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Recent Economic Developments in the United Kingdom:  
July-October, 1964

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Summary

The sluggish export and domestic output performances of the U.K. economy during early 1964 continued to be evident in the period under review.<sup>1/</sup> For the months, April to August, three seasonally adjusted indicators of output changed little: the index of industrial production remained flat at the January level; the volume of retail trade fluctuated around a horizontal trend; and the volume of exports tended slightly downward. Seasonally-adjusted GNP was virtually unchanged from the first to the second quarter. At the same time, current trade returns for the third quarter showed little change from earlier months: imports remained at high levels, export values--despite wide month-to-month variation--had a downward tendency and the resultant trade deficit remained unsustainably high.

Despite these underlying weaknesses, however, pressures on the pound prior to the election on October 16, were only sporadic and reserve losses by the Exchange Equalization Account to support the spot rate were only moderate in amount. The narrow Labor victory had little effect on the foreign exchange market. On October 26, however, the new government announced a series of measures to strengthen the "profoundly unsatisfactory" underlying economic situation.

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<sup>1/</sup> For a review of the British economy in the preceding period, see "Recent Economic Developments in the United Kingdom, April-June, 1964," July 28, 1964.

For the short-run, the new government indicated "the immediate and prospective deficit in the basic balance on foreign transactions for 1964-65" was "most unlikely to be below £700 million" for 1964 and "may well reach £800 million in 1965." As late as mid-August 1964, the National Institute of Economic and Social Research published an estimated deficit of around £500 million for 1964 and was widely criticized for being pessimistic. Short-run measures "to arrest the tendency of imports to rise and get exports on an upward trend" include:

- a. A temporary surcharge of 15 per cent to be levied on all imports, excluding foodstuffs, unmanufactured tobacco and basic raw materials, from all sources without discrimination, on all goods entering with the United Kingdom customs from October 27;
- b. Rebates to exporters of "some part of the burden of indirect taxation are expected to average some 1-1/2 per cent of the value of exported goods, the rates of rebate will probably range from 1 per cent to 3 per cent by half per cent stages." Exports as of October 26, qualify for these rebates which are expected to involve about £70 million a year.

It is estimated by British officials that the surcharge will affect 58 per cent of the imports from the E.E.C.; 48 per cent of the imports from the U.S.; and 13 per cent of the imports from the British Commonwealth.

The program also includes a wide range of measures designed to "begin the task of dealing with the more intransigent underlying economic problem" of making "British industry . . . much more competitive and aggressive." The more important of these measures include:

- a. Immediate consultations with "both sides of industry on the outline of a plan to increase productivity and to ensure that an incomes policy which covers all forms of income and is related to productivity becomes effective;"

- b. Establishment of a price review body;
- c. "Severance payments and other measures to make it easier for workers to change jobs;"
- d. A strict review of government expenditures to reduce foreign payments and to cut out "prestige projects" of low economic priority, and shift domestic resources from the abandoned projects to the private economy.

The initial reaction of financial markets to this program was favorable. The spot pound climbed from 278.28 US cents on October 23, to 278.51 US cents on October 28, and the forward discount narrowed from 0.905 per cent to 0.818 per cent per annum. Yields on Treasury bills and government securities which had begun to drift higher in mid-October stabilized or turned slightly easier. The stock market climbed rapidly from a pre- and post-election shakeout, the index on industrial stocks moving from a recent peak of 377.8 on October 1, to a post-election low of 351.7 and to 359.6 on October 26.

Aggregate output unchanged through August

From January through August, industrial activity was virtually stagnant in sharp contrast to the buoyant performance of 1963, the seasonally adjusted index of industrial production holding steady at 127. (See Table 1.) By contrast, the index rose, on the average, over one per cent per month throughout 1963. During 1963, all major industrial sectors participated in the growth of aggregate output; by contrast, through June of 1964 (the last month for which a complete industrial breakdown is available) several industrial sectors--textiles, engineering and allied industries, timber, and paper and publishing--exhibited output declines and for a wide range of industries it fluctuated

Table 1. United Kingdom: Selected Economic Indicators, 1963-1964

	1963		1964					
	IV Qtr.	I Qtr.	May	June	II Qtr.	July	Aug.	Sept.
Index of Industrial Production	124*	127*	127	127	127*	127	127	n.a.
Volume Index of Retail Trade	105*	106*	104	105	105*	105	106	n.a.
Business Expenditures on Fixed Capital (£ mn.)	490	510	-	-	525	-	-	-
Inventory Investment in Manufacturing (£ mn.)	75	94	-	-	120	-	-	-
Export Volume Index	110*	111*	116	108	109*	102	111	n.a.
Unemployment rate (per cent)	2.1*	2.1*	1.6	1.4	1.5	1.4	1.6	1.5
Import Volume Index (Manufactured goods)	121*	137*	134	146	141*	129	148	n.a.
Gross Domestic Product at factor prices (£ mn.)	6,064	6,057	-	-	6,070	-	-	-

\* Monthly average.

Note: All series except unemployment rate are seasonally adjusted.

Table 2. United Kingdom: Indices of Industrial Output, 1963-1964

	1963				1964		
	Mar.	June	Sept.	Dec.	Jan.	Mar.	June
Expanding industries in 1964							
Chemicals and allied industries	134	137	139	143	147	147	150
Total metals	107	110	116	124	119	127	a/ 131
Gas, electricity and water	130	127	131	135	134	142	137
Stable industries in 1964							
Mining	96	95	95	97	96	97	96
Food and drink	113	116	116	117	115	116	115
Bricks, pottery and glass	123	127	137	142	146	142	143
Other	125	125	127	133	135	135	n.a.
Construction b/	102	124	127	131	n.a.	131	n.a.
Declining industries in 1964							
Engineering and allied industries	117	117	120	124	127	125	124
Textiles and allied industries	110	114	113	115	121	118	116
Textiles	107	109	110	112	118	117	113
Timber and allied industries	100	115	122	121	135	128	126
Paper, printing and publishing	122	126	129	136	140	139	137

\* Seasonally adjusted.

a/ May.

b/ Calendar quarterly average.

fractionally around a horizontal trend. Even for the more narrow range of industries which have exhibited output gains, the percentage increases were smaller than in 1963. (See Table 2.)

Two factors have contributed to the change this year in the industrial picture: (1) a weakening of demand; and (2) capacity limitations in terms of plant, equipment, and labor. Two major factors contributed to the weakening of demand: the declining trend of the export volume index, and the stability of the volume index for retail trade. (See Table 1.)

One expansionary factor to be found in 1964 is the steady rise in capital spending, especially by the private sector. (See Table 1.) Inventory investment has also risen during the first half of 1964. Data on public sector capital spending in the second quarter are not available but may well have continued to expand.

#### Labor markets remain tight

Labor shortages continued to be evident during the period under review. In particular, the unemployment rate hovered around 1.4 per cent of the labor force and the ratio of unemployed to vacancies has fluctuated around 100 per cent. (See Table 3.)

Statistics on plant utilization are not as extensive nor as widely published. However, an FBI survey published in June showed that 56 per cent of the respondents were operating at or near full capacity as compared to 48 per cent in the February survey. This is the highest level since the boom years of 1960-61 and the fifth consecutive increase beginning with February 1963. In addition, press reports suggest that

Table 3. United Kingdom: Labor Market Indicators, June-Sept., 1964

	1964				1963	
	June	July	Aug.	Sept.	June	Sept.
Total unemployed (Thous.)	322	318	368	341	479	485
Seasonally adjusted change (excludes school leavers)	-9.8	+2.8	+1.5	-10.7	-19.5	-11.7
Employment vacancies (Thous.)	368	380	357	334	215	214
Seasonally adjusted change (Thous.)	+17	-5	+6	+2	-19	-11
Ratio of unemployed to vacancies	0.875	0.836	1.030	1.021	2.22	2.26
Unemployment rate (per cent)	1.4	1.4	1.6	1.5	2.1	2.1

Table 4. United Kingdom: New Orders, and Building Contracts and Authorizations, 1963-64<sup>a/</sup>

	1963	1964		
	IV	I	II	July
Index of New Orders				
Electrical and Engineering goods	145	146*	156*	143
Industrial building authorizations (million square feet)	10	13	15	-
Value of new orders for new work obtained by contractors (£ mn.)	544	686	725	-

\* Monthly averages.

<sup>a/</sup> Figures are not seasonally adjusted.

Table 5. United Kingdom: Basic Price Indices, 1963-1964

	1963		1964		
	Jan.	Aug.	Jan.	May	Aug.
Wage rates (weekly average)	132	135	138	140	141
Wholesale prices					
Manufactured goods, home market sales	119.4	120.0	122.1	124.3	125.0
Basic materials	102.4	100.2	107.3	105.6	107.0
Retail prices	102.5	103.0	104.7	107.0	107.8
Export prices	102.0	104.0	105.0	106.0	107.0
Import prices	101.0	103.0	107.0	107.0	106.0

such industries as steel, machine tools and building supplies are, and have been, working at plant capacity.

The lengthening of order books through the second quarter, especially in the construction industries, suggests that the pressure on already hard pressed building materials is likely to continue. The exception here is the electrical and engineering industries where declining output indicates the existence of at least available plant capacity. (See Table 4.)

#### Prices and wages continue to advance

Further indication of the pressure upon domestic resources is given by the continued advance of basic price indices through August (the latest date for which data are available). Comparing the first eight months of 1964 to the first eight months of 1963, there has been no general relaxation of the rate of increase of prices this year. In fact the cost of living index and the price index of manufactured goods for home market sales rose faster in 1964 than during the same period in 1963. The rate of increase of wage rates and export prices was about the same in 1964 as in 1963, and the basic materials price index, which usually falls during these months, fell much less in 1964. On the other hand, the import price index rose during 1963, but fell slightly in 1964. (See Table 5.)

#### Borrowing by the private sector continues to expand

New borrowing by the private sector continued to increase during the second and third quarters of 1964, but not in a consistent and uniform

pattern. However, the rate of increase this year was noticeably greater than for the same period one year ago. Seasonally adjusted bank advances expanded at an increasing rate in 1964, in marked contrast to the decreasing rate of 1963. The advance of instalment credit followed a "see-saw" pattern, as it did in 1963, but quarter for quarter, the increases were greater this year. New capital issues by United Kingdom corporations rode a downward trend in the first three quarters of 1964, but the quarterly values this year were greater than in 1963. (See Table 6.)

Treasury budget records growing deficit

Government expenditures outpaced receipts by a growing margin in the second and third calendar quarters compared with the first. However, according to the Bank of England's quarterly Bulletin, the growth of spending is somewhat less than would be expected on the basis of the original budget estimates. During the second quarter there was an over-all cash deficit of £238 million compared with a first quarter surplus of £628 million. (See Table 7.) Data for all budget items are not available for the third quarter, but preliminary evidence suggests that cash requirements grew substantially. In particular, the over-all deficit between regular receipts and expenditures, grew by nearly £250 million in the third quarter. Other budgetary transactions are not likely to significantly reduce the over-all third quarter deficit of 507 million pounds.

The second quarter cash deficit was financed mostly in the form of national savings securities, Tax Reserve Certificates and currency issues by the Bank of England. (See Table 7.)

Table 6. New Borrowing by the Private Sector, 1963-64  
(millions of pounds)

	1963				1964			<u>Total Outstanding Sept. 1964</u>
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>I</u>	<u>II</u>	<u>III</u>	
Bank advances (seasonally adjusted)	165	105	95	90	80	95	195	4,375
Instalment credit - finance houses and dept. stores	-13	32	28	20	31	57	a/ 28	b/ 1,070
New issues of U.K. corporations c/	109	83	102	139	175	137	126	--

a/ July and August.

b/ August.

c/ Net of redemptions.

Table 7. United Kingdom: Central Government Finance, 1964  
(in millions of pounds)

	<u>Changes in Quarter Ending</u>		
	<u>March</u>	<u>June</u>	<u>Sept.</u>
Revenue Less expenditures	+696	-138	-153
Other receipts and expenses (Net)	- 68	-120	-344
Overall difference	+628	-258	-507
Extra-budgetary funds	- 4	+ 40	n.a.
Exchange equalization account	+ 4	- 12	n.a.
Other external items	--	- 8	n.a.
Cash surplus/deficit	+628	-238	n.a.

Securities strong after new measures announced

The announcement by the new government on October 16 of a series of measures to deal with the balance-of-payments weakness, brought to an end a period of erratic movements in stock and government bond prices which had been related to electoral uncertainties and the continuance of monthly trade deficits.

From the end of July to early October, the prices of gilt-edged bonds and industrial shares fluctuated about an upward trend as public opinion polls first favored and then discouraged the Conservative government. In addition, the monthly trade deficits for August and September continued unfavorable. On balance, however, these markets did not display general weakness in the pre-election period. In the money market, local authority demand for short-term funds increased and deposit rates generally fluctuated around a rising trend. The Treasury bill market rate held steady at 4.50 per cent.

A week before the election, the polls showed a noticeable swing back to Labor and conditions in the gilt-edged and stock markets began to reflect uneasiness; prices in both markets fell. The Treasury bill market rate moved up to 4.59 on October 16.

When it became clear that Labor was victorious, renewed selling pressure developed in the two long-term markets and prices rode a downward trend during the first post-election days. However, before a week had passed, demand revived in both markets and prices firmed at lower levels. The government's announcement of the remedial balance-of-payments measures was well received in these markets, and widespread, though fractional gains were immediately posted. (See Table 8.)

Table 8. United Kingdom: Money and Security Markets, July-October 1964  
(per cent per annum)

	July 31		Aug. 28		Sept.		October	
Money Markets								
Local authority deposits								
2-day	4.69	4.50	4.56	4.88	4.94	4.88	4.84	
90-day	5.06	5.00	5.00	5.06	5.12	5.18	5.40	
Treasury bills								
90-day (market yield)	4.50	4.50	4.50	4.50	4.50	4.53	4.59	
Security Markets <sup>a/</sup>								
Security price indices								
Industrial stocks	116.43	117.53	118.31	117.90	118.54	115.70	113.68	
Government bonds	103.88	104.40	104.13	104.13	103.88	103.88	103.22	
Government bond yields								
5% 1967	5.40	5.47	5.45	5.37	5.37	5.42	5.52	
5% 1971	5.68	5.62	5.64	5.60	5.63	5.62	5.67	
5% 1986-89	6.10	6.07	6.08	6.05	6.05	6.07	6.11	
5-1/2% 2008-12	6.18	6.15	6.15	6.12	6.12	6.15	6.17	
3-1/2% War Loan	6.24	6.22	6.22	6.18	6.20	6.22	6.24	

a/ Previous Thursday.

Balance of payments shows widening current account deficit

The trend of widening current account deficits in Britain's balance of payments continued in the second quarter of 1964, both on a seasonally adjusted and unadjusted basis. Basically, exports have failed to match the high and moderately rising level of imports. As a result the seasonally adjusted current account deficit of £113 million for the second quarter was £108 million greater than that in the fourth quarter of 1964. The rising trend of long-term capital has compounded this source of strain on Britain's reserve position. However, two factors served to mitigate this pressure, at least in the second quarter of 1964: a large inflow of short-term capital, exceeding the long-term outflow by £42 million; and the accumulation of sterling claims by the outer sterling area. These two sources together more than offset the combined balance of current- and long-term capital transactions of £194 million. As a result, gold and foreign exchange holdings rose by £16 million in the second quarter. (See Table 9.)

The composition of the short-term inflow is particularly noteworthy. Eighty per cent of the 163 million pounds was split equally between liabilities in nonsterling currencies and sterling liabilities to private nonsterling area institutions. Increases in the former were due solely to increase in U.S. dollar deposits. (See Table 10.)

Adverse trade balance continues through September. Through the third calendar quarter the deficit on trade account continued to widen by about 10 million pounds a month. Present estimates place the balance of payments current account deficit on a seasonally adjusted basis for this

Table 9. United Kingdom: Balance of Payments, Quarterly 1963-1964  
(millions of pounds)

	1963				1964	
	II	III	IV	I	II	
A. Current Account						
Imports (seas. adj.)	1069	1111	1139	1215	1248	
Exports and re-exports (seas. adj.)	1063	1087	1097	1109	1117	
Visible balance (seas. adj.)	-6	-24	-42	-106	-131	
Invisible balance (seas. adj.)	+40	+26	+37	+37	+18	
Total	+34	+2	-5	-69	-113	
Seasonal factors	+34	-44	-2	+12	+50	
Recorded current balance	+68	-42	-7	-52	-73	
B. Long-term capital	-10	-31	-51	-95	-121	
C. Balancing item	-38	-1	-65	+56	+29	
D. Private short-term capital	-9	+44	+9	+10	+163	
Surplus or Deficit	+11	-30	-114	-81	-2	
E. Financing						
Foreign central bank assistance	-83	--	--	--	+15	
Sterling liabilities to non-sterling area official	-39	-8	+75	+33	-64	
Outer sterling area:						
Payments surplus with U.K.	-19	-31	+12	-58	-5	
Payments surplus with non-sterling area	+91	+75	-1	+107	+75	
Drawing rights on IMF	+3	+2	--	--	-1	
Gold and foreign exchange	+36	-8	28	-1	-16	
Total	-11	+30	+114	+81	+2	

period in the neighborhood of 150 million pounds; nearly 40 million more than that registered during the second quarter. Over these three months there were synchronous movements in imports and exports, but when imports rose, exports increased by a smaller amount and when imports fell, exports declined by a larger amount. (See Table 11.)

Reserve losses continue through September

The pressure of the trade deficits upon official reserves was in evidence during the four months ending in September.. Reserve losses were recorded in each month and totaled \$221 million. (See Table 12.) To a certain extent the existence of continued reserve losses is indicative of waning support from the outer sterling area and short-term capital inflows. During the third calendar quarter the widening of the trade deficit was not appreciable, but reserve losses were nearly three times reserve accruals of the first six months.

Sterling weakens steadily in foreign exchange markets during pre-election period

During the pre-election period spot sterling weakened against the dollar from 278.84 on July 31, to 278.34 on October 19. Between the end of July and the first week in September, the forward discount held steady and the covered differential on Treasury bills favored London by about 40 basis points. (See Table 13.)

However, during the third week in September the forward discount widened sharply and with Treasury bill market rates relatively stable the covered differential dropped by nearly 20 basis points; this narrower margin was maintained up to a few days before the election. The widening

Table 10. United Kingdom: Composition of Private Short-term Capital Movement, 1963-1964  
(millions of pounds)

	1963		1964	
	<u>III</u>	<u>IV</u>	<u>I</u>	<u>II</u>
Changes in liabilities in non-sterling currencies	-11	-2	35	61
U.S. dollars	-15	-19	55	78
Other	4	17	-20	-11
Changes in sterling liabilities to non-sterling area private institutions	53	24	-35	65
Miscellaneous capital	2	-13	10	38
Total	44	9	10	163

Table 11. United Kingdom: Foreign Trade July-September, 1964  
(seasonally adjusted, millions of pounds)

	<u>July</u>	<u>August</u>	<u>September</u>
Imports (c.i.f.)	430	479	471
Exports (f.o.b.)	331	370	346
Re-exports (f.o.b.)	13	14	14
Balance	86	95	111
Trade balance <sup>a/</sup>	40p	49p	59p

a/ Balance of payments basis.  
p = Preliminary.

Table 12. United Kingdom: Reserve Position: July-Sept., 1964  
(millions of dollars)

	<u>July</u>	<u>August</u>	<u>Sept.</u>	<u>Outstanding Sept. 30, 1964</u>
Changes in gold and convertible currencies	-28	-92	-45	2539
Drawing rights on I.M.F.	--	--	-2	2439
Total	-28	-92	-47	4978

of the forward discount also made local authority deposits less attractive relative to Euro-dollar deposits. (See Table 13.)

As election day approached, the forward rate widened further more than offsetting the minor advance of the U.K. bill and the covered differential dropped to about two basis points. At the same time the spot rate held firm around 278.37.

Exchange markets firm after Labor victory. The foreign exchange markets had a firm tone in the first days following the election, and the spot pound remained in the neighborhood of 278.30 U.S. cents, through Thursday, October 22. The next day it became known that Labor's plans for dealing with the balance-of-payments difficulties would be announced on the following Monday. Spot sterling then came under very heavy selling pressure. However, when the plans were actually announced, spot sterling strengthened noticeably and was quoted in London at 278.40 U.S. cents. This strength continued throughout the week and on October 28, it was quoted in New York at 278.51 U.S. cents.

Table 13. United Kingdom: Exchange Rates and Arbitrage Calculations July-Oct., 1964

	July 31	August 28	September 4	September 25	October 2	October 9	October 23
Exchange rates							
Spot rate (U.S. cents)	278.84	278.43	278.39	278.33	278.31	278.34	278.28
Forward rate (p.c. p.a.)	-0.67	-0.65	-0.62	-0.75	-0.75	-0.76	-0.905
3-month yield and yield spreads (per cent per annum)							
Treasury bills							
U.K. (covered)	3.83	3.85	3.88	3.75	3.75	3.77	3.69
U.S.	3.44	3.46	3.48	3.52	3.53	3.56	3.56
Differential	0.39	0.39	0.40	0.23	0.22	0.21	0.13
Euro- $\text{\$}$ - local authority							
Euro- $\text{\$}$	4.25	4.25	4.25	4.19	4.43	4.50	4.50
Local authority (covered)	4.39	4.35	4.38	4.31	4.37	4.42	4.42
Differential	0.14	0.10	0.13	0.12	-0.06	-0.08	-0.01
Euro- $\text{\$}$ - N.Y. C/D							
Euro- $\text{\$}$ a/	4.31	4.25	4.25	4.19	4.44	4.50	4.50
N.Y. certificate of deposit a/	3.86	3.86	3.88	3.87	3.88	3.94	3.95
Differential	.45	.39	.37	.32	.56	.56	.55

a/ Previous Wednesday.