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Recent Economic Developments in the United Kingdom,
November 1963 to January 1964

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Summary

The vigorous business recovery in the United Kingdom which commenced in the spring of 1963 was extended and even accelerated in the latter part of the year. While prices rose only moderately during 1963, by year-end it was becoming evident that broad price and wage advances were getting underway. Further growth in industrial output is thought to have been registered in January and there are widespread expectations of continued, and even quickened, business expansion during 1964.

Thus far, the British recovery has proceeded rapidly and smoothly through the absorption of spare factory capacity and unemployed labor. Even at year-end there were only limited signs of strain on available plant, and labor supply problems were found mostly in the booming Midlands and Southeast (London) industrial areas. A survey of the engineering industry in December estimated that the industry was operating at perhaps 10 per cent below optimum output (90 per cent of rated capacity). However, supply limitations, both in plant and in labor, are expected to slow down productivity growth in 1964 and thus impair maintenance of the pace of expansion.

During the course of 1963, the base of the business expansion broadened. Initially, higher exports and government spending provided chief impetus to the recovery, supported by an early pick-up in consumption, including booming automobile sales. By year-end, a flow of new orders into capital goods industries was reported as the down trend in manufacturing investment was reversed. Business inventories continued to decline in the third quarter, the latest available estimate;

however, there is a general expectation that stock rebuilding both within and outside manufacturing industry is either already underway or soon will be.

On the external side, the pound has been maintained at just under the \$2.80 parity, and official reserves (adjusted for special transactions) continued to rise in December for the tenth consecutive month. However, these gains have not fully offset the heavy reserve losses in January 1963 when sterling was under pressure after the Common Market debacle. During the second half of the year, underlying trade trends began to deteriorate, with imports rising rapidly and with exports tending to level off.

Temporary placement of sterling area funds in London financial markets has, in part, obscured developing weakness in Britain's underlying payments position. For the first three quarters, there was a \$448 million capital inflow from the outer sterling area (nearly five times the 1962 volume) as these primary producing countries experienced substantial gains in export proceeds from higher prices and, in some cases, rising volume.

Current foreign-trade and domestic cost trends have prompted Britain's political leaders to express concern, both in repeated public exhortations and in several policy recommendations designed to hold price advances in check. Attempts to obtain labor-management agreement to an incomes policy through the machinery of the National Income Commission and the National Economic Development Council have not yet borne fruit. In January, the government announced that a bill to abolish Resale Price Maintenance (which acts as a bar to price competition over a very wide range of consumer goods) will be introduced to the current Parliament.

Thus far, the monetary authorities have continued to support the business expansion. The clearing banks remain in a comfortable liquidity position following the decision to reduce their liquid asset ratio from 30 to 28 per cent in October, but the recent growth in bank lending has not been rapid.

Despite relative ease in credit markets, a sharp rise in long-term Treasury bond yields in early November brought to an end the steady fall in bond yields which had continued over 27 months (since Bank rate was put at 7 per cent in July 1961). Short-term money rates have been steady, however, and the "covered" differentials on U.K.-U.S. Treasury bills (and of other short-term sterling assets) have been too narrow to encourage any shift of funds between the two centers for arbitrage purposes,

Business expansion broadening at year-end

The business recovery in Britain over the past nine months has been supported chiefly by higher exports, heavier consumption, and increased government spending. (See Table 1.) Even though reduction in inventories and lagging private investment helped to slow business expansion, seasonally-adjusted industrial production in November 1963 was about 10 per cent above the average for the first quarter. At the same time U.K. unemployment fell from a seasonally adjusted peak of 734,000 to an estimated 472,000 workers in January 1964.

National product data for the third quarter, (seasonally unadjusted) reveal a growth of more than 5 per cent over the year-previous level. (See Table 2.) The gains in demand were to be found largely in private consumption, exports, and public investment. Over the twelve month period, exports were up £100 millions or nearly 23 per cent of the total growth in aggregate demand. Private fixed capital formation in manufacturing fell in this period, but fixed capital formation as a whole expanded.

By the end of 1963, however, the base of the business recovery was broadening. Higher government spending and private consumption, together with a revival of private investment spending and continued high export demand, are expected to support further advances in business activity during 1964. A turnaround in business inventories may have already occurred late in 1963 if the expansion in material imports is a reliable guide.

Table 1. Selected Recent U.K. Economic Indicators

	1962			1963			1964	
	III	I	II	III	Oct.	Nov.	Dec.	Jan.
A. LABOR MARKET								
<u>Unemployment</u>								
Registered ^{a/} (ths)	543	734	605	585	528	498	e/489	e/472
Per cent	2.0	3.5	2.4	2.1	2.1	2.1	2.0	c/2.2
Workers on overtime (ths)	1640	1600	1740	1700	1953	--	--	--
Ratio of unemployed to vacancies ^{b/}	2.7	4.4	3.2	2.9	2.4	2.2	e/2.1	e/1.8
B. FINANCE (£ million)								
<u>London Clearing banks</u>								
net advances (changes) ^{s/}		329	90	26	13	e/40	e/25	e/13
Install. Credit Outstanding	891	875	894	926	939	947	--	--
Change/year ago (%)	--	-3	+1	+4	+6	+7	--	--
C. DEMAND AND PRODUCTION								
<u>Expend. on Gross Dom.</u>								
Product ^{u/} (£ million)	6189	6020	6516	6443	--	--	--	--
Rise/year ago (%)	+3.3	+2.0	+4.2	+4.1	--	--	--	--
<u>Capital Expenditure (£ millions)^{d/}</u>								
Fixed capital ^{s/}	473	438	460	449	--	--	--	--
Stocks and work in Progress (Changes) ^{s/}	50	-19	61	-56	--	--	--	--
Personal Consumption at 1958 Prices ^{s/}	4274	4281	4387	e/4491	--	--	--	--
<u>Exports and Re-exports</u>								
(£ million/month) ^{s/}	333	339	348	359	353	355	373	--
Industrial production ^{s/} (Average 1958=100)	116	113	117	121	122	123	--	--
Steel Production ^{s/} (ths. tons/week)	405	398	413	451	480	479	e/471	--
Retail sales volume index: ^{s/}								
1961 prices	101	101	102	105	104	104	--	--
1961=100								
Passenger Cars (ths./week)	22	29	32	28	35	36	31	--
Rise/year ago (%)	--	+17	+27	+25	→+46	←	--	--
D. NEW ORDERS-ENGINEERING (1958=100, at 1958 Prices)								
Total	132	138	p/136	p/145	p/155	--	--	--
Rise/year ago (%)	+1	+13	+18	→+30	←	--	--	--
Home	135	135	p/136	p/144	p/150	--	--	--
Export	121	146	p/137	p/148	p/170	--	--	--
Rise/year ago (%)	-12	+18	+16	→+18	←	--	--	--

a/ OECD seasonally adjusted series for the U.K.

b/ Ratio of two series for the U.K., separately seasonally adjusted by the OECD.

c/ Seasonally adjusted rate for January estimated as 2.0 per cent by The Economist.

d/ For manufactures, distribution, & service industries, all at 1958 prices.

e/ estimated.

p/ preliminary.

s/ Seasonally adjusted.

u/ Unadjusted, at current price.

By year-end it was becoming clear that the industrial expansion had already greatly reduced the margin of spare manufacturing capacity and of unemployed labor which had helped to make possible the smooth advances in activity during 1963. A survey in December found that the engineering industries were already close to 10 per cent of practical capacity and these industries expect by the end of 1964 "to be under as much pressure on capacity as they were at the peak of the 1960-61 boom." 1/ By January 1964, the labor market had also tightened: The number of unemployed (seasonally-adjusted) was down to 472,000 or 2 per cent of the labor force. (See Table 1.)

Booming automobile activity has sparked the industrial expansion throughout 1963 (see Table 1); but at year-end orders were rising throughout most capital goods sectors. By January the financial press was reporting a "widespread move to raise prices over a broad range of engineering goods." 2/ At the same time, Lord Robens, Chairman of the National Coal Board, complained that engineering companies have been putting up prices since they granted a 5 per cent wage increase last fall:

"We have had tumbling into our letter boxes in a spate applications from our suppliers in engineering asking for anything from 2.5 to 8 per cent more." 3/

A Financial Times survey in late January reported price increases within the engineering industries, especially in the heavy goods sector, of about 4-1/2 to 5 per cent; in most cases these rises were "over twice the increase in costs which can be attributed to the recent wage settlements." (January 25, 1964, page 1.)

1/ The Economist (London), January 25, 1964, page 334.
2/ Financial Times (London), January 27, 1964, page 1.
3/ Financial Times (London), January 10, 1964, page 1.

Official concern over price and wage pressures

During 1963 advances in prices proved to be modest, considering the pace of the business expansion and a 6 per cent rise in import prices. For example, retail prices were up less than 2 per cent and wholesale prices only 1 per cent. (See Table 3.) Weekly wage rates were up 4 per cent or about the same rate as in 1961 and 1962.

Recent wage awards have exceeded the 3.5 per cent annual increase recommended by the N.E.D.C.: 5 per cent for Ford workers, 5.5 per cent for the engineering unions, and 6 per cent for railroad workers.

Recent price and wage advances in manufacturing industries seem to mark the beginning of a new period of developing dangers of inflation. The British authorities have been attempting to stem present price wage trends through public exhortation and through action recommendations. The Chancellor and other Cabinet Ministers have complained before Parliament and at public meetings that "on average incomes are still rising faster than the underlying rate of growth of national productivity."

The government has sought to utilize both the National Incomes Council (N.I.C.) and the N.E.D.C. to gain labor/management support for an incomes stabilization program. Some wage settlements were referred to the N.I.C. but labor's hostility has hindered progress through this group. The demand of the unions that profits as well as wages should be restrained is now being seriously discussed in the N.I.C. A comparable suggestion was also made by the Chancellor to the N.E.D.C. although labor representatives refused to agree at the time to support the income stabilization effort.

In January, the government announced a controversial major reversal in policy with the introduction of a bill to abolish Retail Price Maintenance. R.P.M. practices have been widely used in British industry and have had restrictive effects on price competition in a wide range of consumer and consumer-durable industries.

Table 2. Expenditure on Gross Domestic Product
(£ millions, current prices, seasonally unadjusted)

	1962	1963	1963	Actual Change	
	III Qtr.	I Qtr.	III Qtr.	I 63 to 63	III 62 to 63
Gross Domestic Product at Factor Cost	6158	5994	6443	449	285
Final Expenditure on Goods, Services at Market Prices	8427	8179	8866	687	439
of Which:					
Consumption	4669	4436	4945	509	276
Current Public Authority expenditure	1203	1271	1270	- 1	67
Gross fixed capital formation: of which	1153	1051	1231	180	78
Manufacturing ^{a/}	(290)	(241)	(267)	(26)	(-23)
Dwellings ^{a/}	(231)	(153)	(259)	(106)	(28)
Inventories	67	23	-15	-38	-82
Exports	1335	1398	1435	+37	100

a/ Includes public investment. Seasonally adjusted at 1958 prices fixed capital formation in manufacturing was:

(252) (228) (225) (-3) (-27)

Table 3. United Kingdom: Prices and Wages

	Domestic (1958=100)			External (1961=100)		
	Wkly. Wage Rate	Whlse. Retail Prices	Whlse. Home Mkt. Sales	Export Prices	Import Prices	Terms of Trade
1960-Dec.	107	103	103	^{a/} 100	^{a/} 101	^{a/} 99
1961-Dec.	111	107	106	101	100	102
1962-Sept.	115	109	107	102	100	102
Dec.	116	110	108	104	100	102
1963-Jan.	116	111	108	102	101	101
March	116	112	108	103	102	101
May	117	112	108	103	103	100
July	118	111	108	104	103	101
Aug.	118	111	108	104	103	102
Sept.	118	111	109	104	103	101
Oct.	118	112	109	105	105	100
Nov.	119	112	109	105	106	99
Dec.	121	112	109	--	--	--
% rise (+):						
Nov. 63/Dec. 62	--	--	--	+1%	+6%	-3%
Dec. 63/Dec. 62	4%	+2%	+1%	--	--	--

a/ January 1961.

Bond yields rise but credit remains easy

A shake-out in bond prices in early November brought to an end a 27-month decline in bond yields which began in the second half of 1961 after Bank rate was raised to 7 per cent. Between late October and mid-November, bond yields rose by 23 to 31 basis points on intermediate and by 28 to 30 basis points on undated maturities. (See Table 4.) The market steadied in early January, with prices improving temporarily.

A wide range of factors contributed to this turnabout in bond yields. Market expectations that interest rates will gradually rise in the near future have been promoted by rising trends in European centers and in New York. At the same time, the return of local authority financing to the Public Works Loan Board will increase the Treasury's annual cash needs to be met in part by borrowings in the gilt-edged market. The increased attractiveness of equities and the expectation that credit restraints may be required during 1964 also help to explain recent developments in the gilt-edged market.

The U.K. bill rate has been stable. Despite the shift in trend in gilt-edged yields, weekly rate fluctuations have been limited, partly because the U.K. authorities have sought to keep the covered New York-London yield differential narrow. Even though the forward discount on sterling widened in January, the covered yield in favor of New York fluctuated around 1/4 of 1 per cent per annum. (See Table 5.) There have been no reports of arbitrage flows to London in the period under review.

The shake-out in bond yields occurred even though the monetary authorities have continued to support business expansion. Last summer, the banks appeared to be getting into a position where liquidity difficulties would force them to restrain their lending activities. In October, however, the Bank of England

Table 4. Selected United Kingdom Money Rates and Stock Prices
(per cent per annum or index)

	1 9 6 3					1 9 6 4	
	Aug. 15	Oct. 25	Nov. 14	Nov. 28	Dec. 24	Jan. 16	Jan. 30
<u>Treasury bills</u> ^{a/}	3.69	3.61	3.61	3.61	3.61	3.61	3.61
<u>Bonds:</u>							
1964	3.77	3.70	3.73	3.66	3.81	3.79	3.80
1965-75	4.90	4.83	5.14	5.16	5.33	5.22	5.26
1982-84	5.28	5.25	5.53	5.60	5.66	5.60	5.67
2008-12	5.45	5.50	5.73	5.81	5.93	5.96	6.00
War Loan	5.49	5.55	5.83	5.85	5.98	5.96	6.01
Consols	5.35	5.41	5.71	5.70	5.83	5.81	5.86
<u>Stock price index:</u>							
Industrials	320.4	342.6	342.6	343.5	347.7	333.9	329.4
<u>Euro-dollar rates:</u> ^{a/}							
3-month deposits	4.12	4.12	4.12	4.12	4.62	3.88	3.94

a/ Friday data.

Table 5. Selected U.S.-U.K. 3-month Yield Spreads:
September 1963-January 1964
(per cent per annum)

	Sept.	Oct.	Nov.	December			January		
	13	18	15	6	20	27	3	24	31
<u>TREASURY BILLS (Plus favors U.K.)</u>									
United Kingdom	3.58	3.61	3.61	3.64	3.61	3.61	3.61	3.61	3.61
United States	3.34	3.47	3.52	3.49	3.51	3.50	3.51	3.49	3.48
Favor U.K.(+)	.24	.14	.09	.15	.10	.11	.10	.12	.13
Forward £ discount (-)	-.03	-.26	-.22	-.19	-.16	-.16	-.24	-.35	-.31
Net incentive	.21	-.12	-.13	-.04	-.06	-.05	-.14	-.23	-.18
<u>FULLY HEDGED YIELD SPREADS (Plus favors U.K.)</u>									
Treasury bills	.21	-.12	-.13	-.04	-.06	-.05	-.14	-.23	-.18
Time deposits	.46	.37	.30	.62	.80	.39	.26	-.04	.06
Local Authority less									
Euro-dollar	-.03	-.26	-.09	-.32	.10	.15	.08	.08	.13

informed the clearing banks that the minimum liquid-asset ratio to which they would be held would be lowered from the traditional 30 per cent to 28 per cent. With a liquidity ratio of 33 per cent in mid-January, the banks will thus be able to absorb the reduction in their Treasury bill holdings which always occur between January and March when Exchequer tax receipts are seasonally high. By year-end, however, the pace of rise in bank advances had slackened; while bankers had large commitments to industrial borrowers outstanding, "many of these are still not being drawn on." (The Economist, January 25, 1964, p. 335.)

Balance of payments moved to deficit in third quarter

Although official reserves have changed little in recent months, the United Kingdom's balance of payments deteriorated steadily in the second half of 1963. (See Table 6.) This worsening has been masked in part by the outer sterling area's continued substantial surplus with non-sterling countries. In the third quarter, for example, British reserves increased by only £8 million, even though the overseas sterling area acquired £40 million in transactions with non-sterling countries. ^{4/}

Estimates for the fourth quarter, based on fragmentary data, suggest that the outer sterling area may have added perhaps £10 to £50 million to their holdings in London. Even though a number of overseas sterling countries drew down their reserves in the fourth quarter, Australia's foreign exchange holdings rose by £100 million (\$280 million). Adjusting for the funds raised on the London capital market in October (£20 million) and for holdings of other currencies, Australia alone may have added £60 to £75 million to its sterling balances.

^{4/} The over-all surplus of the OSA with non-sterling countries was actually around £60 million in the third quarter of 1963; some £20 million was retained in independent non-sterling currency reserves. However, the £40 million of sterling acquired in transactions with non-sterling countries did not necessarily involve equivalent sales of foreign exchange to the Bank of England for sterling because some of the settlements themselves probably were made in sterling.

Table 6. United Kingdom Balance of Payments, 1962-63
(in millions of pounds)

	1962		Jan- June	1963			
	Jan- June	July Dec.		1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.
A. CURRENT ACCOUNT							
Seasonally adjusted:							
Exports, f.o.b.	1981	2010	2086	1029	1057	1083	
Imports, c.i.f.	-1999	-2060	-2077	-1011	-1066	-1109	
Trade balance	-18	-50	9	18	-9	-26	
Services and transfer payments	77	65	84	52	32	41	
Total, seasonally adjusted	59	15	93	70	23	15	
Seasonal influences	39	-39	52	7	45	-43	
Total	98	-24	145	77	68	-28	
B. PRIVATE DIRECT INVESTMENT & GOVERNMENT LONG-TERM CAPITAL	-62	-110	a/ 59	-37	-22	-49	
C. TOTAL (A plus B)	36	-134	86	40	46	-77	
D. OTHER PRIVATE CAPITAL							
Other Long-term	46	44	a/ 2	-30	28	15	
Sterling balances of non-sterling countries	-36	12	a/ 72	-92	20	51	
Miscellaneous capital	84	31	-25	-8	-17	-7	
Total	94	87	-99	-130	31	59	
E. NET ERRORS AND OMISSIONS	78	37	-50	12	-62	-13	
SURPLUS OR DEFICIT (-)	<u>208</u>	<u>-10</u>	<u>-63</u>	<u>-78</u>	<u>15</u>	<u>-31</u>	
F. NET RESERVE MOVEMENTS							
Special aid received	--	--	b/ 18	101	-83	--	--
Drawing rights on IMF (incr.-)	-180	-198	3	--	3	-2	--
Sterling balances of:							
Non-sterling official	-39	-9	a/ 106	-61	-45	-4	n.a.
Outer sterling area							
Sterling acquired directly from U.K.	12	-25	a/ 10	-12	22	5	n.a.
Sterling acquired thru non-sterling countries	40	17	a/ 105	53	52	40	n.a.
Gold and foreign exchange (incr.-)	-41	225	33	-3	36	-8	28
TOTAL FINANCING	<u>-208</u>	<u>10</u>	<u>63</u>	<u>78</u>	<u>-15</u>	<u>31</u>	<u>n.a.</u>

a/ Figures for 1963 are not entirely comparable with those for earlier periods. See: Bank of England, Quarterly Bulletin, June 1963, pp.98-103. b/ Includes: (i) £89 million assistance received from some Continental Central banks in the first quarter and repaid in the second quarter and (ii) the results of F.R. System transactions in sterling (See: F.R. Bulletin, September 1963.)

Source: Central Statistical Office, Economic Trends, December 1963. Figures have been rearranged by F.R. staff. No sign indicates credit; minus sign indicates debit.

Excluding seasonal influences on the current account, Britain's total of current and long-term capital accounts shifted from a surplus of £34 million in the first two quarters to a deficit of £34 million in the third quarter. (See Table 6.) Other capital flows were limited in volume; as a result, the over-all payments deficit was £31 million for the quarter.

The deteriorating trade balance has been the main source of weakness in the U.K. balance of payments. The shift from a surplus of £18 million in the first quarter to a deficit of £26 million in the third quarter (shown in Table 6) has apparently continued in the fourth quarter, if the customs data provide a reliable indicator of the deficit on a payments basis.

According to the customs data, the rise in exports flattened out in the fourth quarter. On an area basis, the relative importance of Britain's major export markets changed only slightly in the fourth quarter. Over the year Western Europe (particularly the E.E.C.) accounted for 58 per cent of the total growth in U.K. exports. (See Table 7.) Average sales to the U.S. and Canada in 1963 remained at 1962 levels.

Food imports accounted for the rise in imports in the first half of 1963; industrial materials expanded steadily through the second half of the year, and in the fourth quarter were running 18 per cent above the 1962 average level. (See Table 8.) Should inventory investment expand in 1964, as seems quite possible, industrial materials imports can be expected to rise further.

Table 7. United Kingdom Exports: Geographic Pattern 1962-63
(% or seasonally adjusted £ million/month)

	Year							% Shares of Total Growth in Exports ^{a/}	
				1 9 6 3				1963	IV 1963
	<u>1957</u>	<u>1962</u>	<u>1963</u>	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	over 1962	over 1962
	(million £ per month)							(%)	(%)
Sterling Area	120	112	121	119	119	123	122	38	31
Western Europe	75	113	127	121	126	130	129	58	50
of which:									
(EEC)	(28)	(60)	(69)	(65)	(69)	(71)	(70)	(38)	(31)
(EFTA)	(38)	(43)	(46)	(44)	(45)	(47)	(49)	(13)	(19)
U.S. & Canada	37	43	43	39	41	45	47	--	12
Other	43	48	49	46	50	49	50	4	6
Total Exports ^{b/}	<u>275</u>	<u>316</u>	<u>340</u>	<u>327</u>	<u>335</u>	<u>346</u>	<u>348</u>	<u>100</u>	<u>100</u>

a/ Measures area per cent share of total expansion of U.K. exports between 1963 IV quarter or 1963-year monthly average and 1962 monthly average.

b/ Excludes re-exports. Details may not add to total because of rounding.

Table 8. U.K. Imports by Commodity Classes: 1962-1963
(Seasonally adjusted monthly rates: £ million)

	1962	1 9 6 3			Per cent Growth		
	<u>Year</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>Year</u>	IV - 1963	1963 over
							over 1962
Food, beverages, and tobacco	131	141	148	143	140	9	7
Fuels	44	49	46	46	47	5	7
Industrial Materials	147	151	163	174	159	18	8
Finished Manufactures ^{a/}	<u>51</u>	<u>56</u>	<u>57</u>	<u>59</u>	<u>56</u>	16	10
Total ^{b/}	<u>374</u>	<u>395</u>	<u>412</u>	<u>422</u>	<u>402</u>	13	8

a/ Includes miscellaneous commodities and transactions, about £1 or £2 million per year.

b/ Detail may not add to totals due to rounding.

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