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August 10, 1966

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Recent Economic Developments in the United Kingdom: April-July 1966.

26 pages

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Summary

In early July the British authorities responded to mounting pressures against the pound in the foreign-exchange market with additional restrictive credit measures; but a further worsening of confidence was followed on July 20 by a package of fiscal measures to withdraw some £500 million from domestic spending.[1] In addition, the government introduced, for the first time in history, a "voluntary" standstill on price and wage increases for a six-month period, and a freeze on dividends for a twelve-month period. On the external side, spending abroad is to be cut by £150 million a year.[2]

The sweeping nature of this program reflected both the gravity of the pressures on the pound in mid-July and the decision of the Labor Government to demonstrate to the world an unqualified determination to defend and maintain the par value of the pound, even at the risk of a significant turn-down in business activity in Britain. As a result of the measures, the British authorities announced that they were revising the National Plan (released last September) which had set as a goal a 25 per cent growth in the economy from 1966 to 1970 because the anticipated rate of growth was no longer feasible.

1/ In the "regular" budget for 1966-67, introduced on May 3, the Chancellor proposed to withdraw some £360 million from current spending.

2/ For a synopsis of the July 1966 measures, see Appendix I, pp. 24-25 For a review of earlier developments see, "Recent Economic Developments in the United Kingdom: January-April 1966", dated April 22, 1966.

The speculative attack came at a time when trade balance developments were turning against Britain. This unexpected worsening of Britain's external position two months after the Chancellor's "regular" budget decisions for 1966-67 was partly the consequence of the 45-day seaman's strike and a rise in the prices of British imports. However, the major factor contributing to this deterioration was the Chancellor's strategy in May to postpone the deflationary impact of the regular budget by not calling for the collections of Selective Employment Tax liabilities until September. The decision not to withdraw purchasing power out of the economy from May to September was, in the Chancellor's words, "a reasonable risk to take" because "the situation was so uncertain at that time."[1/]

The Chancellor's strategy in the budget was based on what has proved to be an unrealistic short-term forecast of consumer spending. On May 3, he had judged that "a good deal of buying by consumers (was) in anticipation of tax increases, and this is likely to be followed by a lull after the Budget."[2/] Retail trade in real terms, which accounts for about 50 per cent of consumer's spending, in April held at the 110 average for the first quarter (1961=100), but rose to 111 in May. (See Table 1.) It is thought to have risen further in June. Hence, the rise in the second quarter may have been almost as rapid as in the first quarter; by contrast, there was no change in retail sales between the first and second quarters of 1965. (See Table 1 and Chart 1.)

1/ Chancellor of the Exchequar Callaghan, The Times, London, July 27, 1966, p.1.
2/ Hansard (Parliamentary Debates), May 3, 1966, column 1442.

Table 1. United Kingdom: Selected Economic Indicators: Volume Basis 1965-1966
(monthly averages, seasonally adjusted 1961=100)

	1965				1966		
	I	II	III	IV	I	April	May
Industrial Production	116	115	116	117	118	118	117
Retail Trade	107	107	108	109	110	110	111
Investment in Manufacturing	106	98	101	100	116	--	--
Exports	115	113	118	121	122	120	122
Imports	114	120	123	122	126	123	127

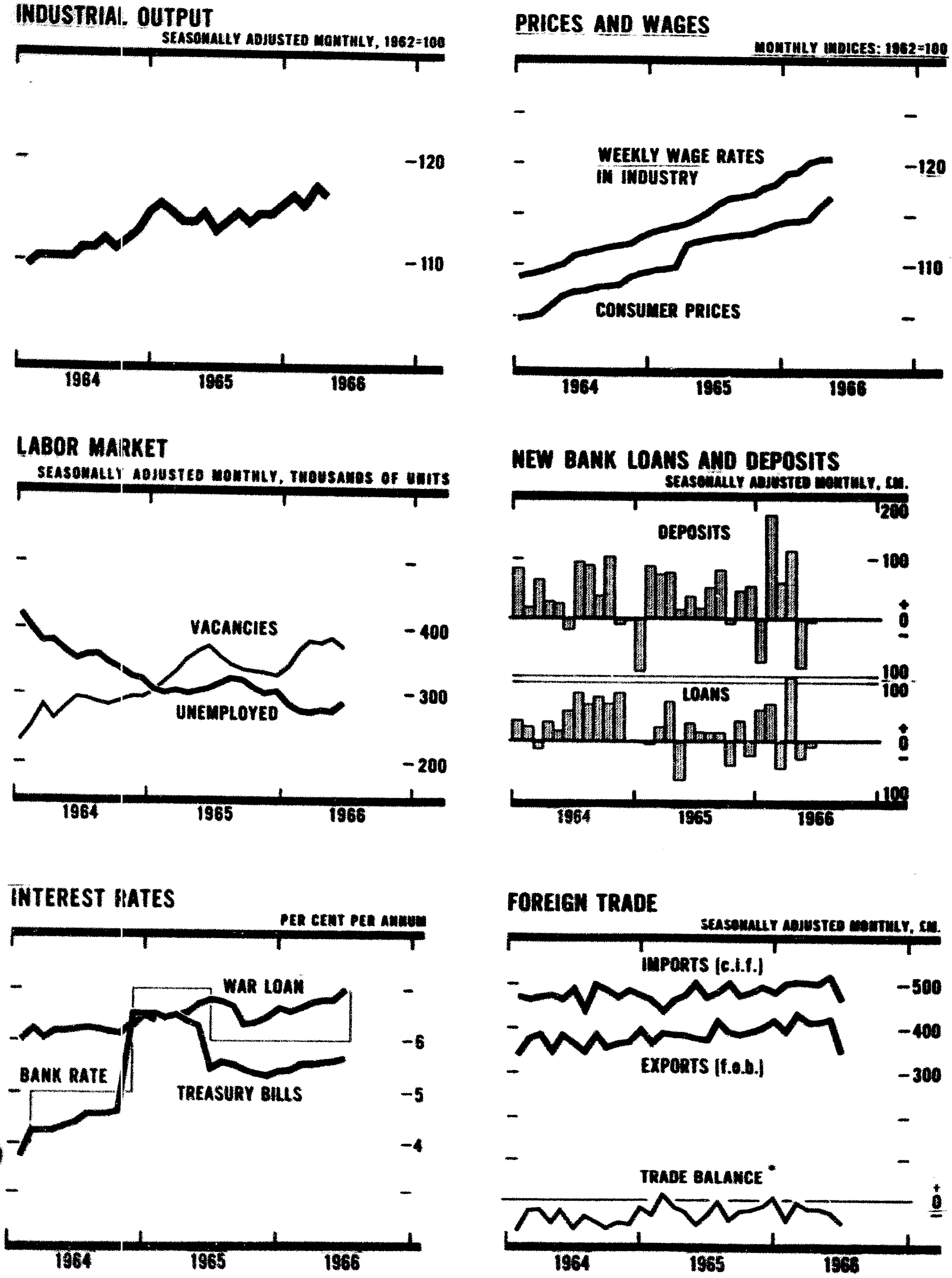
Source: Monthly Digest of Statistics.

The continued expansion in consumer spending this year was undoubtedly related to the 7.9 per cent year-to-year increase in average hourly wages. This rate of wage rises was accompanied by a 4 per cent year-to-year rise in retail prices. (See Chart 1.)

In the midst of the general advances in wages, prices and consumer spending, aggregate output was growing at only a sluggish rate. On an aggregate basis, the rise in gross domestic product in the first quarter of 1966 was 0.7 per cent above the previous quarter and 1.9 per cent higher than a year earlier. At the same time, industrial output in January-March of this year was 0.8 per cent above October-December and 1.5 per cent above the level reached during the same period in 1965. (See Table 1.)

CHART 1

UNITED KINGDOM: MAIN ECONOMIC INDICATORS



* BALANCE OF PAYMENTS BASIS

The slow growth in output has been accompanied by continuing tight labor market conditions. Labor government officials had expected that an easing of labor market pressures and shifts in manpower would follow the earlier restrictive measures introduced in late 1964 and during 1965. However, it would appear that workers have preferred a reduced work-week and more leisure, rather than larger weekly pay packets; as a result, the manpower adjustments expected during 1966 have not been realized.

The absence of substantial gains in total output and of resource shifts into export and import-competing sectors account for the continued large trade deficit during 1966. Even before the seaman's strike, the trade outturn showed hardly any improvement over the 1965 performance. Rising imports have more than matched the continued export gains. (See Table 1.)

The disappointing performance of the British economy during the first half of 1966 contributed to a significant deterioration of confidence in British capital markets. With trading volume at a low level, long-term government bond yields rose as much as 40 basis points between early May and late July when they reached new historic highs. Between late June and the end of July, the price index of equity shares dropped sharply.

Conditions in other credit markets continued mixed. There was little net change in the amount of consumer installment credit outstanding between January and May. Over the first two quarters, bank loans to the private sector grew at about the same pace as during the last half of 1965, but then jumped sharply in July. They now stand at 105 per cent of the March 1965 level and, under the Bank of England's order, no further increase can be made except in response to seasonal factors. Owing to the limited supply of bank loans, business firms have turned to the long-term capital market; in the first half of 1966 they raised two to three times as much new money as during the same period in 1965. Building society mortgage loans have continued to expand rapidly.

On the external side, Britain's balance of payments for the first quarter of 1966 showed little change from the previous year. A slight improvement in the trade account was offset by a modest increase in the outflow of long-term capital. During the second quarter, there was modest deterioration in the trade balance owing largely to the seamen's strike. For the first 6 months of 1966, Britain's trade deficit (seasonally adjusted) was £183 million compared to £146 million for the same period in 1965.

Labor market conditions still tight

The sustained strength of demand pressures in Britain is reflected by the continued tightness of labor market conditions. Over the first 6 months of 1966, the actual level as well as the rate of unemployment dropped steadily. In July actual unemployment rose modestly but not enough to raise the unemployment rate from the 1.1 per cent level reached in June. (See Table 2.)

However, there are some tentative hints of a possible easing in the labor situation. Seasonally adjusted, the level of unemployed has been rising, albeit slowly, since March. (See Table 2.) This movement must be interpreted cautiously, because the seasonally adjusted data showed a similar movement during the same period in 1965.

Table 2. United Kingdom: Labor Market Indicators
1965-1966
(Monthly or monthly averages) a/

	1965	1966 Jan.	Feb.	Mar.	Apr.	May	June	July
Total unemployed								
Actual	328.7	349.6	339.3	314.1	307.3	280.3	261.1	264.0
Seasonally adjusted	310	284	275	272	277	275	288	303
Total vacancies	384.3	346.3	373.1	405.3	432.4	438.5	450.2	454.9
Unemployment rate	1.4	1.5	1.4	1.3	1.3	1.2	1.1	1.1

a/ Unemployed and vacancies data in thousands.
Source: Monthly Digest of Statistics.

Wages and prices still rising strongly

Tight labor market conditions have in turn stimulated further increases in British prices and wages during the period under review. By mid-year, average hourly wage rates were up 7.9 per cent and retail prices 3.9 per cent from year earlier levels. Movements in consumer prices and wages during the first half of 1966 were about the same order of magnitude as a year earlier. (See Table 3.) Part of the increase in retail prices and basic material prices reflects the rise in import prices.

To help moderate the wage-price spiral, the government is seeking a voluntary wage-price standstill backed by statutory authority. The government is now proposing amendments to its Prices and Incomes Bill that will give it statutory authority to halt pay and price increases and to reverse those that have been implemented since July 20. However, labor party officials have stressed that the statutory powers will be used very selectively and that the heaviest emphasis will be given to the voluntary nature of the price wage standstill.

Table 3. United Kingdom: Base Price Indicies 1965-1966
(January 1, 1962=100)

	Retail Prices	Wholesale Prices: Basic Materials	Wholesale Prices: All Manuf. Products	Hourly Wage Rates	Export Prices	Import Prices
Indicies						
1965						
I	109.9	106.0	108.6	116.0	108	105
II	112.7	105.5	110.3	118.0	108	105
III	113.0	105.4	110.8	120.3	109	104
IV	114.1	106.9	111.1	122.1	109	105
1966						
Jan.	114.3	108.3	111.5	123.9	110	105
Feb.	114.4	108.7	111.7	124.2	111	106
Mar.	114.6	108.6	112.3	125.7	112	107
Apr.	116.0	110.3	112.6	126.0	112	108
May	116.8	110.8	112.9	126.0	112	108
June	117.1	110.8	112.9	n.a.	n.a.	n.a.
Per Cent Change from Previous Quarter to:						
1965						
I	0.6	- 0.2	1.1	3.7	1.0	0
II	2.6	- 0.5	1.6	1.8	0	0
III	0.3	- 0.1	0.5	1.9	0.9	-1.0
IV	1.0	1.4	0.3	1.5	0	1.0
1966						
I	0.4	1.6	1.1	3.0	1.8	1.0
II	2.2	2.1	0.5	1.5[a]	0.9[a]	1.0[a]

a/ Through May.
Source: Monthly Digest of Statistics.

Under the voluntary plan proposed by the government, price and wage increases are not to take place before the end of the year and severe restraint is to be exercised between December 1966 and June 1967. There are certain exceptions to this general rule. The standstill is not to apply to price rises that result from: 1) higher costs of imported goods;

2) seasonal factors; and 3) increased indirect taxes. Nor does it apply to wage increases occasioned by: 1) more overtime hours or piece work earnings; 2) promotions; and 3) increases associated with age.

Credit trends still mixed

The mixed nature of credit trends in Britain makes it extremely difficult to judge how effective the government's tight money policy has been in keeping the amount of excess demand below what it might otherwise have been. Over the first 6 months of 1966, the expansion of bank loans was larger than a year earlier, but the banks still had some leeway before reaching the Bank of England's ceiling of 105 per cent of the March 1965 level. Consumer installment credit outstanding fell further in the first quarter, owing largely to restrictive actions taken earlier, but rose slightly in April and May. In contrast, net corporate issues and building society loans grew sharply. (See Table 4.)

Data on the British money supply are available for only the first quarter of 1966. They show a decline of £99 million compared to a £232 million drop for the first quarter of 1965. (See Table 4.) Despite the first quarter decline in 1965, Britain's money supply rose by 7.7 per cent between December 1964 and December 1965. This was largely due to a large government financing requirement. Since the government financing requirement for 1966/67 is not expected to be nearly as large as it was in 1965, the money supply is not expected to show much of an increase in 1966.

Table 4. United Kingdom: Changes in Money and Credit
1965-1966
(£ millions)

	1965				1966		
	I	II	III	IV	I	II	July
Bank Loans							
Actual	174	-12	-30	-249	243	-12	116
Seasonally Adjusted	- 36	12	54	75	69	69	78
Building Society Mortgage Loans	234	219	219	294	297	345	n.a.
Consumer Credit	24	54	10	- 6	-11	12 a/	n.a.
Net Issues by U.K. Corporations	87	93	135	147	252	138	n.a.
Money Supply							
Currency	- 47	77	59	106	- 1	n.a.	n.a.
Deposits	-185	387	122	396	-98	n.a.	n.a.
Total	-232	464	181	502	-99	n.a.	n.a.

a/ April-May average.
Source: Financial Statistics.

In the first half of 1966, net new issues by U.K. corporations were much larger than during the same period last year. The greater part of these issues were in the form of bonds rather than equities despite the fact that firms had to pay between 7.00 and 7.50 per cent for new money. This development is largely explained by the fact that under the new corporation tax interest payments but not dividend payments are deductable in the computation of taxable income.

The flow of building society mortgage loans is also much greater this year than in 1965. (See Table 4.) The societies have been able to satisfy the huge demand for mortgage money because the inflow of new funds, which began in June 1965 when the societies raised their deposit rates, has continued to date. However, the societies profit margins were under pressure for lending rates were not raised at the time deposit rates were increased. Finally, on May 19, 1966, lending rates were raised from 6.75 to 7.13 per cent. When Bank rate was raised on July 14 from 6 to 7 per cent, a building societies' association spokesman stated that mortgage rates would not be raised immediately; however, he stated that the situation would be reviewed in early September.

In July, the British authorities took steps to keep bank lending and consumer credit under control. On July 12, Chancellor Callaghan announced that the ceiling on bank advances would remain in force at least until March 1967, and until further notice thereafter. In addition, he stated that no special arrangements would be made to permit firms to get bank credit for the purpose of meeting Selective Employment Tax liabilities, which begin to fall due in early September. The mid-July balance sheets of the London clearing banks revealed that they were pressing against the ceiling on loans--advances outstanding were 105 per cent of the March 1965 level. As a result one should not expect to see any further increase in the volume of bank loans except for seasonal reasons.

On July 14, the Bank of England announced an increase in the special deposit requirements of the London clearing banks from 1 to 2 per cent and those of the Scottish banks from 1/2 to 1 per cent. This move is designed specifically to put additional pressure on Bank liquidity. Banks could still provide funds to business by acquiring government securities from them in exchange for new deposit liabilities. The banks' willingness to do this could be limited by the concomitent fall in the ratio of liquid assets to gross deposit liabilities. (The minimum level for this ratio is set in agreement with the Bank of England at 28.00 per cent. At mid-July the ratio was 29.85 per cent.) By requiring additional special deposits, which do not count as liquid assets for credit control purposes, the Bank of England evidently hopes to absorb some of the liquid assets held by the clearing banks, thereby exerting downward pressure on actual liquidity ratios.

With regard to consumer credit, part of the Government's July budget called for more stringent hire-purchase requirements. Changes in down-payment requirements and maximum repayment periods were:

	Downpayment Raised	Repayment Period Lowered
Cars	25 to 40 per cent	27 to 24 months
Furniture	15 to 20 per cent	27 to 24 months
Domestic Appliances	25 to 33-1/3 per cent	27 to 24 months

The government estimated that these changes would, in a year's time, keep the amount of consumer installment debt outstanding £160 million below what it otherwise would have been. At the end of May, total consumer debt outstanding was £1,197 million.

Capital market conditions weak: interest rates at all-time high

With the domestic economy continuing to resist earlier deflationary action and with external developments turning against sterling, conditions in British capital markets weakened sharply. Between May 5 and July 28, long-term bond yields rose by as much as 40 basis points, breaking the 7.00 per cent level and passing on to reach all time highs. Between the end of June and the end of July, industrial stock prices dropped sharply and the Financial Times' index of 500 industrials dropped to the lowest level since September 23, 1965. (See Table 5.) Most of the downward price adjustment in the equity and government bond market took place at a time of very low trading volume.

Table 5. United Kingdom: Selected Capital Market Yields
January-July 1966
(Per cent per annum)

	Jan. 6	Feb. 3	Mar. 17	Apr. 7	May 5	June 2	June 30	July 14	July 28
Government bonds									
3% 1959-69	6.37	6.17	6.72	6.77	6.45	6.55	6.72	7.05	7.05
5% 1971	6.52	6.24	6.82	6.79	6.65	6.77	6.86	7.23	7.22
3-1/2% 1979-81	6.47	6.40	6.70	6.70	6.67	6.77	6.97	7.17	7.17
5-1/2% 2008-12	6.55	6.57	6.80	6.80	6.80	6.85	7.00	7.20	7.17
3-1/2% War Loan	6.55	6.60	6.84	6.79	6.80	6.87	7.00	7.21	7.16
Equities a/									
Price index	110.73	115.86	113.32	n.a.	115.92	116.59	119.55	112.82	106.24
Dividend yield	5.44	5.22	5.36	n.a.	5.26	n.a.	5.08	5.39	5.73

a/ Financial Times 500 industrials.
Source: Financial Statistics and Financial Times.

The substantial shake-out in the government bond market reflected domestic developments and expectations of further deflationary action. According to market reports, anticipation of a July budget and an increase in Bank rate began to build in the closing days of May. Bank rate was finally raised from 6 to 7 per cent on July 14 and a new package of restrictionist measures was introduced one week later. Market yields on government bonds moved up about 20 basis points after the Bank rate action, and generally held to these higher levels through the end of July. (See Table 5.)

Money market yields rise on Bank rate increases

At a time of deteriorating conditions in British capital markets, money market conditions remained stable and tight and between April and mid-July interest rate movements were quite minor. When Bank rate was raised from 6 to 7 per cent on July 14, market yields rose by about one percentage point and held to these higher levels through the end of July. (See Table 6.)

Table 6. United Kingdom: Selected Money Market Rates
January 1966-July 1966
(Per cent per annum)

	1966								
	Jan. 7	Feb. 18	Mar. 25	Apr. 15	May 27	June 17	July 8	July 15	July 29
Call money	5.62	5.38	4.62	5.50	5.50	5.50	5.62	6.56	6.62
Treasury bill a/	5.53	5.63	5.62	5.62	5.67	5.70	5.82	6.68	6.70
Deposit rates b/									
Local Authority	6.25	6.15	6.44	6.41	6.25	6.31	6.41	7.31	7.57
Euro-dollar	5.12	5.38	5.69	5.75	5.75	5.81	6.19	6.38	6.38

a/ Maximum tender.
b/ 90-days.
Source: Financial Times and Board of Governors.

The increase in Bank rate was in response to three main developments; the course of the domestic economy; the speculative attack on sterling; and interest rate developments in Europe: between May 2 and July 6, discount rates were raised in the Netherlands, Germany, Belgium, Sweden and Switzerland, and the yield on Euro-dollar deposits rose over 44 basis points to 6.19 per cent. (See Table 6.)

Balance of payments shows small improvement

With underlying economic conditions showing decided resistence to earlier anti-inflationary measures, Britain's current and long-term capital account in the first quarter of 1966 showed only a slightly smaller deficit than during the same period in 1965. A narrowing of the current account deficit more than offset a slight enlargement in the net outflow of long-term capital. (See Table 7.) The results for the first three months of 1966 were not as favorable as for the final quarter of 1965, but this deterioration was largely due to seasonal factors.

Table 7. United Kingdom: Balance of Payments
1964-1966
(£ millions)

	1964	1965					1966
		Year	I	II	III	IV	I
Imports (f.o.b.)	5,006	5,044	1,228	1,270	1,250	1,296	1,368
Exports (f.o.b.)[a]	4,471	4,779	1,140	1,212	1,150	1,277	1,289
Visible balance	- 535	- 265	- 88	- 58	- 100	- 19	- 79
Invisible balance	129	129	50	53	- 18	44	53
Current balance	- 406	- 136	- 38	- 5	- 118	25	- 26
Balance of L-T capital	- 363	- 218	- 66	- 33	- 92	- 27	- 73
Balance of current and L-T capital	- 769	- 354	- 104	- 38	- 210	- 2	- 99
Balancing item	22	105	- 1	48	4	54	77
Balance of monetary movements	747	249	105	- 10	206	- 52	22

a/ Including re-exports.
Source: Economic Trends.

It is impossible to examine short-term capital movements as has been done in the past. During 1965, British authorities published data on central bank assistance with which short-term capital flows could be estimated; such information was not released this time. The account of short-term capital movements given in Economic Trends simply stated they were mixed.

For the same reason, it is impossible to get a true picture of British reserves during, or at the end of, the first quarter. The reported figures show that holdings of gold and U.S. dollars stood at $3,573 million at the end of March--up about $500 million over the end of December 1965. However, according to Economic Trends, there were a number of central bank transactions during the first quarter. Moreover, the British brought about $885 million from the official portfolio into the reserves. It is thus impossible to say what the $500 million increase in reported reserves represents. By the end of July reserves of gold and foreign exchange were down $373 million from the March level to $3.2 billion. According to British Treasury announcements, recourse to central bank aid was made between March and July.

In the last quarter of 1965 and the first quarter of 1966 Britain's balance of payments position has been helped by the international transactions of the overseas sterling area (OSA). Britain's sterling liabilities to the OSA rose noticeably in the last six months after falling in 1964 and the first three quarters of 1965. (See Table 8.) Most of the recent rise can be attributed to a swing in the OSA's balance of payments position with non-OSA countries from deficit into surplus and the resulting transfer of claims on these countries to claims on London.

Table 8. United Kingdom: Balance of Monetary Movements
(£ million)

	1964	1965 Year	1965 I	1965 II	1965 III	1965 IV	1966 I
Miscellaneous capital	+ 54	+135	+ 10	+ 15	+ 74	+ 36	- 8
Change in liabilities in non-sterling currencies	+218	-137	+140	-196	- 54	- 27	- 53
Change in external sterling liabilities							
International organizations	+ 5	- 6	- 8	- 1	- 4	+ 7	+ 4
Sterling area countries	- 42	- 94	- 84	- 48	- 27	+ 65	+ 89
Non-sterling countries	+ 31	+ 98	+ 58	-118	+200	- 42	-126
Total	- 6	- 2	- 34	-167	+169	+ 30	- 33
Change in account with I.M.F.	+359	+499	- 6	+503	+ 4	- 2	+ 3
Transfer from dollar portfolio to reserves	--	--	--	--	--	--	+316
Change in gold and convertible currency reserves	+122	-246	- 5	-165	+ 13	- 89	-203
Total	+747	+249	+105	- 10	+206	- 52	+ 22

Source: Economic Trends.

Trade deficit widens in second quarter

There was a noticeable widening of Britain's trade account in the second quarter of 1966 compared to the first. (See Table 9.) This weaker position reflected in part a pick-up in imports, accompanying strong domestic demand, and in part the seamen's strike. An interesting fact is that, through the first five months of 1966, total export values remained on a rising trend. This would appear to reflect more price advance than increase in volume.

Table 9. United Kingdom: Foreign Trade
1964-June 1966
(£ million: Seasonally adjusted monthly averages)

	1964	1965	1966		
	Year	Year	I	II	First Half
Imports (c.i.f.)	475	480	505	493	499
Exports (f.o.b.)[a/]	381	405	429	405	417
Difference	-84	-73	-75	-86	-81
Trade balance[b/]	-46	-23	-24	-38	-31

a/ Includes re-exports.
b/ Adjusted to balance of payments basis.
Source: Monthly Digest of Statistics.

The effects of buoyant demand conditions in the United Kingdom on Britain's external accounts can be seen in the import figures. Over the first five months of 1966, imports averaged 3.5 per cent higher in value (1.9 per cent higher in volume) over the final quarter of 1965. Imports rose little in 1965 in either value or volume terms.

With only the June figures to go by it is much too early to judge the effects of the seamen's strike. However, the sharp widening of the trade balance would seem to support earlier beliefs that exports would be harder hit than imports.

The substantial rise in imports this year has been confined to industrial materials and finished manufactures. (See Table 10.) Many, though not all, of these goods are subject to the 10 per cent surcharge which the British authorities plan to lift this November. After the surcharge is removed, imports of these goods are expected to jump sharply. The increase in import values this year reflects largely higher prices for industrial materials, such as copper, and higher volume for finished manufactures.

Table 10. United Kingdom: Foreign Trade by Commodity Classes
(£ million; monthly or monthly averages; seasonally adjusted)

	1965				1966	
	I	II	III	IV	I	II*
Imports (c.i.f.)						
Food, beverages and tobacco	132	144	149	148	145	143
Industrial materials	200	211	210	208	216	214
Finished manufactures	65	73	77	78	84	82
Other	61	57	53	56	62	57
Total	458	485	489	490	507	496
Exports						
Manufactures machinery and transportation equipment	159	157	169	177	177	168
Chemicals	36	36	37	37	37	37
Textiles	23	23	23	23	21	21
Other manufactures	104	107	98	109	111	102
Other	65	56	72	64	68	66
Total	387	379	399	410	414	394

* Provisional estimate.
Source: Monthly Digest of Statistics.

On the export side, the continued high level of sales of transportation equipment, largely ships and aircraft, have been an important element in Britain's foreign trade picture this year. (See Table 10.) The sharp second quarter dip in the sales of these goods was confined to the month of June and largely reflects the effects of the seamen's strike. Comparing the first five months of 1966 to the final quarter of 1965 there was no change in the average monthly value of exports sales of machinery and transportation equipment. This stability of these lines undoubtedly reflected a rise in unit values and a fall in volume.

New measures improve balance of payments outlook

Economic forecasts of the British economy made after the May budget, but before the publication of economic indicators for May and June, suggested a balance of payments deficit through the first half of 1967. The National Institute's Economic Review predicted a current and long-term capital account deficit of £165 million for 1966 and £90 million at an annual rate for the first six months of 1967. The London and Cambridge Economic Bulletin forecasted an external deficit of about £170 million at an annual rate for the first half of 1967. (See Table 11.)

Economic indicators published after these forecasts were made, and the likely effects of the seamen's strike, suggested that these predictions were somewhat optimistic. For the first six months of the year, the trade accounts, seasonally adjusted, showed a £176 million deficit compared to the National Institute's prediction of £130 million. On the domestic side, economic trends proved to be more buoyant than the National Institute had estimated. For example, first quarter consumer spending, seasonally adjusted in 1958 prices, was forecast last January at £4,897 million whereas the outturn was £4,977 million.

Table 11. United Kingdom: Balance of Payments
1964-1967
(£ million)

	Actual		Estimates[a]			
			1966[b]		1967	
	1964	1965	1st Half	2nd Half	1st Half	Half[c]
Visible balance	- 535	- 265	- 260	- 70	- 140	n.a.
Imports (f.o.b.)	5,006	5,044	5,290	5,260	5,480	n.a.
Exports (f.o.b.)[d]	4,471	4,779	5,030	5,190	5,340	n.a.
Invisible balance	+ 129	+ 129	+ 110	+ 110	+ 160	n.a.
Current balance	- 406	- 136	- 150	+ 40	+ 20	- 70
Balance of long-term capital	- 363	- 218	- 120	- 90	- 110	-100
Balance of current and long-term capital	- 769	- 354	- 270	- 50	- 90	-170
Balancing item	+ 22	+ 105	+ 70	+ 70	+ 70	n.a.
Balance of monetary movements[e]	+ 747	+ 249	- 200	+ 20	- 20	n.a.

a/ Seasonally adjusted at annual rates.
b/ National Institute of Economic and Social Research.
c/ London and Cambridge Economic Bulletin (1965 prices).
d/ Includes re-exports.
e/ Assets: Increase - ; decrease +.
Liabilities: Increase + ; decrease -.

It is impossible, at this time, to calculate the impact of the seamen's strike, but it seems safe to assume merchandise exports were harder hit than merchandise imports. This was clearly the case in June when exports fell off more sharply than imports. In addition, the strike presumably adversely affected the invisibles account by widening the shipping account deficit. All of these considerations point to a current account deficit for the first six months of 1967 in excess of the London and Cambridge Economic Bulletin's £35 million (£70 million at an annual rate).

If the long-term capital account were to show a £25 million deficit per quarter (the average quarterly outflow over the last six years) in the first half of 1967, the combined current and long-term capital account could show a deficit of over £200 million.

The government's new package of measures could balance Britain's external accounts by mid-1967. Direct balance of payments measures were calculated to save £150 million. The government's fiscal measures to restrain aggregate demand and in turn reduce imports, could contribute about another £100 million. All measures, except the surcharge, went into effect immediately and the government estimated they would take £480 million out of the economy by mid-1967. Assuming aggregate demand were to fall by this amount and that the change in imports was about 20 per cent of the change in demand, the trade balance would benefit by about £100 million.

Sterling still on the soft side

Despite the government's new fiscal measures and the promise of a price-wage standstill, backed by statutory authority, conditions in the sterling foreign exchange markets have remained weak. Spot sterling rose above 279.00 (U.S. cents) just after the July steps were announced but dropped again below that level in recent days. (See Table 12.)

Spot sterling has been drifting unrelentingly lower since the first of the year. (See Table 12.) This trend was temporarily halted by the mid-June announcement that a package of international credits had been arranged

Table 12. United Kingdom: Exchange Rates and Arbitrage Calculations
January-July 1966

	Jan. 14	Feb. 18	Mar. 25	Apr. 22	May 27	June 24	July 15
Exchange rates							
Spot (U.S. cents)	280.44	280.22	279.35	279.29	279.17	278.94	278.66
Forward (p.c.p.a.)	- 1.03	- 0.92	- 0.92	- 0.80	- 0.67	- 0.61	- 1.46
Three-month yields and yield spreads							
Treasury bills							
U.K. (covered)	4.33	4.62	4.53	4.71	4.85	5.00	5.04
U.S.	4.58	4.63	4.46	4.60	4.61	4.31	4.88
Difference	- 0.25	- 0.01	+ 0.07	+ 0.11	+ 0.24	+ 0.69	+ 0.16
Deposit rates							
U.K. local authority (covered)	5.22	5.23	5.32	5.63	5.59	5.78	6.04
Euro-dollar	5.25	5.38	5.69	5.75	5.75	6.13	6.38
Difference	- 0.03	- 0.15	- 0.17	- 0.06	- 0.16	- 0.35	- 0.34
Euro-dollar a/	5.25	5.31	5.69	5.75	5.62	6.00	6.56
N.Y.C.D.'s a/b/	4.88	5.06	5.20	5.25	5.40	5.50	5.62
Difference	- 0.37	- 0.25	- 0.49	- 0.50	- 0.22	- 0.50	- 0.94

a/ Preceeding Wednesday.
b/ Negotiable New York time certificates of deposit.
Source: Board of Governors and *Financial Times*.

to take the place of facilities made available last September. However, confidence began to wane once again and not even the rise in Bank rate restored it. When the government's new program was announced, selling pressures subsided noticeably, but market conditions have remained very weak.

During the period under review, covered spreads on Treasury bills generally remained in favor of London; however, Euro-dollar deposit rates were distinctly more attractive than covered local authority rates. Euro-dollar rates rose much more sharply than did yields on New York CD's and the spread in favor of the former widened to almost one percentage point. (See Table 10.) Covered differentials were largely unaffected by the increase in Bank rate because the forward discount widened very sharply. (See Table 10.)

In early August, the Bank of England issued new instructions to foreign exchange dealers in London reducing the amount of each dealer's open position long or short and the amount of sterling invested in foreign exchange covered by a forward contract. The exact nature of the new instructions has not been made public, because limits vary from dealer to dealer and the limits applicable to each dealer are known only to himself and the Bank of England. The Bank of England has not made a public statement explaining this move. Because the magnitudes of the reductions are not known, it is impossible to suggest how this move will affect the sterling exchange markets.

Appendix I

The British Measures: July 20, 1966

I. Measures to reduce domestic demand

1. Tighter hire-purchase requirements are expected to cut the amount of consumer installment debt outstanding by £160 million. The new requirements are:

   a. Maximum repayment periods reduced from 27 to 24 months;

   b. Minimum downpayment raised from 25 to 40 per cent for autos, 15 to 20 per cent for furniture and 25 to 33-1/3 per cent for domestic appliances.

2. A 10 per cent increase in most excise and purchase tax rates (except those on tobacco) is expected to increase government revenues by £150 million per year.

3. An increase in postal and telecommunication charges effective October 20 is expected to raise government revenue by £20 million per year.

4. A deferal of public sector investment projects is expected to reduce government spending in 1967/68 by £150 million below what it otherwise would have been.

5. An extension of government control of office building in the greater London area to the East and West Midlands and the remainder of the Southeast region of England.

6. A tightening of controls on other private-sector building activity: official permission is now required for projects valued at £50,000--down from £100,000.

7. A surcharge of 10 per cent on sur-tax payments beginning in 1966/67 payable from 1967.

II. Measures to directly aid the balance of payments

1. A planned saving of £100 million per year from reduced overseas government civil and military spending.

2. Reductions in tourist and emmigrant allowances and in the amount of personal cash gifts sent to residents outside the sterling area leading to an estimated saving of £50 million per year.

3. An attempt will be made to secure from the German government offsets to the fuel foreign exchange costs of Britain's military posture in Germany.

III. A price-wage standstill

1. The Prime Minister announced that the government would soon seek the voluntary support of both management and labor groups for a 6-month standstill on prices and wages to be followed by 6 months of severe restraint.

2. Dividend payments are not to be increased for 12 months.

3. In order to give some incentive for the voluntary system, the government is seeking statutory powers to enforce price-wage stability wherever necessary. These powers will be incorporated into the Prices and Incomes bill now before Parliament which is expected to receive Royal Assent by August 19.

4. Certain price and wage adjustments are exempt from the proposed freeze.

   a. Prices can be raised if they reflect:

      (1) Increased taxes;

      (2) Increased cash of imports; or

      (3) Seasonal factors.

   b. Wages can be raised if they reflect:

      (1) Promotions;

      (2) Normal increases due to age or advancement within a pre-determined range or scale; or

      (3) Increased output such as price work or commissions on sales.