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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

June 24, 1965

Economic Developments in the United Kingdom:
April-June 1965

17 pages

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Recent Economic Developments in the United Kingdom: April-June 1965

Summary

By the spring of 1965, the apparent substantial improvement in Britain's key economic indicators during the latter months of 1964 had proved to be temporary.[1/] During the period under review, industrial production receded from the January (1965) peak, the export volume declined from December and February highs, and the import volume rebounded appreciably from the low point reached in February.[2/] (See Table 1.) At the same time, prices and wage rates continued to advance strongly, even after taking account of the effects of the new excise taxes on the consumer price index.

Table 1. United Kingdom: Selected Economic Indicators, 1964-1965
(monthly average or monthly)

	1964				1965			
	III	IV	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
Industrial production	127	131	131	132	133	132	130	131
Volume of retail trade	106	107	107	106	108	108	109	107
Export volume	109	113	111	119	111	118	116	115
Import volume	120	119	121	120	116	110	116	118
Unemployment rate	1.5	1.5	1.5	1.5	1.6	1.6	1.6	1.5
Retail prices	106.8	108.0	108.8	109.2	109.5	109.5	109.9	a/ 112
Wage rates	141.2	141.9	142.2	142.9	143.8	140.0	144.4	144.8

a/ First month after increase in excise taxes and postal charges
Source: Monthly Digest of Statistics.

1/ For a review of earlier developments see "Recent Economic Developments in the United Kingdom: January-April 1965" dated April 20, 1965.
2/ It is important to note, however, that February imports were depressed by the U.S. dock strike.

The breaks in output and export growth have occurred at a time of growing foreign and domestic demand on Britain's economic resources. Foreign demand, as measured by export order inflows in the important engineering industries, grew appreciably in the first quarter of 1965 over the final quarter of the preceding year. On the domestic side, the seasonally adjusted volume of retail trade grew substantially in the first quarter of 1965 over the preceding quarter, although it receded in April with the ending of a pre-budget buying wave. (See Table 1.)

With demand continuing to expand, the marked change in Britain's output and export performance may have reflected in part supply bottlenecks--especially on the labor front. By mid-May, the number of unemployed had dropped to 1.3 per cent of the work force; there were almost 1.5 job vacancies for each unemployed worker. During the first quarter, moreover, there was a substantial increase in the number of working days lost due to industrial stoppages; since then, wild-cat strikes have dampened output in such key areas as autos and ships. In contrast, pressures on plant and equipment capacity may have been somewhat less severe than in the recent past; perhaps because of the very large expenditures on fixed capital in 1964. According to the latest quarterly inquiry of the Federation of British Industries fewer firms are operating a full capacity compared to four months ago.

Partly in response to export and perhaps to output developments, the sterling rates weakened appreciably during May. The mid-June, large selling of spot and forward pounds occurred when the large trade deficit for May was announced.

During the period under review, the authorities took several further steps in the direction of credit restraint. On April 29, the Bank of England made a call for special deposits of 1 per cent for the London clearing banks and one half per cent for the Scottish banks. In early May, the Bank requested the commercial banks and other financial institutions to limit the expansion of loans to domestic users (except nationalized industries and local authorities) to 5 per cent between March 1965 and March 1966. Finally on June 3, when Bank Rate was lowered to 6 per cent, the Board of Trade announced a 5 percentage point increase in the downpayment requirements on hire-purchase contracts.

Downturn in aggregate output

Between January and March, the seasonally-adjusted index of industrial output fell three points and then moved up one point in April. The net January-April downturn is in sharp contrast to the 5 point increase that occurred between September (1964) and January. Output by industrial groups through April on a seasonally-adjusted basis are available only for selected manufacturing industries. These data show that, for the most recent four months, output declines were widespread; only the chemicals and allied industries group showed a net rise. (See Table 2.) Output in engineering and allied industries--one of Britains most important export oriented sectors--fell very sharply. (See Table 2.)

Labor markets remain tight.

Labor shortages which have been prevalent since the middle of last year became more intense during April and May of 1965. (See Table 3.) Over these two months, total unemployed fell and vacancies rose more than could be expected on seasonal grounds. By mid-May,

Table 2. United Kingdom: Seasonally-Adjusted Indices of Industrial Output, 1964-1965
(1958 = 100; monthly)

	1964			1965			
	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
Total: all industries	129	131	132	133	132	130	131
Mining	94	95	97	97	96	n.a.	n.a.
Manufacturing	130	132	133	135	133	131	133
Food	119	121	122	122	122	123	118
Chemicals and allied industries	152	154	154	156	155	157	159
Engineering and allied industries	130	130	133	136	133	128	130
Metals	131	132	132	138	138	132	136
Textiles	120	118	118	121	120	116	119
Bricks	152	152	156	152	150	n.a.	n.a.
Timber	123	130	136	136	134	n.a.	n.a.
Paper, etc.	139	139	138	144	140	n.a.	n.a.
Other a/	137	143	144	n.a.	n.a.	n.a.	n.a.
Construction	137	137	137	--	--	--	--
Gas, electricity, water	142	139	141	143	148	n.a.	n.a.

a/ Fourth quarter average.
Source: Monthly Digest of Statistics

unemployed as a percentage of the work force had fallen to 1.3 per cent and the ratio of unemployed to vacancies to 0.73 (both unadjusted for seasonality).

Recent evidence suggests that labor shortages will continue to plague British industry in the near future. In the last latest F.B.I. survey of industrial and export trends, some 41 per cent of 1085 respondents reported that shortages of skilled labor would limit output over the next four months. This ratio has been rising steadily since February 1963 when only 8 per cent reported that skilled labor would be a serious factor in limiting output.

Table 3. United Kingdom: Labor Market Indicators, 1964-1965
(monthly or monthly averages)

	1964		1965				
	III	IV	Jan.	Feb.	March	April	May
Total unemployed	342	348	376	367	372	341	307
Actual change a/	0	-5.6	+25.7	-7.4	-14.2	-28.0	-16.0
Seasonal change a/	+2.0	+15.0	+40.7	+2.1	-18.8	-19.0	-23.0
Employment vacancies	357	318	311	326	358	408	420
Actual change	-10.0	-9.0	-0.3	+14.0	+32.5	+49.6	+12.0
Seasonal change	-8.3	-12.3	-12.0	-0.4	+18.4	+30.5	+0.6
Ratio of unemployed to vacancies	0.95	1.09	1.21	1.12	1.03	0.84	0.73
Unemployment rate (%)	1.5	1.5	1.6	1.6	1.6	1.5	1.3
Total working days lost due to industrial stoppages (all industries and services)	169	129	123	362	394	n.a.	n.a.
Productivity index	127.5	132.0	n.a.	n.a.	n.a.	n.a.	n.a.

a/ Excludes school leavers.
Source: Monthly Digest of Statistics and Economic Report 1964.
Note: All series in thousands. Not seasonally adjusted.

Table 4. United Kingdom: Basic Price Indices, 1963-1965

	1963	1964		1965		(%) Change:	
	Dec.	June	Dec.	Jan.	May	Dec.'63-Dec.'64	Dec.'64-May'65
Retail prices	104.2	107.4	109.2	109.5	112.4	+4.8	+2.8
Wholesale prices							
Manufactured goods, home market sales	121.0	124.4	126.5	127.3	129.2	+4.5	+2.1
Basic materials	106.3	106.1	107.9	107.7	108.3	+1.5	+0.3
Wage rates (wkly. avg.)	137.6	140.0	142.9	143.8	145.0	+3.8	+1.5
Export prices	105.0	106.0	107.0	107.0	a/ 108.0	+1.9	+0.9
Import prices	106.0	106.0	107.0	108.0	a/ 107.0	+0.9	-0.9

a/ April.
Source: Monthly Digest of Statistics.

The restraining influence of plant and equipment upon output growth appears to have moderated in recent months; at least, the business community does not regard it as a serious deterrent to the future expansion of output. According to the F.B.I. survey 54 per cent of the respondents were operating at full capacity in June compared with 59 per cent in February. In addition, only 18 per cent expected plant and equipment to be a limiting factor over the next four months compared with 23 per cent four months ago.

It would appear that additions to plant capacity are responsible for the changes in these percentages, rather than a possible diminution of demand. Expenditures on fixed capital in manufacturing (seasonally adjusted at 1958 prices) averaged £ 272 million a quarter in 1964. In the first quarter of 1965, they reached a new peak of £ 319 million.

Prices and wages still rising strongly

Another sign of further demand growth has been the continued increase in prices and wages over the first five months of 1965. (See Table 4.) Retail and wholesale prices have risen about 2-1/2 per cent (not adjusted for the new taxes), wage rates somewhat less. Export prices have also risen, but import prices have edged down.

If the increase in the cost of living index is adjusted for the new excise taxes, the December-May rise is still about 1.6 per cent--3.8 per cent at an annual rate, as compared with a rise of 4.8 per cent in 1964. (See Table 4.) This comparison suggests, although rather modestly, that the rise in prices might be beginning to slow down.

During the period under review, government officials pressed forward with the incomes policy. In April, they presented several cases of price increases, and in May and June a select group of wage disputes and settlements, to the Prices and Incomes Review Board for investigation. One of the more important of the wage cases involves the 45,000 electricity supply white collar workers. It is the first reference to the Board of a dispute in a State owned industry. Wage settlements in the public sector have exceeded the 6 per cent average for all industries, stimulating criticism of government policy. The outcome of this case may have a significant effect upon the future course of incomes policy.

New orders position strengthens in first quarter.

Additional evidence of continued growth in demand is given by the strengthening in the first quarter of the net new orders position of key industries--engineering and shipbuilding. (See Table 5.)

Table 5. United Kingdom: Net New Orders Domestic and Export 1964-1965

	1964				1965
	I	II	III	IV	I
Engineering industries (1958 = 100)					
Domestic	150	163	138	156	163
Export	134	151	148	169	174
Shipbuilding a/ (Ths gross tons)					
Domestic	269	294	60	n.a.	250
Export	30	16	53	b/	207

a/ All vessels 100 gross tons and over
b/ Modifications and cancellations exceeded new orders for this period
Source: Monthly Digest of Statistics

In the engineering industries, net new home orders rose 4.5 per cent and export orders 3.0 per cent between the first quarter of 1965 and the last quarter of 1964. In shipbuilding, new orders were less than modifications and cancellations in the fourth quarter of 1964. However, in the first three months of this year, British shipyards received new orders for 207,000 tons of merchant ships. (See Table 5.)

New borrowing by the private sector.

Between February and April, there was an increase in borrowing by the private sector after a noticeable downturn around the first of the year. Bank loans, instalment credit, and advances by building societies expanded sharply over these two months, but new issues by U.K. corporations showed no clear trend. (See Table 6.)

Table 6. United Kingdom: New Borrowing by the Private Sector, 1964-1965
(£ million)

	1964 IV	1965 Jan.	Feb.	Mar.	Apr.	May	Total outstanding May 1965
Bank advances a/	190	-50	-40	45	88	-76	4574
Instalment credit b/	31	-2	10	16	18	n.a.	c/1157
New issues (net) U.K. corporations	71	21	26	40	6	28	--
Advances by building societies	273	83	67	84	79	n.a.	--

a/ London clearing banks; seasonally adjusted.
b/ Debt owed to finance houses and department stores; not seasonally adjusted.
c/ April 30, 1965.
Source: Financial Statistics.

These data suggest that the high level of British interest rates were not materially affecting the demand for credit. During the second quarter, the authorities adopted additional credit controls. On April 29, the Bank of England made a call for special deposits--1 per cent for the clearing banks; 1/2 per cent for the Scottish banks. In early May, the Bank placed a 5 per cent ceiling on the growth of clearing bank loans to domestic users, excluding the local authorities and nationalized industries but including private industry. Loans for plant and equipment had been excluded from the initial credit squeeze criteria presented by the Bank last December. On June 3, when Bank rate was lowered from 7 to 6 per cent, the Board of Trade raised the minimum downpayment for hire-purchase contracts by 5 percentage points--from 20 to 25 per cent on automobiles and from 10 to 15 per cent on most other goods.

It is difficult at this time to assess the probable impact of these steps upon overall credit expansion. However, it should be noted that the clearing bank advances (seasonally adjusted) fell by £ 76 million in May. (See Table 6.) Other relevant data are not available at this time.

At the moment, the reduced flow of credit to house building has been a major consequence of recent government actions. Unlike many institutional borrowers, the building societies did not raise their deposit rates when Bank Rate was increased last November. As a result, the flow of funds to the societies greatly diminished in 1965 and loan commitments were satisfied by the sale of liquid assets.

Owing to the strain on their liquidity positions, the societies have been cutting down on their commitments. With the decrease in Bank Rate in June, most money-market deposit rates fell: the societies, however, raised their deposit rates in an attempt to secure more funds.

Foreign trade position weakens in April and May.

Stagnant exports and rising imports led to a trade deficit of £ 76 million in April and £ 109 million in May, reversing trends that had been developing since last November. (See Table 7.) Expectations were for a somewhat better performance, especially on the export side. Some bunching of imports was expected in April, because of the U.S. dock strike, and in May because of the 5 percentage point drop in the import surcharge. The substantial rise of imports in May confirms earlier suspicions that the surcharge was reducing import purchases.

Table 7. United Kingdom: Foreign Trade, 1964-1965
(£ million; seasonally adjusted)

	1964		1965				
	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May
Imports (c.i.f.)	487	476	465	440	468	476	501
Exports (f.o.b.)	369	396	368	390	389	387	379
Re-exports (f.o.b.)	14	13	14	14	13	13	13
Surplus/Deficit	-104	-67	-83	-36	-68	-76	-109
Trade balance	-56	-19	-34	+11	-19	-29	-49

In fact, between the third quarter of 1964 and April 1965, imports of finish manufactures fell noticeably; during January and February of this year, there was some easing in the importation of industrial materials. (See Table 6.) Both categories of goods were covered by the surcharge and both showed substantial increases in May. However, the declining trend of imports through March owed much to the substantial short-fall in food imports, which were down 25 per cent between the third quarter of 1964 and February 1965. (See Table 8.)

Table 8. United Kingdom: Foreign Trade by Commodity Classes, 1964-1965
(£ million; seasonally adjusted, monthly or monthly averages)

	1964			1965				
	II	III	IV	Jan.	Feb.	Mar.	Apr. p/	May p/
Imports (c.i.f.)								
Food, Beverages tobacco	147	152	143	139	122	134	148	143
Industrial materials	206	204	209	195	199	205	208	215
Finished manufactures	71	70	69	67	60	68	64	86
Other	53	50	57	64	59	62	56	57
Exports (f.o.b.)								
Manufactures								
Machinery and Transport Equipt.	150	148	154	152	165	160	158	157
Chemicals	33	35	35	34	37	37	38	36
Textiles	23	23	24	23	23	24	24	23
Other manuf.	99	100	101	98	104	107	110	107
Other	60	57	63	62	61	60	57	56

p/ Provisional

The fall of exports in May was not expected. For that month, the reduction in foreign sales was not confined to single category of goods. Exports of machinery and transport equipment, chemicals and textiles all declined below their April levels. In fact, since February, exports of machinery and transport goods have declined steadily and those of chemicals and textiles have shown little change. (See Table 8.)

Reserve losses mount through April

As evidence of domestic inflationary pressures continued to mount, sterling remained quite weak in the foreign exchange market in the period under review. While there was a brief respite in February, market conditions deteriorated in late March and early April before the budget was presented. For the four months as a whole, the Bank of England,had to draw heavily on central bank credits in order to maintain orderly market conditions. (See Table 9.)

Table 9. United Kingdom: Official Financing and Reserve Position, 1965
(millions of dollars)

	Level as of Dec. '64	Net changes during month of: Jan.	Feb.	Mar.	Apr.	May	Level as of May '65
Credits from:							
Federal Reserve Bank of New York	200	0	-95	+215	-40	-280	--
Other short-term assistance	325	+275	0	+20	+197	-817	--
Total short-term	525	+275	-95	+235	+157	-1097	--
I.M.F.	1000	0	0	0	0	+1400	2400
Swiss bilateral credits	80	0	0	0	0	+40	120
Total	1605	+275	-95	+235	+157	+343	2520
Gold and foreign exchange holdings	2315.6	-16.8	+64.4	-33.6	+22.4	+506.8	2858.8

Source: Bank of England Quarterly Bulletin.

At the end of December, short-term credits extended to the Bank of England totaled $525 million: by the end of April these had increased by $572 million to $1,097 million. The total reserve position adjusted for this central bank assistance fell $537 million. (See Table 9.)

In May, the United Kingdom drew \$1.4 billion from the IMF raising its total indebtedness to \$2.4 billion. At the same time, a \$40 million bilateral credit was arranged with the Swiss. All but \$343 million of these long-term loans were used to re-pay central bank credits, making the true reserve rise for the month of May about \$164 million. (See Table 9.)

At the end of May, British reserves totaled \$2.8 billion; long-term indebtedness \$2.5 billion. However, the authorities also possess a portfolio of U.S. dollar securities which, according to the Bank of England, has had in the recent past an average market value of about \$1.2 billion.

Money market remains tight after change in Bank Rate

Although many money rates fell by about one percentage point after the reduction in Bank Rate (see Table 10), credit conditions have been kept tight by the new selective control measures and the apparent absence of money flows to London. The Bank of England had to purchase bills from the market on a number of occasions in June, but there has been no borrowing from the central bank since the change in Bank Rate. In addition, local authority rates rose modestly during the second week of June after falling more or less steadily since the middle of March.

Prior to the change in Bank Rate, special factors had led to noticeable changes in the Treasury bill and local authority deposit rates. (See Table 10.) In the Treasury bill market, expectations of cut in

Bank Rate together with the low amount of Treasury bills on offer at the weekly tender led the discount houses to raise their bidding price. As a result, the market yield on Treasury bills was pushed down to 6.19 per cent on May 21. By the end of May, the discount houses finally reacted to the pressures of repeated borrowing at Bank rate; they lowered their bidding price and pushed the market rate up to 6.28 per cent.

Table 10. United Kingdom: Selected Money Market Rates, March-June 1965
(per cent)

	Mar. 12	Apr. 23	May 28	June 4	June 11	June 18
Call money a/	6.44	6.50	6.38	5.38	5.38	5.38
Local authority deposit rates						
2-day	7.68	7.25	7.12	6.06	5.94	n.a.
90-day	7.81	7.31	6.88	6.37	6.44	n.a.
Treasury bill 90-day (market yield)	6.20	6.35	6.28	5.56	5.49	5.49
Euro-dollar deposits						
Call	b/4.19	4.12	4.38	4.38	4.38	4.38
90-day	b/5.13	4.75	5.25	5.12	5.00	5.00

a/ Median of a range of rates published in the Financial Times.
b/ March 10, 1965.

In the local authority deposit market rates fell appreciably between mid-March and late May after rising steadily since late in 1964. This turn-around apparently reflected two factors: (1) increased borrowing at the Public Works Loan Board (a Treasury agency) and (2) the general decline of the discount on forward sterling. Between April 1 and June 6, the authorities had borrowed £ 157.1 million or nearly half of the £ 360 million authorized for the entire fiscal year 1965-66.

In the Euro-dollar market, rates moved up appreciably in May (see Table 10). Late in that month, the 90-day rate reached 5.25 per cent--12 basis points higher than the previous peak reached March 10. However, in June rates eased and stabilized at lower levels.

Capital markets weaken further after May trade returns

Conditions in British capital markets weakened sharply after the announcement on June 14 of a £ 109 million trade deficit for May. There were but few buyers for the large offerings of stocks and government bonds; by June 17, gilt-edged yields were above, and stock prices below, their week-earlier levels. (See Table 11.)

Table 11. United Kingdom: Selected Capital Market Yields, April-June 1965

	Apr.	May			June		
	15	13	20	27	3	10	17
Government bonds (per cent)							
5% 1967	6.65	6.65	6.65	6.62	6.42	6.40	6.50
5% 1971	6.82	6.69	6.57	6.69	6.71	6.66	6.74
5-1/2% 1982-84	6.64	6.70	6.66	6.68	6.70	6.69	6.71
5-1/2% 2008-12	6.60	6.72	6.67	6.70	6.77	6.75	6.77
3-1/2% War loan	6.65	6.69	6.63	6.73	6.80	6.73	6.79
Stocks							
Price index a/	104.67	109.13	109.00	106.15	104.36	105.56	103.52
Yield b/ (per cent)	5.66	5.25	5.43	5.58	5.62	5.61	5.73

a/ Financial Times 500 industrials.
b/ Dividend yield on Financial Times 500 industrials.
Source: Bank of England and Financial Times.

This recent shake-out does not represent a break in market sentiment but rather an intensification of conditions that have prevailed since early May. For the larger part of that month, market trading was very samll and there were only minor changes in bond yields and stock prices.

However, toward the end of May, when conditions continued to deteriorate in the foreign exchange market, heavy selling pressure developed in the stock market and prices fell sharply. There was little change in market conditions in early June after the announcement of the cut in Bank rate and the change in hire-purchase requirements.

Sterling weak

Sterling exchange rates weakened sharply after the release of the May trade returns. By June 18, the spot rate had fallen to 279.14 U.S. cents and the forward discount had widened to 1.96 per cent. (See Table 12.)

The selling pressure in mid-June did not mark an alteration in market sentiment. Spot sterling had drifted lower throughout May; toward the end of that month, the forward discount widened sharply when the long-expected cut in Bank rate did not materialize. When the cut finally came on June 3, there was but a temporary improvement in market conditions. (See Table 12.)

During much of May, when the forward discount was drifting lower, there was an incentive to move funds to London on a covered basis. The covered differential on Treasury bills favored London by as much as 40 basis points. For a time, covered local authority deposits were earning more than Euro-dollar deposits. However, with the substantial widening of the forward discount at the end of May, the incentive to acquire sterling assets on a covered basis vanished. (See Table 12.)

Table 12. United Kingdom: Exchange Rates and Arbitrage Calculations, April-June, 1965

	Apr. 30	May 7	May 21	May 28	June 4	June 11	June 18
Exchange rates							
Spot (U.S. cents)	279.94	279.85	279.66	279.30	279.42	279.36	279.14
Forward (per cent per annum)	-2.33	-2.05	-1.82	-2.44	-1.82	-1.68	-1.96
3-month yields and yield spreads							
Treasury bills							
U.K. (covered)	3.87	4.08	4.28	3.76	3.67	3.74	3.46
U.S.	3.90	3.87	3.88	3.85	3.82	3.79	3.77
Differences	-0.03	+0.21	+0.40	-0.09	-0.15	-0.05	-0.31
Deposit rates							
Local authority (covered)	4.73	5.01	5.00	4.44	4.45	4.76	4.48
Euro-dollar	4.81	4.88	4.93	5.25	5.12	5.00	5.00
Differences	-0.08	+0.13	+0.07	-0.81	-0.67	-0.24	-0.52
Euro-dollar a/	4.81	4.81	4.88	5.00	5.25	5.00	5.06
New York CD's a/b/	4.29	4.31	4.33	4.33	4.34	4.33	4.30
Differences	+0.52	+0.50	+0.55	+0.67	+0.91	+0.67	+0.76

a/ Previous Wednesday.
b/ Secondary offering rates for negotiable New York certificates of time deposits.