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Recent Economic Developments in the United
Kingdom: October 1962 through January 1963

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Recent Economic Developments in the United Kingdom:
October 1962 through January 1963

Summary

The economic position of the United Kingdom deteriorated perceptibly in the period under review ^{1/} even though the pound has been maintained consistently above the \$2.80 parity and small additions have been made to official reserves. The break-off of the negotiations with the Common Market countries in late January has added a new and important element of uncertainty to cloud domestic business prospects and the external payments outlook for 1963.

On the domestic side, seasonally-adjusted unemployment continued to increase despite a number of monetary and fiscal actions taken to stimulate private demand. The rate of unemployment reached 3.6 per cent on January 14; with registered unemployed above 7 per cent in certain industrial areas, the word "depression" appeared in a press comment on the current business situation. At the same time, industrial production, which in November was 1 per cent below the June-September level, has not significantly advanced from mid-1961 levels.

While abnormally severe weather has contributed to the deterioration this winter, declining private investment and the sluggish export trend are primarily responsible for the adverse business situation. Private investment

^{1/} Economic developments prior to this period are reviewed in the paper "Recent Economic Developments in the United Kingdom: May-October 1962" (November 8, 1962).

expenditures in manufacturing have dropped continuously from the peak reached in the third quarter of 1961, in part as a consequence of the uncertainties of the Common Market negotiations and of Britain's domestic political outlook.

On the export side, shipments in the fourth quarter of 1962 failed to rise above the second-quarter level. In fact, exports have failed to provide the stimulus to economic expansion which the authorities had intended when they introduced measures in July 1961 to hold back domestic demand in order to expand exports. Compared with the mid-1961 level, unemployment is much higher and production has not advanced; while the overall balance of payments position has improved, exports have increased much less than had been anticipated. (See Table 1).

Table 1. United Kingdom: Selected Economic Indicators
(seasonally adjusted)

	<u>Average June-July 1961</u>	<u>Average Sept.-Nov. 1962</u>
Industrial production (index)	116	116
Manufacturing production (index)	117	116
Unemployment (thousands)	307	<u>a/</u> 604
Exports (millions of pounds, monthly average)	318	<u>b/</u> 318

a/ Nov. 1962-Jan. 1963. b/ Oct.-Dec. 1962.

On this evidence, the conclusion must be drawn that, thus far, the 1961 stabilization measures have failed to achieve one of the most critical objectives of the program.

Growing unemployment and spare capacity

The business situation in Britain has deteriorated since mid-year. (See Table 2.). This is evident from the industrial production index and the unemployment figures. By June 1962 output had recovered from the late 1961 decline, but had advanced no further through November. In October, in fact, seasonally adjusted industrial production fell sharply and only partially recovered in November.

Unemployment has continued to climb. By January, over-all unemployment at 3.6 per cent of the labor force was the highest since 1947, in part because of severe winter weather. Some areas in Great Britain are more depressed than others; unemployment was 3.0 in the London and South Eastern area, but it was 7.1 per cent in Scotland and 7.8 per cent in Northeast England, reflecting weak demand in shipbuilding and other heavy industries. Even though the high January figure reflects the effects of over thirty days of sub-freezing temperatures, the number of those unemployed for more than 8 weeks had risen from 524,000 in December to 628,000 in mid-January. (See Table 2.)

The failure of exports to expand and the decline in private fixed capital formation were the main factors contributing to the sluggish business situation investment expenditure of manufacturing industry has been declining steadily since the third quarter of 1961; the fall from the second to the third quarter this year was 9 per cent. (See Table 3.) To some extent this has been offset by a recovery of fixed capital expenditures in the distributive and service industries since the first quarter of 1962, but the over-all spending for industry as a whole has been downward. Inventory investment

Table 2. United Kingdom: Production and Unemployment, selected dates, 1961-1962.

	1961		1962				
	<u>June-July Average</u>	<u>Dec.</u>	<u>Mar.</u>	<u>June</u>	<u>Sept.</u>	<u>Dec.</u>	<u>Jan.</u>
<u>INDUSTRIAL PRODUCTION</u> (1958 = 100)							
All industries	116	113	115	117	117	a/116	
Manufacturing	117	113	115	118	118	a/116	
<u>EMPLOYMENT (thousands)</u>							
<u>Unemployment (unadjusted)</u>	<u>262</u>	<u>389</u>	<u>442</u>	<u>397</u>	<u>465</u>	<u>556</u>	<u>811</u>
Wholly unemployed:	252	355	411	372	439	524	628
8 weeks or less	(147)	(125)	(247)	(215)	(269)	(246))
Over 8 weeks	(105)	(129)	(164)	(157)	(170)	(278)) (628)
Temporarily stopped	10	34	31	25	26	42	186
<u>Percentage of labor force</u>	1.2%	1.7%	2.0%	1.8%	2.1%	2.5%	3.6%
<u>Unemployment (seasonally adjusted)</u>	307	390	401	432	497	557	758
<u>Unfilled vacancies (seasonally adjusted)</u>	354	277	222	223	195	185	179

a/ November.

recovered in the third quarter of 1962, mainly at the wholesale distribution level, but this rise may have reflected heavier imports as well as higher production.

Table 3. United Kingdom Fixed Capital Expenditure in Industry
(In millions of pounds in 1958 prices; seasonally adjusted)

<u>Private Fixed Capital Expenditure:</u>	1961		1962		
	<u>III</u>	<u>IV</u>	<u>I</u>	<u>II</u>	<u>III</u>
Manufacturing industry	311	299	281	277	252
Distributive and service industries	<u>243</u>	<u>224</u>	<u>207</u>	<u>225</u>	<u>232</u>
TOTAL	554	523	488	502	484
<u>Inventory Investment:</u>					
Manufacturing	+53	+64	-32	+32	+29
Wholesale distribution	- 8	- 1	-16	-10	+13
Retail distribution	<u>-24</u>	<u>-11</u>	<u>+33</u>	<u>-11</u>	<u>+ 1</u>
TOTAL	+21	+52	-15	+11	+43

Source: Board of Trade Journal, December 14, 1962

Retail sales figures for October and November suggest only a modest increase may have occurred in consumer expenditures since early summer. The index of retail sales was steady at 118 during the first seven months of 1962 and, after rising in late summer, returned in October and November to the January-July level.

Government continues to expand with caution

The British authorities have taken a number of credit and fiscal measures to stimulate domestic demand, especially since late 1962. Each of these measures represented a cautious attempt on the part of the authorities to expand local demand without inducing external payments difficulties. Yet

combined, these actions constitute a substantial effort to get the economy to expand (see Appendix A).

In addition to these credit and tax measures, short-term interest rates have moved down with the cuts in Bank rate. Long-term market yields, however, have tended to remain stable: the rates on January 25, in fact, were higher than in early October. (See Table 4.)

Table 4. United Kingdom: Selected Securities Yields
(In per cent per annum)

	Treasury Bills	4½% Conversion Stock 1964	3½% Savings Bonds 1965-75	5½% Funding Stock 1982-84	2½% Consols	Share Yield	Yield Gaps
<u>1962</u>							
Mar. 1	5.44	5.51	6.22	6.30	6.26	5.19	1.07
June 28	3.84	4.54	6.22	6.20	6.16	5.86	.30
Oct. 4	3.55	4.03	4.79	5.35	5.56	5.59	-.03
Dec. 21	3.53	3.90	5.13	5.45	5.64	5.51	.10
<u>1963</u>							
Jan. 10	3.41	3.77	5.02	5.45	5.59	5.25	.34
Jan. 25	3.41	3.86	5.19	5.56	5.75	5.46	.29

Monetary ease has not produced a substantial expansion in bank lending to the private sector. On the contrary, since October the banks have expanded credit to the public sector much more than loans to the private sector. (See Table 5.) The fact that the banks have bought government securities or Treasury bills instead of making private loans must be attributed primarily to the lack of business demand for loans.

Table 5. London Clearing Banks: Net Deposits and Selected Assets ^{1/}
(In millions of pounds)

	Changes				1963 Jan.	Outstanding January 16, 1963
	1962 Jan. Dec.	1962 Oct.	1962 Nov.	1962 Dec.		
Net Deposits	+235	+ 86	- 12	- 32	+127	6,702
Claims on Public Sector	<u>+180</u>	<u>+104</u>	<u>+ 6</u>	<u>+ 98</u>	<u>+104</u>	<u>3,150</u>
Government securities	+197	+ 83	- 9	+ 7	+ 28	1,232
Treasury bills	- 95	- 25	+ 17	+ 26	+ 65	1,051
Call loans	+ 80	+ 43	- 9	+ 60	+ 15	801
Loans to nationalized industries	- 2	+ 3	+ 7	+ 5	- 4	66
Claims on Private Sector	<u>+311</u>	<u>+ 39</u>	<u>- 3</u>	<u>+ 20</u>	<u>+ 44</u>	<u>3,860</u>
Advances (net)	+295	+ 42	+ 12	+ 10	+ 46	3,482
Commercial bills	+ 16	- 3	- 15	+ 10	- 2	266
Other investments	--	--	--	--	--	112
Special Deposits with Bank of England	-183	- 75	+ 2	- 39	- 38	--
Reserve Ratios (end of period)						
Liquid assets	34.0	33.5	33.3	34.0	34.6	34.6
Cash	8.2	8.3	8.2	8.2	8.1	8.1
Special deposit	0.5	1.0	1.0	0.5	--	--

Source: The Committee of London Clearing Banks

^{1/} As of the third Wednesday of each month.

Lagging exports a drag on economic recovery

Even though the pound has remained stable in foreign exchange markets, the trade balance has been a matter of great concern to the authorities in recent months. Exports were expected to rise continuously in 1962, but fourth-quarter shipments did not exceed those of the second quarter. (See Table 5.) By contrast, imports rose sharply in the third quarter and remained in the fourth quarter at a level well above the monthly average for 1962. The 2.9 per cent growth in the value of exports in 1962 over calendar 1961 was far below the export growth rate target of 5.7 per cent per year set by the National Economic Development Council as being essential for maintaining an over-all 4 per cent rate of domestic economic growth.

From 1958 to the end of 1962, the value of both exports and imports rose by 20 per cent, even though imports were encouraged by relaxation of import controls. But this favorable result reflects a 7 per cent improvement in the terms of trade which took place between 1958 and 1962. Furthermore, it is widely agreed that Britain's payments position requires a more rapid growth in exports than in imports.

Table 6. United Kingdom: Exports, F.O.B., 1958 to 1962.
(In millions of pounds; seasonally adjusted monthly averages)

	<u>1958</u>	<u>1961</u>	<u>Year</u>	<u>1962</u>			
				<u>1st Qtr</u>	<u>2nd Qtr</u>	<u>3rd Qtr</u>	<u>4th Qtr</u>
<u>By Commodity Classes:</u>							
Basic materials	9	11	12	12	13	12	12
Fuels	11	10	12	11	11	15	12
Engineering products	116	140	143	140	144	143	144
Other manufactures	107	120	123	119	123	123	123
Other	22	26	26	24	28	27	27
	—	—	—	—	—	—	—
Total exports	<u>265</u>	<u>307</u>	<u>316</u>	<u>306</u>	<u>319</u>	<u>320</u>	<u>318</u>
<u>By Area:</u>							
Sterling area	116	117	112	108	114	112	114
EEC	35	51	60	55	60	63	62
EFTA	29	40	43	42	43	43	44
U.S.A.	23	24	28	27	27	28	28
Canada	16	18	16	18	16	16	14
Other	46	57	57	56	59	58	56

The increase in exports in 1962 was evenly divided between fuels (refined petroleum products), engineering goods and other manufactures. (See Table 5.) But on a regional basis British export sales to the sterling area were appreciably lower than in the two preceding years. Sales to Australia have

not recovered fully from their decline in the latter part of 1961. Exports to India, Ghana, Nigeria, Rhodesia and Nyasaland fell sharply in 1962 owing to balance of payments difficulties, in part reflecting low prices for primary products. On the other hand, exports to the Common Market (EEC) countries expanded 17 per cent. Exports to Europe, the U. S. and Canada ceased to grow in the second half of 1962 because of the slowdown in the over-all level of activity in these countries.

Because of the rapid increase in exports to the EEC countries, the break-off in British negotiations with the Common Market casts a cloud over the export outlook. Should trade barriers between the EEC and Britain be maintained while they are eliminated within the Common Market, Britain might well have difficulty in continuing to expand exports in this direction. Insofar as this expansion requires boom conditions in the EEC countries, the expected easing of demand pressures in 1963 may also affect export prospects.

The fundamental element in the steady rise in imports has been in the category of manufactured goods which expanded by 61 per cent between 1958 and 1962 reflecting largely the easing of import controls. Other categories of imports have expanded at much slower rates.

Third-quarter current-account deficit

Even though sterling has remained strong in the foreign exchange markets, the balance of payments moved into deficit in the third quarter. (See Table 6.) On a seasonally adjusted basis the goods and services account shifted from a £37 million surplus in the second to a £13 million deficit in the third quarter. Over all, the payments balance declined only from a surplus of £36 million in the second to £18 million in the third quarter. A £128 million credit in errors and omissions was responsible for this surplus. The British

balance of payments authorities have no full explanation of this unusual phenomenon, but they believe that it was due mainly to fluctuations in trade financing (leads and lags) rather than to a significant inflow of short-term volatile capital. If this hypothesis is correct, it may, to some extent, be a counterpart to the third-quarter deficit in the errors and omissions category in the U.S. balance of payments for the third quarter.

Table 7, United Kingdom: Balance of Payments, 1961-1962 a/
(in millions of pounds)

	1961		1962		
	Jan.- June	July- Sept.	Jan.- Mar.	Apr.- June	July- Sept.
Balance of Payments:					
A) GOODS, SERVICES, AND TRANSFER PAYMENTS, SEASONALLY ADJUSTED					
Exports, f.o.b.	1,931	1,932	960	1,010	1,006
Imports, f.o.b.	-2,048	-2,958	-985	-1,003	-1,039
Trade balance	-117	-26	-25	7	-33
Services and transfer payments	30	36	34	30	20
Total, seasonally adjusted	-87	-10	9	37	-13
Seasonal influences	27	-27	11	39	-32
Total	-60	-17	20	76	-45
B) LONG-TERM CAPITAL	b/- 72	b/ 8	19	-60	-53
C) PRIVATE SHORT-TERM CAPITAL					
Sterling liabilities to foreign private					
Sterling area	51	34	14	43	6
Other	c/- 427	c/ --	-35	2	-23
Miscellaneous capital	c/- 59	c/- 16	111	-24	5
Total	-435	18	90	21	-12
D) NET ERRORS AND OMISSIONS	39	41	94	-1	128
Surplus or deficit (-)	-528	50	223	36	18
Financed by:					
E) EXTRAORDINARY AID b/ c/	368	-278	--	--	--
F) STERLING LIABILITIES TO FOREIGN OFFICIAL					
Sterling area	68	--	-72	-73	-31
Other	c/- 58	c/ 34	-14	-25	-21
Total	10	34	-86	43	-52
G) RESERVE MOVEMENTS					
Drawing rights at IMF (increase -)	-15	389	-89	-91	-19
Gold and foreign exchange (increase -)	165	-195	-48	7	225
Total	150	194	-137	-84	34
TOTAL FINANCING	<u>528</u>	<u>-50</u>	<u>-223</u>	<u>-36</u>	<u>-18</u>

Source: "U.K. Balance of Payments, 1959-62," Cmnd. 1837 (October 1962); Economic Trends (Oct. 1962); Central Statistical Office, Press release (third quarter 1962 data)

a/ No sign indicates credit; minus sign indicates debit.

b/ Excluding advance debt payments (£ 45 million for the first half of 1961, £ 27 million for the second half at 1961, which are included in Group F).

c/ Excluding Basle agreement aid, which is included in Group F.

Reserve accruals continue: market rate maintained

Gold and foreign reserves rose in the fourth quarter by £5 million, in spite of the £66 million scheduled repayments of the U.S. and Canadian loans and some outflow of funds late in December to the Continent for window-dressing purposes. The spot rate remained above par throughout the fourth quarter. (See Table 8.)

Table 8. United Kingdom: Selected Exchange Rates and Gold Price
(In U.S. cents per pound)

	Spot rate	3-month Fwd. premium <u>a/</u> or discount(-)	Security sterling	Gold price ^{b/}
<u>1962</u>				
Oct. 5	280.10	-0.57	279.87	35.130
19	280.24	-0.54	279.62	35.138
Nov. 2	280.12	-0.41	279.25	35.123
16	280.15	-0.43	279.50	35.092
30	280.34	-0.44	280.00	35.083
Dec. 14	280.41	-0.51	280.00	35.074
28	280.26	-0.43	279.87	35.069
<u>1963</u>				
Jan. 11	280.57	-0.45	279.87	35.052
25	280.56	-0.58	279.62	35.060
30	280.33	-0.83	279.88	35.070
Feb. 1	280.41	-0.74	279.49	35.074

a/ In per cent per annum.

b/ In dollars per fine ounce.

The Cuban crisis (October 22-26) had only a temporary effect on sterling exchange rates or the gold price in the London market. The spot rate fell temporarily from October 22 to October 24, but quickly recovered during the following week. However, the demand for forward sterling increased during the crisis, reducing the forward discount from 0.54 on October 19 to a low of 0.27 per cent on October 24. The forward discount remained low, in relation to the U.K.-U.S. Treasury bill interest differentials, providing an incentive to move

funds to London in the early part of November.

Reserves increased by £21 million in January; there were very substantial flows of funds into and out of London during that month. Early in January, there was a substantial inflow from the Continent, especially from Germany, as commercial banks unwound year-end window-dressing operations, and the sterling rate climbed from 280.26 cents on December 28 to a peak of 280.63 cents on January 14. The Bank of England took in substantial dollar assets in this period. However, on January 29 and 30, sterling was under considerable pressure as a large exodus of funds took place in the wake of the news that France had broken off negotiations over British membership in the Common Market and spot reached a low of 280.33 cents. (See Table 8.)

Wages drift continues; prices stable

Although the Government requested last February that wage claims should be held to 2 to 2-1/2 per cent, weekly wage rates rose by approximately 5-1/2 per cent between November 1961 and November 1962. (See Table 9.) The wage rate index remained stable in the three months from August through October, but it inched up one point in November. Prices, however, continued to remain stable. Wholesale prices were unchanged from March through November of 1962. The cost of living index, which had recovered in late summer from the earlier high food prices, rose again in November. Export and import prices rose one point in October. The terms of trade remain unaffected and were 7 per cent above the 1958 level.

Table 9. United Kingdom: Prices and Wages
(1958 = 100)

	Wholesale Prices: Home Market <u>Sales</u>	Cost of <u>Living</u>	Export <u>Prices</u>	Import <u>Prices</u>	Terms of <u>Trade</u> ^{1/}	Weekly Wage <u>Rates</u>
1960 - Sept.	102	101	102	99	103	106
Dec.	103	103	101	99	102	107
1961 - Mar.	104	103	102	98	104	109
June	104	105	102	99	103	110
Sept.	105	106	102	96	106	110
Dec.	106	<u>107</u>	103	97	106	111
1962 - Mar.	107	108	103	97	106	112
June	107	111	103	97	106	113
July	107	110	103	96	107	114
Aug.	107	110	103	96	107	115
Sept.	107	109	103	96	107	115
Oct.	107	109	104	97	107	115
Nov.	107	110	104	97	107	116

^{1/}The ratio of export prices to import prices.

U.K. dollar indebtedness to the United States

British dollar indebtedness to the United States Government exceeds \$4 billion. It consists mainly of the 1946 loan of \$3.75 billion. Repayments of outstanding loans amounted to \$66 million in the year ending June 1961 and \$69 million in the year ending June 1962. British indebtedness to U.S. commercial banks is less than \$200 million, and declined between June 1960 and June 1962. The bulk of these liabilities are short-term. (See Table 10.)

Table 10. United Kingdom: Indebtedness to the U. S.
Government and to Commercial Banks
(In millions of U.S. dollars)

	<u>June 1960</u>	<u>June 1961</u>	<u>June 1962</u>
<u>To U. S. Government</u>			
1946 Loan	3,367	3,314	3,260
Mutual security program	374	369	364
Prior grants converted into credits	499	493	484
Other	<u>37</u>	<u>35</u>	<u>35</u>
Total ^{1/}	4,278	4,212	4,143
 <u>To Commercial Banks</u>			
Long-term	28	11	12
Short-term	<u>181</u>	<u>165</u>	<u>151</u>
Total	209	176	163
 <u>Total</u>	 <u>4,487</u>	 <u>4,388</u>	 <u>4,306</u>

Source: Foreign grants and credits; Federal Reserve Bulletin

^{1/} Details may not add to totals because of rounding.

APPENDIX A

CHRONOLOGY OF OFFICIAL MEASURES TAKEN TO STIMULATE THE BRITISH ECONOMY

The stabilization measures adopted in July 1961 to correct the balance of payments crisis have been removed piecemeal over a considerable period of time. The re-expansionary steps that the government has taken to help eliminate the growing unemployment and to stimulate domestic demand, combine into a substantial effort to promote recovery.

Principal restrictive measures enacted on July 25, 1961:

1. A surcharge of 10 per cent was placed on purchase tax and other main excise and customs duties.
2. Bank rate was increased from 5 to 7 per cent.
3. A "pay pause" was requested to enable the rate of economic growth to catch up with the rise in incomes.

Chronology of relaxation of credit and fiscal policy:

1961: October 5 Bank rate reduced to 6-1/2 per cent
November 2 " " " to 6 per cent

1962: March 8 " " " to 5-1/2 per cent
March 22 " " " to 5 per cent
April 26 " " " to 4-1/2 per cent

May 31: Special deposit reduced (from 3 to 2 per cent for London and from 1-1/2 to 1 per cent for Scottish banks).

June 4: Installment credit controls eased (minimum downpayment requirements were reduced from 20 to 10 per cent on all goods except motor vehicles).

September 27: Special deposit reduced (from 2 to 1 per cent for London and from 1 to 1/2 per cent for Scottish banks).

October 3: Expansionary monetary and fiscal measures:

- a. The Bank of England removed the restrictions on bank lending for financing personal consumption and real estate development.
- b. The Chancellor of the Exchequer announced that:
 - (1) Public investment in schools, universities, housing and slum clearance would be increased by £70 million over the next 18 months.
 - (2) Post-war credits amounting to £42 million were released by reducing the age of repayment to 60 for men and 55 for women.

November 5: Tax reductions:

- a. Purchase tax on automobiles reduced from 45 to 25 per cent.
- b. Tax benefits on increases in investment spending were increased from 20 to 30 per cent on new equipment and from 10 to 15 per cent on new industrial building.

November 29: Remaining special deposits released (half as of December 10 and the remainder as of December 17; bank liquid assets increased by £80 million).

December 31: Purchase tax reduced (the top rate of purchase tax, 45 per cent, was abolished. Goods formerly in this bracket--television and radio sets, phonographs, records, perfumes and cosmetics--taxed at 25 per cent effective January 1, 1963).

1963: January 3: Bank Rate reduced (from 4-1/2 to 4 per cent). At the same time, the Bank of England announced that it would reserve the right to charge more than the Bank Rate on penal loans to the discount market.