965
(per cent)

	Jan. 8	Feb. 12	March 12	April 2	April 9	April 16
Call money a/	6.38	6.50	6.44	6.31	6.44	n.a.
Local authority deposit rates						
2-day	7.00	7.12	7.68	7.87	8.31	7.31
90-day	7.18	7.18	7.81	7.62	7.75	7.50
Treasury bill 90-day (market yield)	6.44	6.32	6.20	6.35	6.32	6.29
Euro-dollar deposits						
Call	3.88	b/ 4.06	c/ 4.19	4.12	4.12	4.12
90-day	4.50	b/ 4.50	c/ 5.13	4.75	4.75	4.81

a/ Median of a range of rates published in the Financial Times.
b/ February 10, 1965.
c/ March 10, 1965.

February 10 and the announcement of a program designed to moderate the flow of U.S. dollars abroad. Between February 10 and March 10, the important 90-day Euro-dollar rate moved up 63 basis points to 5.13 per cent. After March 10, the rate began to ease and on April 9 was quoted at 4.75 per cent. This easing in the 90-day rate, together with the small February to March rise in the call rate for Euro-dollars, suggests that the strong reaction of the market to the United States program was in anticipation of the squeeze on Euro-dollars rather than in response to an actual squeeze. In the market for long-term dollar bonds, however, the Kingdom of Norway had planned to raise $40 million in the long-term Euro-dollar market but revised its plans in late March due to a shortage of funds: the issue floated totaled $30 million, however.

Local authorities were particularly hard hit by the rise in Euro-dollar rates. They tend to be short of funds in the last month (March) of the British fiscal year and they were forced to compete actively in the deposit market. As a result, between February 12 and March 12, the three-month local authority deposit rate moved up 63 basis points to 7.81 per cent. Since then, this rate has tended to fluctuate widely. However, the general trend has not declined as has the trend in Euro-dollar rates.

The fall in the Treasury bill rate during the January-April period was due to special considerations. Repeated rumors of a decrease in Bank rate and relatively small issues of new bills led the discount houses to raise their bidding price at the weekly tender upon a number of occasions. Consequently, the market rate on bills dropped 24 basis points between January 8 and March 12. (See Table 7.) The Bank of England forced the discount houses to borrow at the penalty rate repeatedly throughout February, March, and early April. It succeeded in moving the bill rate up to 6.35 per cent by March 19 and kept it there until April 9 when the rate moved down to 6.32 per cent.

Security markets give budget mixed reaction

Equity and government bond markets gave the budget a mixed reception. Stock prices fell initially, but rallied later in the week; the price index of 500 industrial shares closed on April 8 about one point higher than the level reached one week earlier. Some bond yields rose on the news that "gilts" would be covered by the capital gains tax. However, by April 8 many yields were unchanged from their previous week levels. (See Table 8.)

In the three months prior to the presentation of the budget, fluctuating trade returns contributed to wide swings in bond yields and equity prices. (See Table 8.) Between March 4 and April 1, budget considerations undoubtedly became dominant; but they affected the bond and stock market in different ways: bond yields rose noticeably, but stock prices eased very slightly. Different attitudes toward the impending capital gains tax probably accounted for this difference in behavior. It had been known for some time that equities would be subject to the tax but the status of government bonds was still uncertain.

Sterling strengthens in response to budget

Sterling has strengthened noticeably in the post-budget period. Between April 2 and April 16, the spot rate climbed 63 points

Table 8. United Kingdom: Selected Capital Market Yields, December 1964 - April 1965

		1964	1965					
		Dec.	Jan.	Feb.		March	April	
		17	14	11	18	4	1	8
Government bonds (per cent)								
5%	1967	6.40	6.52	6.35	6.42	6.37	6.57	6.57
5%	1971	6.43	6.50	6.25	6.40	6.39	6.59	6.65
5-1/2%	1982-84	6.29	6.38	6.39	6.42	6.42	6.53	6.54
5-1/2%	2008-12	6.40	6.47	6.40	6.42	6.42	6.52	6.52
3-1/2%	War Loan	6.46	6.50	6.44	6.47	6.45	6.54	6.54
Stocks								
Price index a/		103.58	106.43	100.77	111.39	107.46	106.68	107.11
Yield b/ (per cent)		5.40	5.26	5.10	5.13	5.35	5.51	5.52

a/ *Financial Times* 500 industrials.
b/ Dividend yield on *Financial Times* 500 industrials.

Sources: Bank of England and *Financial Times*.

to 279.70 (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 16; by April 9 the covered yield on local authorities' deposits was above the yield on Euro-dollars. (See Table 9.)

Between February 19 and March 26, sterling weakened steadily: there were repeated rumors on the Continent of a devaluation of the pound. The spot rate fell 58 points to 278.94 (U.S. cents) and the forward discount widened by 70 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 9.)

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 February 19 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 certificates of deposit. (See Table 9.)

Balance of payments deficit for 1964 set at £745 million

The outturn of the balance of payments for 1964 showed a spectacular deficit on current- and long-term capital account of £745 million. This compares with £78 million for 1963. However, there is one encouraging note. The fourth quarter current-account deficit

Table 9. United Kingdom: Exchange Rates and Arbitrage Calculations, January - April 1965

	Jan.	Feb.	March		April		
Exchange rates	8	19	5	26	2	9	15
Spot (U.S. cents)	278.97	279.54	279.43	278.96	279.09	279.51	279.72
Forward (per cent per annum)	-2.61	2.55	2.78	3.25	3.02	2.97	2.55
3-month yields and yield spreads							
Treasury bills							
U.K. (covered)	3.83	3.49	3.48	3.13	3.33	3.35	3.74
U.S.	3.77	3.94	3.93	3.89	3.91	3.90	3.91
Differences	+0.06	-0.45	-0.45	-0.76	-0.58	-0.55	-0.17
Deposit rates							
Local authority (covered)	4.57	4.59	5.02	4.57	4.60	4.78	5.12
Euro-dollar	4.50	4.56	4.75	4.88	4.75	4.75	4.81
Differences	+0.07	+0.03	+0.27	-0.31	-0.15	+0.03	+0.32
Euro-dollar a/	4.56	4.50	4.68	4.88	4.75	4.75	4.81
New York C/D a/b/	4.13	4.20	4.25	4.24	4.24	4.26	4.27
Differences	+0.43	+0.30	+0.43	+0.64	+0.51	+0.49	+0.54

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

is almost one-half that for the third quarter, breaking a rising trend that began in the last quarter of 1963. (See Table 10.)

Throughout the year, the current- and long-term capital accounts contributed about equally to the deficit. The budget's new export incentives and incomes policy attempt to deal with the current account, the exchange control measures with the capital account.

Although the balance of payments problem was acute throughout 1964, the impact on reserves was concentrated in the fourth quarter, after the election. In those three months, "net reserves" fell by £541 million compared with a £136 million fall in the July-September period. To meet its balance of payments commitments, the United Kingdom drew down its official reserves by £80 million, borrowed £357 million from the I.M.F. and utilized £145 million of central bank credits. (See Table 11.)

One factor that accentuated the fourth-quarter difficulties was the £175 million short-fall in the amount of sterling liabilities held by the sterling area. These liabilities had risen steadily throughout 1963 and the first half of 1964. (See Table 11.)

Improved trade returns for first quarter of 1965

The higher level of exports and lower level of imports which materialized in the last quarter of 1964 were maintained in the first quarter of 1965. In fact, monthly trade deficits on a seasonally-adjusted balance of payments basis narrowed significantly: £43 million in the first quarter of 1965 compared to £127 million for the last quarter of 1964. (See Table 12.) The impact of the surcharge is

Table 10. United Kingdom: Balance of Payments, 1963 - 1964
(£ million)

	1963 I	1963 II	1963 III	1963 IV	1964 I	1964 II	1964 III	1964 IV
A. Current account								
Imports	1,049	1,075	1,084	1,159	1,252	1,261	1,221	1,290
Exports and re-exports	1,057	1,087	1,017	1,126	1,126	1,153	1,030	1,162
Visible balance	+ 8	+ 12	- 67	- 33	- 126	- 108	- 191	- 128
Invisible balance	+ 74	+ 52	+ 24	+ 26	+ 72	+ 48	+ 9	+ 50
Current balance	+ 82	+ 64	- 43	- 7	- 54	- 60	- 182	- 78
B. Long-term capital	- 67	- 15	- 35	- 57	- 86	- 114	- 69	- 102
C. Current and long-term capital account	+ 15	+ 49	- 78	- 64	- 140	- 174	- 251	- 180
D. Short-term capital	- 27	- 92	+ 40	+ 27	+ 10	+ 150	+ 96	- 114
E. Balancing item	+ 11	- 30	+ 4	- 58	+ 45	+ 17	+ 11	- 72
F. Overall balance	- 1	- 73	- 34	- 95	- 85	- 7	- 144	- 366
G. Net reserves	- 41	- 1	- 10	+ 85	+ 34	- 65	+ 136	+ 541
H. Sterling liabilities to sterling area	+ 42	+ 74	+ 44	+ 10	+ 51	+ 72	+ 8	- 175

Source: Board of Trade.

Table 11. United Kingdom: Net Reserves and Central Bank Aid, 1964
(£ million)

	I	II	III	IV
A. Gold and foreign exchange				
Gold	+ 9	+ 7	+49	+59
Foreign exchange	-10	-23	+10	+21
Total	- 1	-16	+59	+80
B. I.M.F. position				
Drawings	--	--	--	+357
Other	--	- 1	+ 1	+ 2
Total	--	- 1	+ 1	+359
C. Sterling liabilities to non-sterling are "official"				
Official aid	--	+ 5	+66	+145
Non-£ currency deposits	--	--	(+59)	(+13)
Swaps	--	(+ 5)	(+ 7)	(+132)
Ordinary transactions	+35	-53	+10	-43
Total	+35	-48	+76	+102
D. Net reserves	+34	-65	+136	+541

Source: Board of Trade.
Note: Assets: increase (-) decrease (+); liabilities; increase(+) decrease (-).

difficult to judge, especially because of the U.S. dock strike. However, the Board of Trade has pointed out that, comparing the first quarter of 1965 with the last quarter of 1964, imports of chemicals were down 7 per cent and semi-manufactures down 5 per cent. Imports of finished manufactures (goods which were reported to be particularly affected by the dock strike) were off by 7 per cent.

Table 12. United Kingdom: Foreign Trade 1964-1965
(£ million; seasonally adjusted)

	1964				1965		
	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
Imports (c.i.f.)	487	472	487	476	465	440	468
Exports (f.o.b.)	358	365	369	396	368	390	389
Re-exports (f.o.b.)	14	12	14	13	14	14	13
Surplus/Deficit					-83	-36	-68
Trade balance	-67	-52	-56	-19	-34	+11	-19

Foreign exchange position shows little change in first quarter of 1965

Britain's gold and foreign exchange reserves rose by about $10 million in the first quarter of 1965, but all of the rise was concentrated in the month of February. In fact reserves fell in January and again in March. However, the $64.4 million increase in February more than offset these downturns. (See Table 13.)

Table 13. United Kingdom: Foreign Exchange; January-March, 1965

	Jan.	Feb.	Mar.	Total Outstanding March 31, 1965
Gold and foreign exchange	-16.8	+64.4	-33.6	2329.6

APPENDIX I

Summary of the 1965/66 British Budget and Related Measures

I. Measures to restrict demand

1. Income tax (announced last November)--Rate up 6d, on the pound, £122 million.

2. Custom on excises on tobacco and alcoholic beverages--Tobacco, £74 million in 1965/66 and £75 million in 1966/67. Alcoholic beverages, £49 million in 1965/66 and £52 million in 1966/67.

3. Motor vehicle duties--Higher licensing fees, £48 million in 1965/66 and £54 million in 1966/67.

4. Postal Charges--Higher postal rates, £32 million in 1965/66.

5. Capital gains tax--

    a. Short-term gains--No change in existing statutes.

    b. Long-term gains (assets held more than a year)--Individuals to pay 30 per cent, companies 35 per cent--eventual revenue to reach £125 million a year.

6. Cancellation of TSR-2 project--Estimated saving, £35 million.

II. Measures to reform corporate taxation

1. Internal aspects:

    a. Corporations--Under the new system, a single tax: the rate will be set later somewhere between 35 and 40 per cent. (Currently, companies are subject to both the income tax and a profits tax).

    b. Dividends to companies--These dividends will not be subject to corporation tax.

    c. Dividends to individuals--These will be subject to income tax. Under old system, income tax paid by companies satisfied the income tax liability of shareholders on dividends received.

2. <u>External aspects</u> (will benefit the balance of payments by an estimated £100 million when tax becomes fully operative)

    a. <u>Overseas Trading Corporations</u>--These comapnies will be subject to corporation tax. Currently they are not subject to profits tax and enjoy special privileges under income tax.

    b. <u>Dividends to non-nationals</u>--The government plans to renegotiate those double taxation agreements which it thinks, "unreasonably restricts /its/ right to deduct tax from dividends going overseas."

    c. <u>Dividend income from overseas companies</u>--The government plans to renegotiate its double taxation agreements with the intent of raising the effective rate of tax on dividend income from overseas corporations. Under current arrangements, the effective rate of tax on this source of income is, in many instances, lower than the rate of tax on dividends from U.K. companies to U.K. residents.

III. <u>Measures to limit capital outflow</u> (will benefit the balance of payments by £100 million in 1965).

1. <u>Conversion of foreign currency earnings</u>--25 per cent of all earnings from the sale of foreign securities or direct investments are to be converted into sterling at the official rate.

2. <u>Direct investment abroad</u>--stiffer criteria for obtaining official exchange for direct investment abroad.

3. <u>Investment currency market</u>--foreign currency receipts from selected sources can no longer be disposed of in the investment currency market. They must be converted at the official rate.

4. <u>Creation of property currency market</u>--proceeds from the sale of houses and similar property in other countries will be earmarked as "property" currency. Only such earmarked currency will be available for the purchase of houses or similar property abroad.

5. <u>Travel expenditures</u>--the government will require more rigorous reporting of overseas travel expenditures.

6. <u>Payments for exports</u>--the government is intensifying its sampling of exporters to assure that payments for exports are made in the required six months time. (This requirement was established by the Exchange Control Act of 1947.)

On April 9, separate from the budget, the government announced certain improvements in the amount of financial credits and guarantees extended to U.K. exporters. These were:

(1) an increase in the standard minimum percentage of insurance cover provided by the Export Credits Guarantee Department from 85 to 90 per cent;

(2) an extension in the system of guaranteed bank loans carrying a fixed interest rate of 5-1/2 per cent from credits of three years and over to credits of two years and over;

(3) a 50 per cent reduction in the charge for the bank guarantee; and

(4) an increase in the proportion of the total credit normally covered by the bank guarantee from 90 to 100 per cent.

On the same day, the government also published a white paper setting out 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 permitted to increase more than 3-1/2 per cent a year. The rule will not be applied indiscriminately to all prices and incomes because the paper deals at length with exceptions justified on social and economic grounds. The Board's terms of reference are quite broad and it can examine any question referred to it by the government relating to: (1) "prices charged for goods or for the application of a process to goods or for services"; (2) "claims, settlements or questions relating to pay or other conditions of service of employment"; and (3) "questions relating to other money incomes."