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April 22, 1966

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Recent Economic Developments in the United Kingdom:
January-April 1966

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Recent Economic Developments in the United Kingdom:
January-April 1966

Summary

Inflationary strains within Britain continued unabated during the early months of 1966.^{1/} In January and February of 1966, prices, wages and imports moved to higher levels; throughout the first quarter, labor market conditions remained excessively tight. (See Chart 1.) Partly as a result of these developments and the uncertainties associated with the general election on March 31, conditions in British domestic financial markets weakened sharply in late February and early March but, in the foreign exchange market, the pound weathered the election period without serious difficulty. After the election, domestic financial market conditions remained weak, but sterling recovered some lost ground.

Against the background of unrelenting demand pressures, the British authorities took further steps to curb private sector spending during the period under review. First, on February 1, the Bank of England announced that, until further notice, commercial bank loans to the private sector and holdings of commercial bills were not to rise above 105 per cent of the March 1965 level, except in response to seasonal factors. Secondly, on February 8, the Board of Trade announced new restrictions on consumer credit. Down-payment requirements on most household appliances

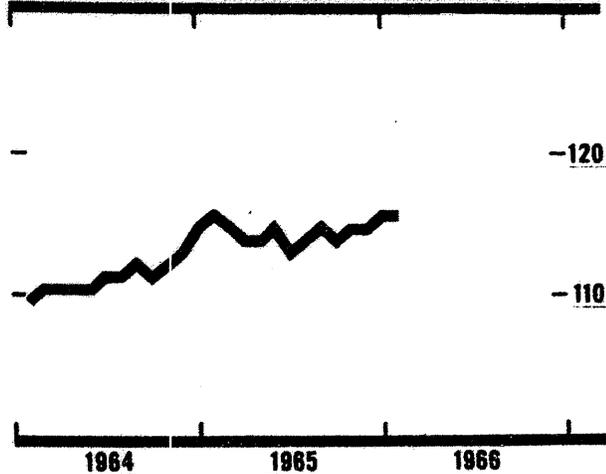
^{1/} For a review of earlier developments see, "Recent Economic Developments in the United Kingdom, October 1965 to January 1966", dated January 21, 1966.

CHART 1

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

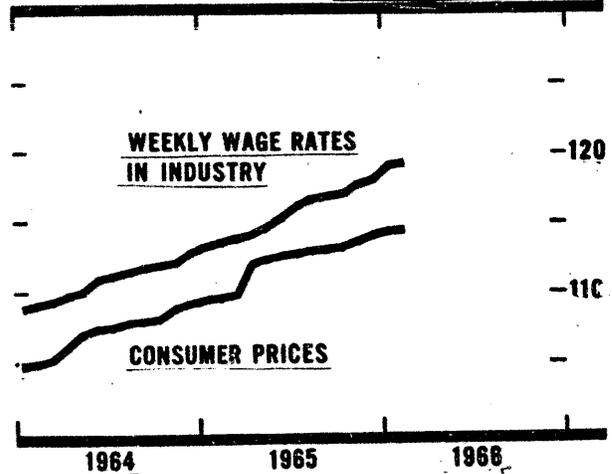
INDUSTRIAL OUTPUT

SEASONALLY ADJUSTED MONTHLY, 1962=100



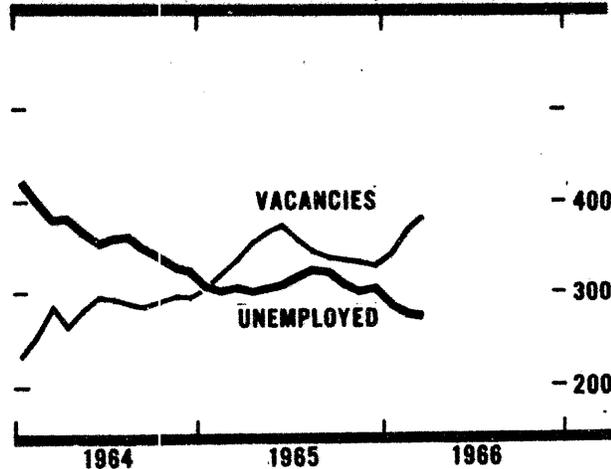
PRICES AND WAGES

MONTHLY INDICES: 1962=100



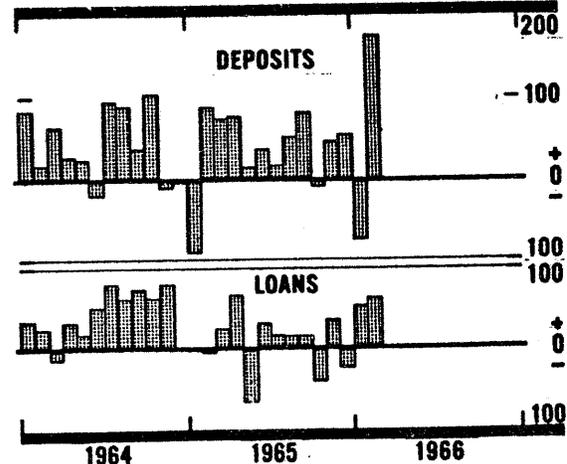
LABOR MARKET

SEASONALLY ADJUSTED MONTHLY, THOUSANDS OF UNITS



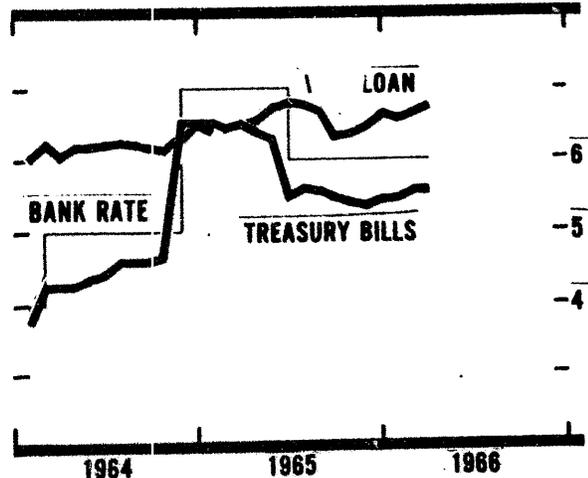
NEW BANK LOANS AND DEPOSITS

SEASONALLY ADJUSTED MONTHLY, £M.



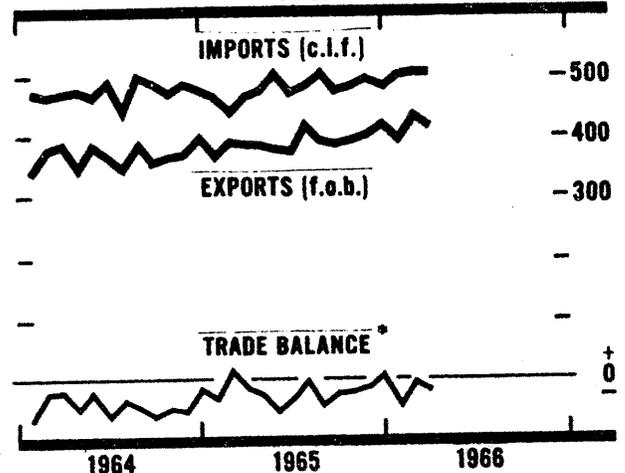
INTEREST RATES

PER CENT PER ANNUM



FOREIGN TRADE

SEASONALLY ADJUSTED MONTHLY, £M.



* BALANCE OF PAYMENTS BASIS

and consumer durables (except autos) were raised from 15 to 25 per cent, and the repayment period was reduced from 30 to 27 months. The 25 per cent down-payment requirement for autos was left unchanged, but the repayment period was reduced from 30 to 27 months.

Even before these actions, evidence was accumulating that the measures taken in 1965 to restrict private-sector credit growth were becoming increasingly effective. Bank loans (seasonally-adjusted) grew at an annual rate of less than 3 per cent between March 1965 and January 1966--noticeably less than the Bank of England's 5 per cent guideline. Consumer installment credit outstanding actually declined in the fourth quarter of 1965, largely in response to the more stringent down-payment and repayment requirements the Board of Trade had imposed in July, 1965. Credit trends in 1965 contrast quite sharply to those in 1964, when both bank loans and installment purchases rose substantially. (See Chart 1.)

Despite the slowdown in the growth of private credit during 1965, private-sector spending at current prices remained very buoyant throughout the year. (See Table 1.) Investment expenditures rose more than 6 per cent in 1965 over 1964; consumer spending also rose by more than 6 per cent, both with the higher disposable income and with the increased proportion of disposable income spent in 1965 compared to a year earlier.

Two factors were primarily responsible for the rise in disposable incomes: (a) a 7.2 per cent rise in wage and salary receipts; and (b) a 12.9 per cent rise in social welfare payments--especially government pensions that were requested in the November 1964 budget.

Table 1. Selected National Income Accounts 1964-1965
(billions of pounds, current prices)

	1964 Year	1965				Year	Per Cent Change 1964-1965
		I	II	III	IV		
Consumption	21.3	5.3	5.6	5.7	6.0	22.6	6.1
Private fixed capital investment	3.2	.8	.8	.8	.9	3.4	6.3
Inventory investment	.5	.1	.1	.1 <u>a/</u>	--	.3	-16.6
Government spending							
goods and services	5.4	1.4	1.5	1.5	1.5	5.9	9.3
fixed capital	2.6	.7	.7	.7	.7	2.8	7.7
Exports	6.1	1.5	1.6	1.6	1.7	6.4	4.9
Imports	6.7	1.6	1.7	1.8	1.7	6.8	1.5

a/ Less than £ 4 million.

Source: Monthly Digest of Statistics.

Labor market conditions extremely tight

Sustained tightness in British labor markets reflected the continuation of heavy demand pressures in 1966. During the first quarter of 1966, the number of unemployed continued to fall and employment vacancies rose on a seasonally adjusted basis. (See Chart I and Table 2.) At the same time, the unemployment rate--unadjusted for seasonal factors--averaged 1.4 per cent for the January-March period, compared with 1.6 per cent for the same quarter in 1965. (See Table 2.)

Evidence of acute labor shortages are also found in the rise in the ratio of job vacancies to unemployed (seasonally adjusted) since the fourth quarter of 1965. (See Table 2.) Labor shortages, especially in skilled categories, help to explain the sluggish performance of industrial output over the past few months. (See Chart I.) In addition, a goodly number of British companies expect inadequate labor supplies to continue

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

	1965				1966		
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>
Total unemployed	306	304	324	305	284	275	272
Total vacancies	322	364	346	333	342	368	382
Ratio vacancies to unemployed	1.05	1.20	1.07	1.09	1.20	1.34	1.40
Unemployed rate	1.6	1.3	1.4	1.4	1.5	1.4	1.3

a/ Unemployed and vacancies data in thousands and seasonally adjusted.

to restrict output growth in the coming months, according to the industrial trends survey conducted in February by the Confederation of British Industries. The survey also revealed that more concerns were operating below full capacity than a year earlier, partly as a result of labor shortages.

Wages and prices still rising strongly

With continued labor market strain, British wage rates moved steadily upward during the period under review at about the same rate as in the fourth quarter of 1965. By contrast, increases in retail prices, although still large, were somewhat more moderate than in earlier months. (See Table 3.)

The recent relatively smaller rises in retail prices appear partly attributable to temporary factors rather than to basic changes in the underlying economic situation. Since mid-1965, the British authorities have been able to persuade many corporate executives to postpone intended price increases.

Table 3. United Kingdom: Basic Price Indices 1965-1966

	Per cent Change					
	1965-1964				1966-1965	
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>Jan.</u>	<u>Feb.</u>
Retail prices	4.5	5.2	4.8	4.9	4.4	4.5
Wholesale prices						
Manufactured goods						
(home market)	4.5	4.3	4.2	3.4	2.8	n.a.
Basic materials	0.7	1.5	0.0	0.0	1.8	n.a.
Weekly wage rates	4.2	4.2	4.6	5.0	5.1	5.1
Export prices	2.9	1.8	1.9	1.9	2.8	n.a.
Import prices	0.0	0.9	0.0	0.0	-0.9	n.a.

How much longer such delaying tactics can be expected to be effective is being debated in Britain at the moment. With increases in wages and other costs outpacing the rise in prices, profits have been squeezed. On a seasonally-adjusted basis, gross trading profits of British companies fell between the first and fourth quarters of 1965 after they had risen steadily during the preceding 9 quarters; the CBI survey indicated that this declining trend is expected to continue.

Some upward price adjustments have already taken place. In March, prices on selected steel and aluminum fabricating products were raised 4 per cent, the largest steel price increase since 1958. Similar adjustments are expected in other sectors as the impact of these two actions spreads through the economy.

Growth of private sector credit still shows mixed tendencies

Demand pressures within the United Kingdom have remained strong despite a noticeable curtailment in the growth of bank loans and consumer

installment credit. Bank loans rose only 2-1/2 per cent over the 12 months ending at mid-March 1966--well below the Bank of England's 5 per cent guideline and the 12 per cent rise during the preceding 12 months. The amount of consumer credit outstanding actually declined in the final quarter of 1965 and again in January of this year. It had been rising rapidly prior to the middle of 1965. (See Table 4.) This about-face in the trend of installment credit was clearly due in large measure to the larger down-payment requirements and shorter repayment periods imposed by the Board of Trade last July.

Table 4. New Borrowing by the Private Sector 1965-1966
(£ m, monthly or monthly average)

	1 9 6 5				1 9 6 6		
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>
Bank loans <u>a/</u>							
Actual	58	-4	-10	-83	+43	+152	+48
Seasonally adjusted	-12	4	18	25	+25	+ 20	-15
Building society mortgage loans	78	73	73	98	93	87	n. a.
Consumer credit	8	18	10	- 2	- 2	n. a.	n. a.
Net issues by U.K. corporations	29	31	45	49	46	81	124

In contrast to these developments, new mortgage loans by the building societies and net new issues by British corporations moved up sharply during the period under review. (See Table 4.) The rise in mortgage loans was made possible by the continued large inflow of new deposits to the building societies; the substantial increase in market borrowing by British corporations probably reflects in large part the diminished supply of bank funds.

During the period under review, the British authorities took new steps to further limit bank loans and consumer credit. On February 1, the Bank of England requested that the clearing banks keep their advances--seasonally adjusted--to 105 per cent of the March 1965 level until further notice. This meant the level of advances was not to rise above £ 4,788 million. Since the level was only £ 4,679 million at mid-March of this year, the banks could expand their loans by another £ 209 million. On February 8, the Board of Trade raised the down-payment requirements on most household durable goods from 15 to 25 per cent and at the same time reduced the maximum repayment period from 30 to 27 months. The down-payment requirement for automobiles was left unchanged at 25 per cent, but the repayment period was also reduced from 30 to 27 months.

Slightly tighter money market conditions

During the period under review, there was a general tendency for most British money market interest rates and Euro-dollar rates to rise; by mid-April they were somewhat higher than at the first of the year. (See Table 5.) Seasonal factors (mostly heavy tax payments to the British Treasury far in excess of government disbursements) were partly responsible for a reduced availability of short-term sterling funds. The rise in Euro-dollar rates, on the other hand, seemed to be related to the general tightening of money market conditions in the United States where 90-day CD rates, for example, rose from 4.88 per cent on January 14 to 5.24 per cent on April 13.

Table 5. United Kingdom: Selected Money Market Rates
December 1965-April 1966
(per cent per annum)

	1965	1966					
	Dec. 17	Jan. 7	Feb. 11	March		April	
				4	25	15	22
Call money	5.25	5.62	5.38	5.44	4.62	5.50	5.38
Treasury bill <u>a/</u>	5.44	5.50	5.60	5.63	5.62	5.62	5.65
Deposit rates <u>b/</u>							
Local authority	6.44	6.25	6.15	6.31	6.44	6.38	6.41
Euro-dollars	5.44	5.25	5.50	5.50	5.69	5.75	5.75

a/ Maximum tender.

b/ 90-days.

Renewed weakness in government bond markets

Between early February and mid-March, government bond yields rose sharply to the peak levels reached last August. Market conditions became more settled thereafter and interest rates, especially at the short end of the market, eased slightly. (See Table 6.)

Several factors contributed to the sharp deterioration of market conditions, but considerations relating to the general election seemed to be the dominant influence. Selling pressures subsided in the final days of the election campaign, when the public opinion polls predicted a large Labor victory, and buying interest revived when the Labor Party won its expected majority.

Payments position improves in fourth quarter of 1965

The overall balance of Britain's international payments (which is similar to the official settlements definition employed by the United States) moved into surplus during the final quarter of 1965, in sharp

Table 6. United Kingdom: Selected Capital Market Yields
January-April 1966
 (per cent per annum)

	Jan. <u>13</u>	Feb. <u>3</u>	Mar. <u>17</u>		April	
				<u>7</u>	<u>14</u>	<u>21</u>
Government bonds						
3% 1959-69	6.37	6.17	6.72	6.77	6.60	6.60
5% 1971	6.54	6.24	6.82	6.79	6.64	6.65
3-1/2% 1979-81	6.47	6.40	6.70	6.70	6.67	6.67
5-1/2% 2008-12	6.57	6.57	6.80	6.80	6.77	6.80
3-1/2% War Loan	6.57	6.60	6.84	6.79	6.77	6.80
Equities						
Price index	112.47	115.86	113.32	n. a.	112.56	112.64
Dividend yield	5.36	5.22	5.36	n. a.	5.41	5.41

contrast to the sizeable deficits recorded during the first nine months of the year. As a result, the deficit for the full year was one-third the size of the deficit for 1964. (See Table 7, Item E.)

Several factors accounted for the major part of the fourth quarter improvement. First, favorable seasonal factors helped to swing the current account balance into surplus. Secondly, oil companies reduced their direct investment abroad, thereby contributing to a decline in the outflow of long-term capital. Thirdly, confidence in sterling, which had revived in the third quarter, was maintained in the fourth, and Britain experienced a substantial inflow of short-term capital. (See Table 7.)

The British authorities used the foreign exchange accruals to pay off outstanding assistance from the Federal Reserve System and other central banks and to add to official holdings of international reserves. (See Table 7, Item F.)

Table 7. United Kingdom: Balance of Payments 1964-65
(millions of pounds)

	1964	1965				Year
	Year	I	II	III	IV	
A. Current account						
Imports	5006	1228	1270	1250	1296	5044
Exports <u>a/</u>	4471	1140	1212	1150	1277	4799
Trade balance	-535	- 88	- 58	-100	- 19	-265
Services (net)	129	+ 50	+ 53	- 18	+ 44	+129
Current balance	-406	- 38	- 5	-118	+ 25	-136
B. Long-term capital	-363	- 66	- 33	- 92	- 27	-218
C. Balancing item	+ 22	- 1	+ 48	+ 4	+ 54	+105
D. Short-term capital	+ 50	- 38	-153	+ 54	+138	+ 1
E. Overall balance	-697	-143	-143	-152	+190	-248
F. Financing <u>b/</u>						
Central bank assistance	+188	+148	-207	+139	- 99	- 19
Swiss loan	+ 28	--	+ 14	--	--	+ 14
IMF drawing	+359	--	+501	--	- 2	+499
Reserves	+122	- 5	-165	+ 13	- 89	-246
Total	+697	+143	+143	+152	-190	+248

a/ Includes re-exports.

b/ Assets: increase -; decrease +. Liabilities: increase +; decrease -.

Source: Economic Trends.

Trade gap widens in first quarter, 1966

During the first three months of 1966, British exports continued on an upward trend, but imports also moved to sharply higher levels. As a result, the trade deficit--seasonally adjusted and on a balance of payments basis--averaged £ 24 million a month compared with £ 12 million a month for the fourth quarter of 1965. (See Table 8.)

Table 8. United Kingdom: Foreign Trade 1965-1966
(£ m: seasonally adjusted monthly or monthly average)

	1965				1966		
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>
Imports (c.i.f.)	458	483	487	489	501	507	506
Exports (f.o.b.) <u>a/</u>	396	393	414	425	411	448	429
Difference	-62	-90	-73	-64	-90	-59	-77
Trade balance <u>b/</u>	-13	-40	-26	-12	-45	- 5	-22

a/ Includes re-exports.

b/ Adjusted to balance of payments basis.

Higher import levels in the past few months were widely spread among major industrial commodities and provide further evidence of severe inflationary strain. Comparing January-February 1966 with October-December 1965 imports of basic materials rose 1 per cent, chemicals 1 per cent, semi-manufactures 5 per cent and finished manufactures 7 per cent.

International reserves boosted by special transactions

During the first three months of 1966, Britain's international reserve position was still being influenced by special transactions. A very important one occurred in February when the authorities transferred \$885 million from the official portfolio of dollar securities to the Exchange Equalization Account. At the same time they repaid \$288 million of outstanding assistance to the Federal Reserve System. For the month as a whole, the authorities reported an official reserve gain of \$630 million. (See Table 9.)

Table 9. United Kingdom: Official Holdings of Gold and Foreign Exchange
1965-1966 (millions of dollars)

	1965				1966			Total holdings March 31, 1966
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>	
Gold and foreign exchange	+14	<u>a/</u> +462	-36	+249	+14	<u>b/</u> +630	-75	3572.8

a/ Of which \$343 million represents residuals of IMF and Swiss credits after repayment of central bank assistance.

b/ After \$885 million transfer from government portfolio of dollar securities to official reserves, and repayment of \$288 million of central bank assistance.

In March, reserves dropped by \$75 million and the authorities reported that this was a true reserve loss. A number of official transactions took place, but British officials stressed that they did not add to the United Kingdom's international indebtedness.

Sterling weak

In early February, selling pressures developed against spot sterling, that continued well into March, and the rate dropped quite sharply. After the general election at the end of March, which gave the Labor party its widely anticipated large majority, market conditions became more settled, and the spot rate recovered a small portion of the earlier loss. However, this respite proved to be short-lived, and toward the end of April the rate tended to drift down. (See Table 10.)

Several factors contributed to the weaker tone of sterling during February and March, but considerations relating to the domestic economic situation and the general election seemed to dominate.

Table 10. United Kingdom: Exchange rates and Arbitrage calculations
January-April 1966

	Jan.	Feb.	March		April	
	14	18	18	25	1	22
Exchange rates						
Spot (U.S. cents)	280.44	280.22	279.52	279.35	279.41	279.29
Fwd. (p.c. p.a.)	-1.03	-0.92	-1.00	-0.92	-0.96	-0.80
Three month yields and yield spreads						
Treasury bills						
U.K. (covered)	4.33	4.62	4.45	4.53	4.49	4.71
U.S.	4.58	4.63	4.61	4.46	4.49	4.60
Difference	-0.25	-0.01	-0.16	+0.07	0.00	0.11
Deposit rates						
U.K. local authority (covered)	5.22	5.23	5.31	5.52	5.48	5.61
Euro-dollar	5.25	5.38	5.69	5.69	5.75	5.75
Difference	-0.03	-0.15	-0.38	-0.17	-0.27	-0.06
Euro-dollar <u>a/</u>	5.25	5.31	5.62	5.69	5.75	5.75
N.Y. C.D.'s <u>a/b/</u>	4.88	5.06	5.18	5.20	5.22	5.25
Difference	-0.37	-0.25	-0.44	-0.49	-0.53	-0.50

a/ Preceding Wednesday.

b/ Negotiable New York time certificates of deposit.

Pressures against the spot rate did not carry over into the forward market to any great extent, and the forward pound remained at about a 1 per cent per annum discount. (See Table 10.) In the absence of any market movements in the forward discount, covered U.K./U.S. interest differentials showed little change, during the period under review. The covered differential on Treasury bills swung on either side of interest parity, and Euro-dollar deposits rates were consistently higher than the covered yields on local authority deposits. (See Table 10.)

However, the interest spread between Euro-dollar deposits and New York CD's tended to widen slightly with the more rapid rise in Euro-dollar rates. (See Table 10.)