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

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Summary

The general deterioration in British economic trends, which began early in 1965, continued through the second quarter.1/ During the period under review, export volume declined further from its February peak, import volume remained at a high level, and industrial output remained below the January high--all on a seasonally adjusted basis. (See Table 1.) Moreover, wage rates and retail prices continued to rise and by the end of June averaged 2.5 per cent above levels reached at the end of 1964.

Table 1. United Kingdom: Selected Economic Indicators, 1964-65
(monthly or monthly average)

	1964	1965					
	IV	Jan.	Feb.	Mar.	April	May	June
Volume indices							
Industrial prod.	131	133	132	130	131	132	
Retail trade	107	108	108	109	107	107	
Exports	113	111	118	116	115	113	p/112
Imports	119	116	110	116	118	125	p/118
Price indices							
Retail prices	108.0	109.5	109.5	109.9	112.0	112.4	112.7
Wage rates	141.9	143.8	144.0	144.4	144.8	145.0	145.2

p/ Provisional estimate.
Source: Monthly Digest of Statistics.
Note: All data seasonally adjusted except retail prices and wage rates.

1/ For a review of earlier developments see "Recent Economic Developments in the United Kingdom: April-June 1965" dated June 24, 1965.

Because of these disquieting developments the British authorities announced, on July 27, supplementary measures designed to bolster the external position. They fall into three broad categories: (1) measures to restrict the growth of domestic demand; (2) measures to aid the balance of trade; and (3) measures to cut the net capital outflow.

1. Measures to curb domestic spending.

   a. Consumer spending. A reduction from 36 to 30 months in the maximum maturity of hire purchase contracts for most consumer goods.

   b. Private investment spending. Application of licensing requirements for all privately sponsored construction projects, except for industrial building and housing, and except in areas of high unemployment.

   c. Government spending. Central and local government agencies are to defer purchase of goods to the maximum possible extent and to postpone for 6 months the start of construction projects for which contracts have not been signed; local authorities are also to reduce their mortgage lending from £180 million to £130 million.

2. Measures to aid the trade balance.

   a. Exports. A reduction by one per cent in the cost of short-term export finance, and a reduction from £50,000 to £25,000 in the minimum value of a foreign buyer's promissory note that can qualify for discounting at the fixed rate of 5-1/2 per cent.

   b. Imports. Prepayment of imports will not be allowed until the goods are shipped; and all government agencies--national and local--are to defer overseas purchases as much as possible.

3. Measures to restrict the net capital outflow.

   a. Official foreign exchange will no longer be made available for direct investment outside the sterling area; exchange will have to be obtained in the investment currency market or through foreign borrowing.

   b. Proceeds of life insurance policies and other assets of immigrants into the U.K. are to be surrendered at the official exchange rate.

   c. Loans to U.K. corporations controlled by non-residents will require special permission--financing requirements will have to be met from non-resident sources.

Prior to the announcement of these new steps there was some evidence suggesting that the rate of growth of aggregate demand might have eased slightly in the second quarter. In April and May, the retail trade volume (seasonally adjusted) edged off from the high first quarter level. Also, in May, June and July, unemployment declined somewhat less than seasonally. Nevertheless, demand pressures were still strong, judging from the actual decline in the unemployment rate and from increases in prices, wages, and imports.

Export and import developments thus far appear to be largely responsible for the continuing weakness of sterling in the foreign-exchange markets. The pound came under heavy selling pressure again in mid-July when the June trade returns showed continued disappointing export performance.

Domestic financial markets were generally quiet during the period under review.

Labor markets tight through June

The persistence of strong demand pressures was reflected in an intensification of the already tight labor market conditions. In the second quarter, the numbers of those out of work fell steadily and the unemployment rate dropped to 1.2 per cent. In addition, vacancies continued to rise, and by the middle of June there were more than one and a half vacancies for each unemployed worker. (See Table 2.)

However, some labor market indicators suggest that demand growth may have slowed, albeit rather modestly. In May, June and July, both the decline in unemployed (excluding school-leavers) and the rise in vacancies were slightly smaller than the normal seasonal movements.

Prices and wages still rising

The strength of demand pressure within the United Kingdom can also be seen from the continued advance of wage and price indices. At the end of June, indices of wage rates and retail prices were, on the average, 2.5 per cent higher than at the end of 1964. (See Table 1.) Contractual wage increases negotiated during the last two months averaged close to 6 per cent. Although these increases were not as large as those recorded earlier in the year, they still exceeded the official guidelines of 3 to 3-1/2 per cent by a wide margin.

Table 2. United Kingdom: Labor Market Indicators, 1965

Item	1965 Jan.	Feb.	Mar.	Apr.	May	June	July
Unemployment rate	1.6	1.6	1.6	1.5	1.3	1.2	1.2
Total unemployed	376	368	372	341	307	276	280
Total vacancies	311	326	358	407	421	449	452
Ratio of vacancies to unemployed	0.83	0.89	0.96	1.19	1.37	1.63	1.61
Changes in:							
Unemployed (excluding school leavers)							
Actual	+26	- 7	-14	-28	-16	-28	- 4
Normal seasonal	+41	+ 2	-19	-19	-23	-33	-15
Vacancies							
Actual	0	+14	+33	+50	+12	+29	+ 3
Normal seasonal	-12	0	+18	+30	+ 1	+25	+17

Note: All data in thousands except unemployment rate and ratio of vacancies to enemployed.
Source: Monthly Digest of Statistics.

In other wage and price developments, the government's "incomes policy" received two major setbacks in July. First, the Transport and General Workers Union--one of Britain's largest and most militant unions--voted again to repudiate the "Declaration of Intent" signed by many representatives of labor and management late in 1964. In addition, the Union made it clear that it would follow a very aggressive wage policy in the future. Secondly, members of the British trucking industry successfully negotiated average rate increases of about 5 per cent, contrary to the earlier recommendation of the Prices and Incomes Review Board that increases of this size "should, if not withdrawn, not be accepted by the industry's customers."

Growth in new borrowing by private sector

Over the first six months of 1965, the rate of growth of new borrowing by the public sector slackened moderately. (See Table 3.) Between the first and second quarters, commercial bank loans fell sharply, while net corporate issues and building society loans eased slightly. However, instalment credit extension moved up strongly in the second quarter after a momentary pause around the turn of the year.

Table 3. United Kingdom: New Borrowing by Private Sector
1964-1965
(£m monthly average)

	1964				1965	
	I	II	III	IV	I	II
Bank Advances a/						
Actual	+83	+26	+45	+35	+58	- 4
Seasonally adj.	+27	+32	+65	+63	-15	+ 4
Instalment credit b/	+10	+19	+14	+10	+ 8	c/ +19
Advances by building societies	+76	+90	+95	+91	+78	+73
New issues by U.K. corp. (net)	+58	+46	+42	+24	+29	+21

a/ London clearing banks.
b/ Debt owed to finance houses and department stores.
c/ April and May.
Source: Financial Statistics.

This easing in the rate of growth of private-sector borrowing (apart from instalment credit) appears to be more than seasonal. Seasonally adjusted bank loans actually declined £5 million a month in the first half of this year. The flow of building society loans and new issues by U.K. corporations were smaller in the first half of 1965 than during the same period one year ago. (See Table 3.)

The outlook for a continuation of these trends is clouded by a number of factors. On the one hand, it is reasonable to expect that bank loans will be held in check by the five per cent growth limit imposed by the Bank of England last May, and the growth of instalment credit may well be limited by the increase in downpayment requirements announced in June and the smaller repayment periods just made public. On the other hand, building society loans are expected to rise in coming months because the societies have experienced a significant increase in net new deposits since raising their deposit rates to 4 per cent net one month ago. In addition, British firms are expected to turn increasingly to the long-term bond market to finance expenditure plans now that bank credit extentions are limited.

Balance of payments improves substantially in the first quarter

According to data recently released by the Board of Trade, the British balance of payments improved substantially in the first quarter of 1965. (See Table 4.) Compared to the fourth quarter of last year the overall deficit was cut from £582 million to £143 million. The improvement was due mainly to a sharp decline--of about £315 million--in the outflow of short-term capital. A reduction in imports, a rise in invisible earnings, and a small decline in the outflow of long-term capital accounted for the remainder of the quarter-to-quarter gain.

Table 4. United Kingdom: Balance of Payments, 1964-1965
(£ million)

	1964 I	1964 II	1964 III	1964 IV	1965 I
A. Current account					
Imports	1,252	1,261	1,221	1,290	1,227
Exports and re-exports	1,126	1,153	1,030	1,162	1,140
Visible balance	-126	-108	-191	-128	- 87
Invisible balance	+ 72	+ 48	+ 9	+ 50	+ 80
Current balance	- 54	- 60	-182	- 78	- 7
B. Long-term capital	- 86	-114	- 69	-102	- 90
C. Current and long-term capital account	-140	-174	-251	-180	- 97
D. Balancing item	+ 45	+ 17	+ 11	- 72	- 31
E. Short-term capital	+ 94	+146	+115	-330	- 15
F. Overall balance	+ 1	+ 11	-125	-582	-143
G. Financing					
Central bank assistance:					
as non-sterling currency deposits	--	--	+ 59	+ 13	+ 28
as swap transactions	--	+ 5	+ 7	+104	+120
Swiss loan	--	--	--	+ 28	--
I.M.F. drawing	--	--	--	+357	--
Reserves	- 1	- 16	+ 59	+ 80	- 5
Total	- 1	- 11	+125	+582	+143

Source: Board of Trade.

The overall deficit of £143 million was financed exclusively by the use of short-term central bank credits.[2/] In fact, borrowings exceeded the deficit by £5 million; the excess was used to boost Britain's holdings of gold and foreign exchange. (See Table 4.)

2/ For a review of the use of central bank credit since January see "Recent Economic Developments in the United Kingdom: April-June 1965," dated June 24, 1965.

Foreign trade accounts deteriorate in the second quarter

The first quarter improvement in Britain's trade position was short-lived. In the second quarter, imports rose by about 5.5 per cent while exports stagnated at the first quarter level. Taking account of seasonal factors, the trade gap--adjusted to a balance of payments basis--widened from £39 million in January-March to £111 million in the second quarter. (See Table 5.)

For the first six months of 1965 exports have increased by about 4 per cent and imports have fallen about 1 per cent from the average values of 1964--with all of the improvement confined to the first quarter. If the official forecast of a 6 per cent year-to-year gain in exports is to be realized, exports will have to average about £400 million a month during the July-December period, or roughly £25 million more per month than during the first half of 1965.

Table 5. United Kingdom: Foreign Trade 1964-1965
(£m monthly or monthly average, seasonally adjusted)

	1964	1965					
		Jan.	Feb.	Mar.	Apr.	May	June
Imports (c.i.f.)	475	465	440	469	477	501	471
Exports (f.o.b.)	368	369	390	388	387	379	375
Re-exports (f.o.b.)	13	14	14	13	13	13	14
Surplus/Deficit	-94	-82	-36	-68	-77	-109	-82
Trade balance a/	-46	-31	+10	-18	-30	- 56	-33

a/ Balance of payments basis.
Source: Board of Trade.

Foreign Exchange Reserves: Further cental bank assistance in June

In June, Britain's reserves of gold and foreign exchange fell by a reported $67.2 million to $2,791 million. (See Table 6.) However, British Treasury officials announced that the decline had been cushioned by utilization of central bank credits. Britain has made use of such assistance in four of the six months since January, although in May it repaid all credits outstanding at that time out of the $1.4 billion Fund drawing.

Table 6. United Kingdom: Foreign Exchange Position 1965
($ m)

	Changes in: Jan.	Feb.	Mar.	Apr.	May	June	Outstanding June 30 1965
Gold and foreign exchange reserves	-16.8	+64.4	-33.6	+22.4	+506.8	-67.2	2791.6

Source: Bank of England.

Money market conditions remain tight

During June and July money market rates registered minor movements and conditions generally remained tight. (See Table 7.) The stability of call-money rates owed much to support activities by the Bank of England (mostly in the form of open market purchases) which were quite prevalent during the period under review. In the market for Treasury bills, high priced bids by the discount houses at the weekly tender kept the market yield under downward pressure. The authorities, not wishing to see the rate fall too far, forced the houses to borrow--at times quite large amounts--at Bank Rate during late June and early July. The houses finally responded by lowering their bidding price, and the market rate on Treasury bills moved up on July 9 to 5.49 per cent, and on July 16 to 5.54 per cent, close to the June average. In the 90-day deposit market, local authority rates tended to rise in June, only to fall in early July, while Euro-dollar rates eased in June to 4.88 per cent and in mid-July to 4.75 per cent. (See Table 7.)

Table 7. United Kingdom: Selected Money Market Rates June-July 1964
(per cent)

	June				July		
	4	11	18	25	2	9	16
Call money	5.38	5.38	5.38	5.50	5.38	5.38	5.44
Local authority deposits							
2-day	6.06	5.94	5.94	6.25	6.13	6.00	5.94
90-day	6.37	6.44	6.44	6.56	6.38	6.38	6.38
Euro-$ deposits							
Call	4.38	4.38	4.38	4.38	4.38	4.38	4.25
90-day	5.12	5.00	5.00	4.88	4.88	4.88	4.75
Treasury bill	5.56	5.49	5.49	5.46	5.42	5.49	5.54

Capital markets quiet and dull.

There was a general lack of buyer interest in British capital markets during the June-July period, and trading volume remained at a low level. In mid-July, government bond yields were above, and stock prices below, their early June levels. (See Table 8.) Bank of England officials attributed the absence of interest to the continually weak tone of the sterling exchange rates; in the last half of June, price movements on Wall Street and the U.K. trade returns for May gave British investors additional reasons for continuing their "wait and see" behavior.

Table 8. United Kingdom: Selected Capital Market Yields, June-July 1965

Item	June 3	June 10	June 17	June 24	July 1	July 8	July 15
Government bonds (%)							
5% 1967	6.42	6.40	6.50	6.50	6.47	6.52	6.60
5% 1971	6.71	6.66	6.74	6.77	6.73	6.75	6.81
5-1/2% 1982-84	6.70	6.69	6.71	6.75	6.84	6.75	6.80
5-1/2% 2008-12	6.77	6.75	6.77	6.80	6.77	6.77	6.80
3-1/2% War Loan	6.80	6.73	6.79	6.80	6.80	6.85	6.88
Stocks							
Price Index a/	105.36	105.56	103.52	102.38	99.80	99.46	100.46
Yield (%) b/	5.62	5.61	5.73	5.79	5.95	5.98	5.92

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

Foreign exchange markets quite but weak

For the most part, the foreign exchange markets for sterling were relatively quiet during the period under review, but the spot rate eased almost continuously from 279.42 (U.S. cents) on June 4 to 279.01 on July 16. The discount on three-month sterling fluctuated a good deal between 1.60 per cent and 1.96 per cent. (See Table 9.) This relative quiet was broken in mid-June and again in mid-July by heavy selling pressure, which developed after the release of unfavorable trade returns for May and June.

Despite the wide movements in the forward discount, arbitrage incentives generally remained against London during June and July. (See Table 9.) At times, the covered differential on Treasury bills favored New York by as much as 37 basis points, while Euro-dollar deposits earned from 24 to 67 basis points more than covered local authority deposits, and 48 to 99 basis points more than New York certificates of deposit.

Table 9. United Kingdom: Exchange Rates and Arbitrage Calculation, June-July 1965

	June 4	June 11	June 18	June 25	July 2	July 9	July 16
Exchange Rates							
Spot (U.S. cents)	279.42	279.36	279.14	279.15	279.09	279.04	279.01
Fwd. (p.c. p.a.)	-1.82	-1.68	-1.96	-1.60	-1.93	-1.82	-1.86
3-month yields and yield spreads							
Treasury bills							
U.K. (covered)	3.67	3.74	3.46	3.79	3.43	3.56	3.61
U.S.	3.82	3.79	3.77	3.74	3.80	3.84	3.82
Difference	-0.15	-0.05	-0.31	0.05	-0.37	-0.28	-0.21
Deposit rates							
Local authority (covered)	4.45	4.76	4.48	4.96	4.44	4.56	n.a.
Euro-dollar	5.12	5.00	5.00	4.88	4.88	4.88	4.75
Difference	-0.67	-0.24	-0.52	0.08	-0.44	-0.32	n.a.
Euro-dollar a/	5.25	5.00	5.06	4.88	4.81	4.81	4.75
New York C.D.'s a/ b/	4.34	4.33	4.30	4.29	4.29	4.33	n.a.
Difference	-0.99	-0.67	-0.76	-0.59	-0.52	-0.48	n.a.

a/ Previous Wednesday.
b/ Negotiable New York certificates of time deposit.