II/213/74

E U R O P E A N   C O M M U N I T I E S

Monetary Committee

# Monetary Policy in the Countries of the European Economic Community

—

## Institutions and Instruments

Supplement 1974

Denmark

Ireland

United Kingdom

# CONTENTS

## PART ONE

## MONETARY POLICY IN DENMARK


Chapter One – Basic Elements of Monetary Policy

Section I – Institutional framework 1

Para I Monetary and foreign exchange authorities 1

1. Danmarks Nationalbank 1
2. Government Inspector of Commercial Banks and Savings Banks 3
3. Capital Market Board 4

Para II Structure of money and capital market 4

1. Money and capital market institutions 4
   - a) Commercial banks 5
     - (i) Commercial Bank Act 5
     - (ii) Bank lending 5
     - (iii) Deposits in banks 6
     - (iv) Foreign business 6
   - b) Savings banks 7
     - (i) Savings Bank Act 7
     - (ii) Lending 8
     - (iii) Deposits 8
   - c) Post Office Giro 8
   - d) Mortgage credit institutes 9
   - e) Other financial institutes 11
     - Denmark's Ship Credit Fund
     - Industrial Finance Institute
     - Municipal Credit Institute
   - f) Insurance companies and pension funds 13
   - g) Supplementary (Labor Market) 13
     Pension Fund and Social Pension Fund
2. The banking system and the capital market 14
3. Private non-bank sector's saving habits 15
4. External payments 16

Section II - Liquidity 17

Primary money supply
Secondary liquidity
Secondary money supply

Para I Non-bank sector's liquid resources 19

1. Definition 19

2. Composition 19

3. Movements 19

4. Factors affecting the money supply 19

Para II Commercial bank liquidity 20

1. Definition and composition 21

2. Movements 22

3. Factors affecting bank liquidity 23

Para III Liquidity and public finance 23

Chapter Two - Instruments of monetary and foreign exchange policy

Introduction 24

Section I - Refinancing 29

Para I Official discount rate 29

Para II Nationalbank credit facilities available to banks 31

Section II - Control of commercial and savings bank liquidity etc. 38

Para I Liquidity ratios prescribed by law 38

Para II Solvency 39

Para III Danmarks Nationalbank's deposit agreements with commercial banks and savings banks 40

Section III - Regulation of the money and capital market and of external transactions 41

Para I Intervention on the money and capital market 41

1. Money market 41

2. Capital market 43

Para II Regulation of external transactions 45

1. Foreign exchange regulations 46

a) Current payments 46

b) Direct investments 46

c) Issues 47

d) Portfolio investment 47

e) Commercial loans and credits and financial loans 48

f) Residents'accounts abroad and non-residents' accounts in Denmark 48

2. Impact of international capital movements on economic policy 49

3. Regulations governing the net foreign exchange position of commercial banks 49

4. Nationalbank intervention in the forward market for foreign exchange 51

Section IV - Direct restrictions on credit 51

Para I General quantitative restrictions 51

1. Credit ceiling 51

2. Restrictions on local government borrowing 53

Para II Selective credit regulations 53

1. Refinancing of non-profit housing projects and construction of student dwellings 53

2. Ship Credit Fund bonds 53

3. Export credit scheme 53

Annexe 1 Deposit Agreements: Main Features 1965 - 1971 55

Annexe 2 Aims of Monetary and Foreign Exchange Policy 56

Annexe 3 Supervision of Local Government Borrowing 59

Statistical Tables

References

PART TWO

MONETARY POLICY IN IRELAND

Chapter One – Institutional and Structural Aspects of the Monetary System 1

Section I – The Institutions 1

Para I The Monetary Authority 1

Para II Monetary and financial institutions 3

The principal institutions and their charactheristics 4

1. The associated banks 4
2. The non-associated banks 4
3. Hire purchase finance companies 6
4. Building societies 6
5. Assurance companies 7
6. Credit unions 7
7. Other financial institutions 7
8. The money and financial markets 8

Section II – Liquidity 10

Chapter Two – The objectives of monetary policy 13

Para I General objectives and the "Policy Mix" 13

Para II Specific monetary policy objectives 14

Chapter Three – The instruments of monetary policy 17

Section I – General purpose instruments 17

Para I Introduction 17

Para II Rediscounting and refinancing policy 18

Para III Solvency and liquidity ratios 20

Para IV Changes in interest rates 22

Para V Quantitative global restrictions on credit 24

Section II – Instruments for specific purchases 24

| | | |
|---|---|---|
| Para I | Exchange control | 24 |
| Para II | Selective control of domestic credit | 25 |
| Annexe 1 | Objectives of monetary policy in Ireland | 27 |
| Annexe 2 | Controls exercised over Local Authorities in the field of credit | 30 |

Statistical Tables

PART THREE

MONETARY POLICY IN THE UNITED KINGDOM


Chapter One – Basic principles of monetary policy

Section I – Institutional framework and structural conditions

| | | |
|---|---|---|
| Para I | The institutional framework | 1 |
| Para II | Structural conditions | 3 |
| | 1. Structure of the financial intermediaries | 3 |
| | 2. Banking system and capital market | 7 |
| | 3. The public's habits with regard to investment | 12 |
| | 4. Importance of financial transactions with foreign countries | 13 |

Section II – Liquidity

| | | |
|---|---|---|
| Para I | The liquidity of the economy | 15 |
| Para II | Bank liquidity | 17 |
| Para III | Liquidity and public finances | 18 |
| | 1. Management of cash balances | 18 |
| | 2. Functions of the monetary authorities, and the ways in which their activities affect the liquidity of the banks and the economy | 18 |
| | 3. Means by which the Government raises finance | 19 |

Chapter Two – Instruments of monetary policy

Development of techniques of monetary policy 22

Section I – Refinancing policy

| | | |
|---|---|---|
| Para I | General data | 23 |
| Para II | Refinancing | 24 |
| | 1. Rediscounting | 24 |
| | 2. Advances against securities | 24 |
| Para III | Effectiveness of refinancing policy and action through interest rates | 25 |

Section II – Regulation of bank liquidity

| | | |
|---|---|---|
| Para I | Minimum reserves policy | 26 |
| | 1. Organisation of the system | 26 |
| | a) Reserve and public sector lending ratios | 27 |
| | b) Special deposits with the Bank of England | 28 |

2. How the system works 30

Para II Other banking ratios 31

Section III - Control of the money market and of relations with foreign money markets

Para I Open-market policy 32

1. The money market 32

2. Open-market operations 34

Para II Operations affecting short-term international capital flows 36

Section IV - Direct action on lending

Para I Quantitative credit control 38

Para II Selective credit control 38

Bibliography

Statistical Tables

## Summary

PART ONE

Monetary Policy Instruments in Denmark

PART TWO

Monetary Policy Instruments in Ireland

PART THREE

Monetary Policy Instruments in the United Kingdom

# P A R T   O N E

## MONETARY POLICY INSTRUMENTS

## IN

## D E N M A R K

# Chapter One Institutional and structural framework of monetary and foreign-exchange policy

## Section I Institutional framework

### Paragraph I Monetary and foreign-exchange authorities

It is the responsibility of Danmarks Nationalbank, as the Central Bank of Denmark, to maintain a sound monetary system and to facilitate and regulate money transactions and lending activities (Danmarks Nationalbank Act of 7 April 1936). The Nationalbank is thus the central monetary authority of Denmark. The Bank discharges its responsibilities in co-operation with the government, notably the Royal Bank Commissioner (at the present time: the Minister of Economic Affairs and the Budget) who supervises the performance of the duties assigned to the Bank under the Danmarks Nationalbank Act.

The legislation governing the business activities of commercial banks and savings banks is administered by the Ministry of Commerce, Industry and Shipping. The supervision of the banks' compliance with legislation has been delegated to a Government Inspector of Commercial Banks and Savings Banks who is responsible to the Ministry of Commerce.

In the beginning of 1972 a Capital Market Board was set up to advise the government on matters relating to the capital market. The Board has no administrative authority.

Since 1931, the main principles of foreign-exchange policy have been laid down by the government. In practice, guidelines are established after consultation between the government and Danmarks Nationalbank. The principal executive bodies in charge of foreign-exchange policy are the Ministry of Commerce and the Bank.

#### 1. Danmarks Nationalbank

The above mentioned Danmarks Nationalbank Act of 7 April 1936 changed the status of the Bank from that of a joint-stock company to a self-governing non-profit institution.

The Bank's management consists of a Board of Directors, a Committee of Directors and a Board of Governors.

The Board of Directors has 25 members: Eight of them are elected by the Folketing (parliament) from among its members; two (one of whom must be a graduate in economics and the other in law) are appointed by the Royal Bank Commissioner; the remaining fifteen members (who must be thoroughly familiar with economic life) are elected by the Board of Directors as a whole; in such elections the Board is required to ensure comprehensive representation of economic life, including the workers employed in economic life, as well as representation of the various parts of the country. Elections cover periods of five years, and members may be re-elected.

The Committee of Directors consists of the two members of the Board of Directors who are appointed by the Royal Bank Commissioner and five members elected by the Board of Directors from among its members for periods of one year.

The Board of Governors has three members. The Chairman is appointed by the King; the other members are nominated by the Committee of Directors and elected by the Board of Directors.

The Royal Bank Commissioner chairs the meetings of the Board of Directors. He is entitled to attend meetings of the Committee of Directors (but in practice he has not availed himself of this right) and to ask for any information he may want about the Bank's activities.

The Board of Governors is primarily responsible for the Bank's activities in the field of monetary policy. Although the Danmarks Nationalbank Act vests a wide range of authority in the Bank in this field, important policy decisions will in practice be taken only after consultation between the government and the Board of Governors. The latter will also consult the organisations of the commercial banks and the savings banks before decisions are taken which affect the Bank's relations to them.

The Board of Governors has regular consultations - normally once a month - with those members of the cabinet who are responsible for matters involving economic activity. In addition, the Bank will contact the government whenever necessary.

Monetary policy is pursued by way of the official discount rate, by regulating the liquidity of commercial banks and savings banks - for instance through the rules governing their borrowings from the Bank - and by means of voluntary agreements between the Bank and the financial institutions. The primary aim of these agreements is to achieve a rate of growth in bank lending which is commensurate with the performance of the economy. There is no legal provision for regulation of the banking system's liquidity by way of variable cash reserve ratios.

Close co-operation is also maintained between the government and the Bank in the field of foreign-exchange policy. Legislation governing transactions in foreign exchange comes within the purview of the Ministry of Commerce, but many administrative responsibilities have been delegated to the Bank, which is also in charge of the daily quotation of exchange rates and the administration of Denmark's official international liquidity.

Finally, Danmarks Nationalbank serves as the banker of the government.

## 2. Government Inspector of Commercial Banks and Savings Banks

Commercial bank and savings bank activities are governed by respectively the Commercial Bank Act of 15 June 1956 and the Savings Bank Act of 15 January 1960.

Compliance with the provisions of these two Acts (which will be discussed below) is supervised by a Government Inspector of Commercial Banks and Savings Banks who is responsible to the Ministry of Commerce.

It is the duty of the Government Inspector to undertake regular examinations of the methods of operation and the financial position of all commercial and savings banks. His decisions may be appealed to the Ministry of Commerce. He also promulgates rules on the form of presentation of monthly balance sheets, annual accounts, etc. of commercial and savings banks.

In addition, the Government Inspector is the monopoly control authority in fields where the Monopoly Control Act

applies to commercial banks and savings banks.

He publishes annual reports on the activities of commercial banks and savings banks.

### 3. Capital Market Board

The Capital Market Board was established by an administrative decision taken by the government in January 1972. The Minister of Economic Affairs and the Budget is chairman of the Capital Market Board; its vice-chairman is the Chairman of Danmarks Nationalbank's Board of Governors. The Capital Market Board is composed of representatives of the organisations of the money and capital markets and of the other principal trade organisations, as well as of a few government departments. A small group of experts has been set up to undertake studies of the capital market on behalf of the Board.

The Capital Market Board came into being in response to the government's desire to achieve a more satisfactory distribution of the scarce capital funds available, so as to ensure priority for the capital requirements of economic life. The government did not find it expedient to tackle this problem of distribution through a public regulation of allocations of credit. It was found preferable to discuss this allocation problem with representatives of financial institutions and business and industry within the framework of a Capital Market Board. The Board has only advisory functions in relation to the government.

## Paragraph II Structure of money and capital market

### 1. Money and capital market institutions

Normal banking business is transacted through commercial banks and savings banks, which cover a wide range of activities. Commercial banks are not divided according to specific categories of lending and they accept savings deposits in the same way as savings banks. Under the legislation governing banking activity commercial banks and savings banks have the sole right to advertise for deposits.

The Post Giro Office, which is a government agency, plays an important part in money transfer services.

Long-term lending is concentrated in mortgage credit institutes whose functions and methods of operation are very different from those of mortgage credit systems in other countries.

In addition, a number of institutions make medium-term credit available to industry and crafts, including ship-building.

Finally, the money and capital market institutions comprise insurance companies, pension insurance funds and two public pension funds.

(a) Commercial banks

(i) Commercial Bank Act

Under the terms of the Commercial Bank Act of 15 June 1956 a bank must be constituted in accordance with the provisions of the Companies Act. Only commercial banks are allowed to engage in banking business and they have the sole right to use the work "bank" in their names.

The Commercial Bank Act lays down rules on the activities of banks, including their management, capital and reserves, solvency and liquidity, and the type and scope of individual engagements.

The Commercial Bank Act is at present under revision with the aim of bringing its provisions up to date.

Denmark has about 80 banks (1972) of which three main banks account for a little over half the total deposits and advances of all commercial banks. In recent years, amalgamations have reduced the number of banks considerably, while branch networks have been greatly extended.

Commercial bank activities will be described below, while the rules of the Commercial Bank Act governing the solvency and liquidity of banks will be dealt with in Chapter II.

(ii) Bank lending

Banks typically make short-term credit available to business and industry by discounting Bs/E and granting cash credit and overdrafts; most of these, however, are short--term only in form and not in fact. About one fourth of bank

advances consists of loans which are amortised over periods of up to ten years.

In recent years, the banks' intermediate financing of building projects has risen faster than other forms of lending. Out of total bank advances about one fourth consists mainly of loans for new building projects. Such building loans are replaced by mortgage financing when the projects have been completed.

Commercial bank investment in bonds and shares are much less important than their direct lending, although their portfolios of securities - especially bonds - are relatively large. This is explained by the fact, among other things, that the volume of short-term securities available for investment is small.

(iii) Deposits in banks

About 60 per cent of the liabilities of commercial banks consists of deposits of which more than half are sight deposits while the balance represents time deposits subject to 3 and 12 months' notice of withdrawal.

Since the 1930s the most important rates of interest allowed on deposits have been regulated by an interest rates agreement concluded between the central organisations of the commercial banks and the savings banks. The rates fixed under this agreement have normally been adjusted in approximate conformity with changes made in the official discount rate.

In recent years, the question has been raised whether it is still justifiable to maintain the interest rates agreement, seeing that it restricts competition. With the exception of a few non-member banks, the commercial banks and the savings banks have found it preferable to keep the agreement in force, while the monopoly control authority (the Government Inspector of Commercial Banks and Savings Banks) has taken a critical view of the agreement. But the agreement has so far been upheld, especially because the scarce liquidity of the banking system entails abnormal conditions of competition.

(iv) Foreign business

In their capacity of authorised dealers in foreign exchange

commercial banks handle most remittances of business and industry to and from foreign countries; within certain limits banks are also allowed to accept deposits from and grant loans to non-residents.

In addition, banks take an active part in international arbitrage transactions in foreign exchange and securities. On the other hand, their net balances with foreign banks have been subject to varying degrees of regulation since 1965 - see below.

Banks cannot obtain loans abroad for re-lending to finance the domestic activities of Danish borrowers, but foreign loans may be raised for the financing of foreign trade. For some years, however, the latter category of international borrowing has been severely restricted by the rules governing the net foreign-exchange position of commercial banks - see below pp.49-50. (Certain relaxations of these rules are under consideration). Most prospective borrowers wanting to avail themselves of the existing possibilities of raising loans abroad therefore have to do so on their own, but they often ask a Danish bank for assistance, and Danish banks have guaranteed such loans in many cases.

(b) Savings banks

(i) Savings Bank Act

Under the terms of the Savings Bank Act of 15 January 1960 savings banks must be constituted as non-profit self-governing institutions whose profits may be allocated only to reserves or to activities serving public interests. The objects of savings banks are to accept interest-paying deposits from the general public and to invest such deposits in a safe manner. Only institutions complying with the provisions of the Savings Bank Act are entitled to use the designation "savings bank" in their names.

The Savings Bank Act lays down rules on the activities of savings banks, including management and, especially, the investment of deposits held by savings banks.

Denmark has a little less than 300 savings banks (1972) of which about half are very small. As in commercial banking, a rapid process of concentration in the savings bank sector

has reduced the number of savings banks very appreciably in the last few years.

Savings banks are not allowed to engage in commercial bank activities such as the discounting of Bs/E. It is also assumed that they cannot issue guarantees (unless specially authorised by statute), undertake collection of debts, deal in securities on their own account, or take part in the establishment of business undertakings. Nor can they engage in international business transactions (not being authorised foreign-exchange dealers), but they may accept deposits in krone accounts from private non-residents in the same way as commercial banks.

The Savings Bank Act is under revision with a view to bringing its provisions up to date. The savings banks have asked the government for liberalisation of the Act so as to widen the range of their business activities to practically the same extent as that of commercial banks.

(ii) Lending

Most savings bank advances are medium and long-term loans used to finance dwelling houses, farms, local government authorities and co-operative undertakings. In recent years, however, savings bank lending in the form of cash credits has been increasing at a fast rate; this reflects the growing competition of savings banks with commercial banks.

Like the portfolios of bonds held by commercial banks, the savings banks' bond holdings - though fairly large - are of much less importance than their direct lending.

(iii) Deposits

About 85 per cent of the funds held by savings banks consists of deposits; roughly two thirds are time deposits subject to 3 and 12 months' notice of withdrawal.

The most important rates of interest allowed on deposits are regulated under the above mentioned interest rates agreement between commercial banks and savings banks.

(c) Post Giro Office

Money transfers by way of Post Giro accounts are an important element of the payments transfer system. As Denmark

has no bank giro, the participation of commercial and savings banks in the payments system is based mainly on their customers' use of cheques.

The Post Giro, operated by the PTT Administration, is a government agency. It cannot be compared with the postal savings banks existing in certain other countries. The all--important activity of the Post Giro Office is to facilitate money transfers. There are no other governmental banking institutions in Denmark.

Post Giro accounts are widely used, especially by public authorities and business and industrial firms (notably for collection of debts); in recent years, growing numbers of private persons have opened Post Giro accounts.

About 200,000 accounts had been opened by 31 March 1971. The total balance held in these accounts exceeded kr.2 billion, but the balance shows big fluctuations from month to month. In fiscal 1970/71 more than kr.350 billion was paid into Post Giro accounts.

Funds held in Post Giro accounts are placed in bonds, lent or placed on deposit in Danmarks Nationalbank in an account with the Ministry of Finance. At year-end 1971 the funds consisted of

| | Million kroner | Per cent |
|---|---|---|
| Bonds | 1,645 | 57 |
| Advances | 183 | 6 |
| Account with the Ministry of Finance | 1,086 | 37 |
| | 2,914 | 100 |

Direct lending, which is thus very modest, consists mainly of loans to telephone companies and - indirectly - to local government authorities, and deposits in commercial banks, etc.

Like commercial banks, the Post Giro Office can effect payments into and out of Denmark.

(d) Mortgage credit institutes

The activities of these institutes are regulated by the Mortgage Credit Act of 10 June 1970.

The Danish mortgage credit system was built up in the middle of the 19th century and has since been expanded in various ways. A recent structural reorganisation has considerably reduced the number of institutes, simplified the system, and made the terms of mortgage credit more exacting by shortening the period of amortisation, reducing the size of loans in relation to property values and, finally by restricting the access for local government authorities to raise mortgage loans on certain categories of property.

Mortgage credit is available in two tiers, viz. as first and second mortgage loans. There are seven mortgage credit institutes. With certain exceptions four of them grant first and second mortgage loans on practically all real property. The other three are specialised institutes which grant mortgage loans on industrial and agricultural properties.

Most of the institutes are organised as associations of borrowers. The institutes pay no dividends: profits are allocated to reserve funds. The institutes' activities are regulated by law. The government is represented on their boards but is not financially involved in their activities. The institutes have established a Mortgage Credit Board which is their "professional" organisation. This Board, on which the government is represented, also supervises the compliance with the rules laid down for evaluation of properties and for the percentages of property values within which loans may be granted. The purpose of these rules is to avoid competition in this field.

Loans on new one-family houses may be granted for up to 80 per cent of the property value with maturities of 20-30 years. Loans on non-profit housing projects, for which the government guarantees the last part of the mortgage, are granted for up to 95 per cent of the value and run for 30-40 years. Loans on business and industrial property are granted within narrower limits and generally have much shorter periods of amortisation. Mortgage credit may also be obtained for rebuilding and extension and, within narrower limits, also on older properties.

It is a special feature of the Danish mortgage credit system that loans are financed by current issues of bonds in amounts equal to the mortgage deeds received by institutes

as collateral for mortgage loans. Loans are thus normally disbursed to borrowers in bonds carrying the same nominal interest and with the same maturity as the mortgage deeds accepted as collateral security. Borrowers then have to sell these bonds through a bank or stock-exchange broker. Bonds are issued to bearer; they are negotiable on the Copenhagen Stock Exchange where prices are quoted every day.

The mortgage credit system is very effective; the spread between the interest rate payable by the debtor and the interest rate obtained by the creditor is relatively small -typically about 0.5 per cent. The system also provides easy access to mortgage credit on dwelling, business, agricultural and industrial properties.

This form of financing therefore holds a predominant position on the capital market. In terms of market value, the net supply of mortgage credit bonds to the market has represented 8-10 per cent of GNP in recent years. At end-June 1972 the nominal value of mortgage credit bonds in circulation aggregated kr.94 billion. The market value of the bonds, though rather lower, was much greater than the total of commercial and savings bank lending which amounted to kr.51 billion at the same time.

(e) Other financial institutes

A few other large financial institutes are active on the capital market. Among these are Denmark's Ship Credit Fund, the Industrial Finance Institute, and the Municipal Credit Institute.

Denmark's Ship Credit Fund was established in 1961 as a self-governing non-profit institution by Danmarks Nationalbank, commercial banks, insurance companies, shipyards and shipowners.

The Fund grants loans mainly for new ships built for Danish shipowners by Danish or foreign shipyards and for new ships built for foreign owners by Danish yards.

For ships built by Danish yards, Danmarks Nationalbank has undertaken to buy the bonds issued by the Fund at par within two months of delivery of a new ship. This arrangement, introduced to enable Danish shipyards to obtain orders in

competition with foreign yards, was prolonged in December 1971 for one year in respect of ships for which firm orders had been booked before the end of 1972 for contractual delivery before year-end 1976.

Loans are normally granted for eight years within 80 per cent of the contract price at a nominal interest of 7 per cent plus loan charges which bring the debtor's rate of interest up to 7½-8 per cent. Loans are disbursed in bonds at the same nominal interest and with the same maturity as the underlying loans.

Ship Credit Fund loans aggregated kr.3.5 billion at the end of 1971.

The Industrial Finance Institute was established in 1958 by Danmarks Nationalbank, commercial banks, savings banks, insurance companies and the Federation of Danish Industries.

The Institute grants medium-term loans to industrial undertakings and craft industries, especially for the financing of fixed investments, thereby filling the needs existing for credit in the interval between short-term bank financing and long-term mortgage credit financing. Loans for investments in machinery generally run for 3-5 years, while loans for plant where buildings and installations of machinery constitute an entity run for periods ranging between five and eight years.

The Institute obtains its funds from large combined issues, the proceeds of which are lent in cash at rates of interest based on the yields of the respective bond issues.

The Institute's loans outstanding on 31 December 1971 totalled kr.465 million.

The Municipal Credit Institute makes credit available to local government authorities, joint municipal undertakings, district heating stations, power stations, groups of local authorities operating banks of transformers, waterworks, etc., provided that such loans are fully guaranteed by local government authorities.

The members of the Institute are local government authorities

having obtained or guaranteed loans granted by the Institute. The members are jointly or severally liable to bond holders. Loans are disbursed to borrowers in bonds in the same way as loans obtained from mortgage credit institutes.

The Institute's loans outstanding on 31 December 1971 amounted to kr.4.1 billion.

A number of smaller institutes, e.g. financial companies owned by commercial banks, cater in principle to all undertakings which can offer adequate collateral security for loans. Other companies finance hire purchase contracts. Others again operate in association with trade organisations, purchasing societies, etc. The total volume of loans granted by such companies is very small in relation to total lending.

(f) Insurance companies and pension funds

Insurance companies and pension funds are relatively large suppliers of long-term capital, especially to the bond market. They may also buy shares within certain limits and grant direct long-term loans, especially to local government authorities, and against mortgage on real property. At year-end 1969 the volume of bonds held by insurance companies and pension funds aggregated kr.12.5 billion, and their direct loans amounted to kr.3.4 billion. The biggest life insurance corporation is State-owned. Its operations are based on the same principles as those of private companies.

(g) Supplementary (Labour Market) Pension Fund and the Social Pension Fund

The Supplementary (Labour Market) Pension Fund - known in Denmark as ATP: (Arbejdsmarkedets Tillægspension) - was established in 1964, and the Social Pension Fund (DSP: Den sociale Pensionsfond) was established in 1970.

ATP, whose object is to pay supplementary pensions to all wage and salary earners, administers the contributions which wage and salary earners and their employers pay into the Fund.

Under the ATP Act the funds thus received must be placed primarily in bonds. At end-July 1972 ATP held bonds and shares in a total amount of kr.3.7 billion.

DSP was established in connection with the enactment of a general national supplementary pension. Its funds derive from contributions levied on all taxpayers at the rate of 1 per cent of net taxable income.

Under the DSP Act, DSP funds must be currently invested in bonds. At end-July 1972, DSP's bond holdings amounted to kr.1.2 billion. As the disbursement of supplementary national pensions will not begin until 1976, the DSP's surplus and the resulting bond purchases will increase rapidly in the next few years. Danmarks Nationalbank is the agent of DSP and handles its investments.

## 2. The banking system and the capital market

The Danish capital market is dominated by bonds. By far the greater part of the bond supplies are issued by mortgage credit institutes and the special institutes catering to economic life.

From time to time the government has been a large borrower on the bond market, but since 1958 only a few premium lottery loans have been floated on the domestic market.

As explained under 1 (d) above, loans are effected by current issues of mortgage credit bonds which each borrower sells on the market - normally through a commercial bank, a savings bank or a stock-exchange broker - in step with his need for capital.

Bond prices are fixed by daily quotation on the Stock Exchange. All transactions during official business hours, including those of Danmarks Nationalbank, commercial banks and savings banks, must take place through official stock-exchange brokers. These transactions represent only a small part of the daily turnover, but the quotations determine the prices of transactions outside the Stock Exchange.

For the purpose of their functions on the bond market, financial institutions have to maintain working portfolios of bonds, and their bond holdings also represent part of their liquid assets. Bank investments in bonds are not subject to legal restrictions. By the end of June 1972, the amounts of exchange-listed bonds held by commercial banks and savings banks represented respectively 11 per cent and 12 per cent of their aggregate assets.

Commercial banks and savings banks can use their bond holdings as collateral for loans in the Nationalbank. This credit facility and the easy negotiability of bonds have generated tendencies for the banks' demand for bonds to fluctuate in step with their holdings of liquid funds, regardless of the long maturities of mortgage credit bonds and, frequently, considerable fluctuations in bond prices.

Seeing that short-term fluctuations in bank liquidity may induce banks to engage in compensatory transactions on the market for long-term bonds, which may interfere with monetary policy, Danmarks Nationalbank in 1972 introduced new six- and nine-month deposit certificates supplementing the three-month certificates which had existed since 1958. The interest allowed on the new short-term papers was fixed at levels that should make them realistic alternatives to bonds. The deposit certificates will be discussed in more detail in Section II and Chapter II.

The share market is of a relatively modest size in Denmark. There are many joint-stock companies, but comparatively few of them - notably commercial banks, shipping companies, major business and industrial companies - have registered for quotation of their shares on the Stock Exchange. On 1 January 1970, there were 17,200 joint-stock companies with a total paid-up share capital of kr.12.5 billion. At the end of 1971, the shares of about 275 companies with a total paid-up share capital of kr.5.5 billion were included in the official stock-exchange list of quotations (during and after official business hours).

Commercial banks and stock-exchange brokers take an active part in share issues. Being official foreign-exchange dealers they are also entitled, within certain limits, to take part in issues floated on international capital markets. The biggest of the authorised foreign-exchange dealers have availed themselves of this right through participation in international consortiums.

### 3. Private non-bank sector's saving habits

Very little statistical information is available about private savings in Denmark.

The following table is an attempt to estimate the main

items of the private non-bank sector's acquisition of financial assets.

Domestic non-bank sector's net acquisition of main types of financial assets, 1958-1970

| Million kroner | Increase in cash holdings (see Table 3) | Additions to holdings of bonds and shares (market value) | Increase in assets held with insurance companies and pension funds [1] | Savings, total of the three types listed |
|---|---|---|---|---|
| 1958 | 2,085 | 195 | 360 | 2,640 |
| 1959 | 2,094 | 494 | 605 | 3,193 |
| 1960 | 1,225 | 834 | 460 | 2,519 |
| 1961 | 2,108 | 1,315 | 565 | 3,988 |
| 1962 | 2,001 | 1,042 | 570 | 3,613 |
| 1963 | 3,211 | 1,420 | 695 | 5,326 |
| 1964 | 3,136 | 2,171 | 870 | 6,177 |
| 1965 | 3,096 | 2,254 | 865 | 6,215 |
| 1966 | 4,567 | 1,321 | 1,070 | 6,958 |
| 1967 | 3,876 | 1,562 | 1,160 | 6,598 |
| 1968 | 6,229 | 1,835 | 1,325 | 9,389 |
| 1969 | 5,208 | 4,118 | 1,495 | 10,821 |
| 1970 | 1,347 | 3,634 | 1,620 | 6,601 |

1) Some of the figures given for 1965-1970 represent estimates.

It will be seen from the above table that the private non-bank sector places a large part of its savings in securities; these securities consist almost entirely of bonds. The preference given to bonds is probably due especially to the long history of the Danish mortgage credit system and its predominant role in the financing of real property, which have gradually made the general public familiar with bonds. Another reason is that the yields obtained on these easily marketable instruments normally exceed the highest rate of interest allowed on deposits in commercial banks and savings banks.

4. External payments

During the early part of the period 1958-1971 imports and exports of goods and services accounted for 33-34 per cent of GNP. In the last part of the period the share of imports fell to about 30 per cent, but exports declined even more - to about 28 per cent.

This reflects the disequilibrium that developed on Denmark's external balance during the 1960s.

Foreign-exchange restrictions have been maintained in Denmark ever since 1931.

The present foreign-exchange regulations are laid down in an Executive Order issued by the Ministry of Commerce on 20 June 1961 with subsequent amendments, and in Danmarks Nationalbank's instructions to authorised foreign-exchange dealers.

The main object of the foreign-exchange regulations is to regulate capital movements into and out of Denmark, seeing that practically all restrictions on current payments have been liberalised in conformity with the obligations which Denmark has accepted as a member of the OECD and the IMF.

Capital movements were also liberalised to a large extent during the sixties, but significant restrictions are still in force for many categories of capital movements.

Details of the foreign-exchange legislation will be given in Chapter II.

## Section II Liquidity

Three concepts of liquidity are used: (i) primary money supply; (ii) secondary liquidity; and (iii) secondary money supply. In practice there is little difference between secondary liquidity and secondary money supply.

Primary money supply is defined as the sum of notes and coins in circulation, assets held in Post Giro accounts (excluding the Giro deposits of the government and Danmarks Nationalbank), sight deposits in the Nationalbank, uncommitted holdings of three-month, six-month and nine-month deposit certificates issued by Danmarks Nationalbank, and - in 1965-1971 - tied deposits in Danmarks Nationalbank.[1] Other assets included in the primary money supply are the rediscountable values of Nationalbank credit certificates and bonds of the

------------

1) These deposits were tied under agreements concluded by Danmarks Nationalbank with the commercial banks and the savings banks in 1965. The agreements will be explained in Chapter II, Section II, paragraph III. Tied deposits were included in the primary money supply because they were released in step with declines in deposits and because from 1967/68 they could be freely withdrawn against deposits of equivalent amounts in bonds.

special series issued by the Ship Credit Fund, and, finally, the net foreign-exchange assets of commercial banks because banks can always exchange these assets for kroner. Movements in the primary money supply are illustrated in Table 1 of the Tabular Annex.

Secondary liquidity comprises deposits in commercial banks and savings banks. Many countries include only deposits in commercial banks, because in practice only these deposits are regarded as liquid funds while savings bank deposits are taken to represent more long-term savings. In Denmark, no clear line of demarcation can be drawn in this respect between commercial bank deposits and savings bank deposits. Similarly, a distinction between demand deposits and time deposits would be more formal than real. For these reasons, all bank deposits have been included in secondary liquidity.

Hence, secondary liquidity represents the sum of all deposits held in commercial banks and savings banks in sight deposit accounts, demand deposits, and time deposits, as well those subject to less than as those subject to more than one month's notice of withdrawal.

Formally, secondary liquidity also ought to include unutilised credit lines in commercial banks and savings banks because debtors may draw on these credits up to the limits agreed, thereby obtaining liquid funds similar to withdrawals from deposit accounts. In practice, however, such unutilised credit is not included because the degree to which credit lines are utilised is fairly constant: commercial bank credits are typically utilised for two thirds of their maximum limits and savings bank credits for three fourths.

Secondary liquidity is illustrated in Table 3 of the Tabular Annex.

Secondary money supply, i.e. the liquid funds held by business and households, is defined as that part of the primary money supply which belongs to the private non-bank sector plus secondary liquidity.

## Paragraph I    Non-bank sector's liquid resources

### 1. Definition

See above

### 2. Composition

By far the greater part of the non-bank sector's liquid resources consists of deposits in commercial banks and savings banks, which, inclusive of time deposits, amounted to almost 90 per cent of the total money supply at year-end 1971, while the non-bank sector's holdings of primary liquidity - notes coins and assets held in Post Giro accounts - represented some 10 per cent.

### 3. Movements

Movements in the non-bank sector's money supply (secondary money supply) are illustrated in Table 3 of the Tabular Annex.

It is a characteristic feature of these movements that demand deposits have risen most, while primary liquidity has shown only a moderate increase. One reason is that growing numbers of wage and salary earners are paid by way of payroll accounts. Another reason is that the note circulation has decreased since the introduction of the pay-as-you-earn system of income tax collection in 1970.

### 4. Factors affecting the money supply

The main factors affecting the money supply in 1970 and 1971 were:

| Million kroner | 1970 | 1971 |
|---|---|---|
| Government accounts [1] | -1,566 | 507 |
| Current external account | -4,077 | -3,419 |
| Net capital imports for private sector, local governments, etc. | 3,758 | 2,856 |
| Rise in commercial bank and savings bank lending | 2,855 | 2,027 |
| Bond purchases by commercial and savings banks | 796 | 2,600 |
| Bond purchases by Danmarks Nationalbank | 379 | 1,137 |
| Other (net) | - 798 | - 341 |
| Rise in money supply | 1,347 | 5,367 |

1) Addition to (-) or reduction of the government's net assets in Danmarks Nationalbank after certain adjustments.

The impact of these factors on money supply has shown big variations from year to year. Government operations have normally had contractive effects on liquidity, but in some years these operations have resulted in additions to the money supply. Much of the impact of the big current external deficits on liquidity has been offset by imports of capital. During the sixties, new bank lending showed considerable fluctuations but the average rate of growth was relatively high, whereas the rise in bank lending has been fairly small since 1970 and bank purchases of bonds have gone up. Movements in the Nationalbank's bond purchases have been uneven. Through its open market operations the Bank has endeavoured partly to influence liquidity and partly to prevent excessive fluctuations in market prices and bond yields as a result of changes in the rules governing the lending operations of mortgage credit institutes.

Paragraph II Commercial bank liquidity

Changes in primary money supply affect commercial bank liquidity more than the liquidity of savings banks because the latter's lending and deposit structures make them less sensitive to such changes.

A commercial bank's liquid assets consist of cash in hand, deposits in Danmarks Nationalbank and banks, and holdings of other liquid assets, such as securities which can either be sold in the open market or discounted in Danmarks Nationalbank or other banks.

For purposes of monetary policy, the liquidity of the banking system as a whole is of more interest than that of individual banks. The following discussion is therefore concentrated on the banking system's liquidity.

It should be noted, however, that in the last few years the commercial banks have developed a money market in which savings banks are also active. This short-term market will be explained in more detail on p.43. The activation of idle cash funds achieved through this market has probably augmented the lending capacity of the banking system within a given volume of liquidity.

1. Definition and composition

The liquid assets of the banking system consist of primary liquidity; secondary liquidity; and special credit facilities in the Nationalbank.

Primary liquidity comprises the bank's share of the primary money supply, i.e. cash in hand, deposits in Post Giro accounts and with the Nationalbank; holdings of uncommitted deposit certificates; net foreign-exchange assets; that part of Ship Credit bonds which, under the ship credit scheme, can be resold to Danmarks Nationalbank at par within two months of delivery of a ship (such bonds are normally resold without delay); and, finally, the rediscountable value of Nationalbank credit certificates and certain Ship Credit bonds which are rediscountable in the Bank under special rules.

Commercial bank holdings of cash in hand and assets held in Post Giro accounts and in the Nationalbank are normally kept at the lowest level which is compatible with their needs for liquid funds. The range of variations permitted in net foreign assets is kept fairly narrow by the restrictions imposed by the Foreign-Exchange Regulations. Bank holdings of credit certificates and Ship Credit bonds which can be sold to or rediscounted in the Nationalbank on special terms are also limited in size. Fluctuations in the primary liquidity of commercial banks therefore appear first and foremost as changes in holdings of uncommitted deposit certificates. In 1971, these holdings moved between a minimum of some kr.100 million at end-June to a maximum of more than kr.1,600 million at the end of November.

Secondary liquidity comprises the discountable value of the commercial banks' holdings of bonds other than those mentioned above, plus rediscountable Bs/E less discounted bonds and rediscounted Bs/E. Secondary liquidity is difficult to estimate because of uncertainty about the amount of holdings that can be included in such estimates, because banks have to keep part of their bond holdings as a working reserve for day-to-day transactions and because part of their portfolios of bonds (and of other liquid assets as well) is needed for compliance with the liquidity requirements stipulated in the Commercial Bank Act. Only prime commercial Bs/E are rediscountable in the Nationalbank, and it is estimated that only one third of the portfolio is eligible for rediscounting.

In addition to primary and secondary liquidity, banks have access to certain other credit facilities in the Nationalbank. As these facilities, introduced in 1969 for the purpose of intermediate financing of building projects, are temporary and intended to meet only special needs for liquid funds, they cannot be used for any systematic expansion of credit.

A survey of commercial bank liquidity, arranged according to the above criteria, is given in Table 6 of the Tabular Annex.

### 2. Movements

Commercial bank liquidity has deteriorated considerably since the early 1960s. The banks' net assets in the Nationalbank and in foreign exchange, which may serve as a crude measure of liquidity, have often been negative. In the course of the year there are large seasonal variations, notably as a result of payments to and by the Treasury. In the last few years bank liquidity has been exposed to particularly heavy strains in February and March, which are the last months of the fiscal year.

In December 1971, when liquidity was expected to be unusually scarce in the first quarter of 1972, Danmarks Nationalbank raised the discountable value of bonds from 75 to 90 per cent of market value at buying prices and made credit lines available to commercial banks and savings banks without collateral security during the period from 1 February to 15 April 1972; under these lines each individual bank could borrow up to 25 per cent of its total capital and reserves at year-end 1971, and savings banks could borrow up to 2 per cent of total deposits held at end-1971. In the event, however, liquidity proved to be less scarce than envisaged, and no appreciable needs arose for these additional credit lines.

In 1971 and the early months of 1972 commercial banks and savings banks bought large amounts of bonds. While such purchases may reduce the liquid assets of individual banks, they do not detract from the liquidity of the banking system as a whole. On the contrary: these purchases actually represented additions to the credit facilities available to the banking system in the Nationalbank. In the spring of 1972 the

Bank therefore urged the commercial banks and the savings banks to hold back on bond purchases. As alternatives to these purchases the Bank began in May 1972 to issue six-month and nine-month deposit certificates for sale to commercial banks and savings banks. Since the new certificates may be resold to the Bank at a discount at any time before maturity, they place banks in a better position to adapt their liquidity to the exigencies of actual developments. In June 1972 the discountable value of bonds was lowered from 90 to 60 per cent.

### 3. Factors affecting bank liquidity

The factors which affect the liquidity of banks (i.e. net assets held in the Nationalbank and abroad) are: Payments to and by the Treasury, changes in note circulation and in the net foreign-exchange position, net profit of the Nationalbank, and the Bank's purchases and sales of bonds. The impact of these factors on liquidity varies considerably both within individual years and from year to year. The most potent factor has been the government's account with the Nationalbank, which will be discussed below. The Bank's purchases and sales of bonds are motivated to some extent by considerations of liquidity, but in some periods they have also served to prevent excessive fluctuations in bond prices.

## Paragraph III Liquidity and public finance

As noted previously, Danmarks Nationalbank is the banker of the government, which keeps practically all its accounts in the Bank. Over a given period, net payments to and by the government are therefore reflected in roughly parallel movements in the Treasury's current account with the Bank. Local government authorities maintain accounts with commercial banks and savings banks.

As explained above, the impact of government transactions on bank liquidity varies substantially from quarter to quarter, but in the long view these variations have resulted in large-scale absorptions of liquid funds.

There are no outstanding Treasury bills. The last of these were redeemed in 1959. Except for a few small premium lottery loans, the government has not floated bond loans on the domestic market for many years.

The government's debt has therefore declined very appreciably: Between end-March 1959 and 1971 the net debt fell from kr.8.8 billion to kr.0.5 billion. The domestic debt, which stood at kr.7.8 billion at end-March 1959, moved into a surplus of kr.3.2 billion at end-March 1971. In order to strengthen the foreign-exchange reserve the government's foreign debt was increased from kr.1 billion to kr.3.7 billion in the same period. The additions made to the foreign-exchange reserve during that period are approximately equal to the net increase recorded in the government's net foreign indebtedness.

These movements were reflected, in the first place, in an improvement in the government's net position vis-à-vis the Nationalbank by close on kr.9 billion - from a debt of kr.2 billion to a credit balance of almost kr.7 billion - and, in the second place, in a reduction of the government's domestic bonded debt by some kr.2 billion from more than kr.5 billion to a little over kr.3 billion.

At end-March 1959 commercial banks held net assets of kr.1 billion in Danmarks Nationalbank and abroad. Without Nationalbank intervention they would therefore have been unable to meet demands on their liquidity of the magnitude indicated above. The Bank's intervention took the form of bond purchases of roughly kr.10 billion in the above mentioned period. The Bank did not buy in a volume that maintained bank liquidity at its previously level: In view of the demand pressures which prevailed during most of the sixties, the Nationalbank allowed the liquidity of banks to deteriorate somewhat. By the end of March 1971, the net position of the commercial banks vis-à-vis the Nationalbank and foreign correspondents was negative by almost kr.2.5 billion.

## Chapter Two — Instruments of Monetary and Foreign-Exchange Policy

### Introduction

This Chapter deals with the main features of the monetary policy pursued since the late 1950s in order to explain the reasons for the uses made of the below mentioned instruments of monetary and foreign-exchange policy.

With few interruptions, a vigorous expansion has been the predominant feature of the Danish economy since 1959. The resulting pressures on the economy were soon reflected in serious repercussions on the current account of the balance of payments which has shown big deficits every year since 1960 (except in 1963 when there was a small surplus).

During most of this period, economic policy - including monetary policy - therefore aimed at keeping a tight rein on the economy.

In the first years of the sixties, monetary policy was implemented mainly by means of the traditional instruments: Changes in the official discount rate and in bank availabilities of credit in the Nationalbank. Besides, contractions of liquidity caused by cash surpluses on central government budgets were allowed, more or less, to penetrate to bank liquidity. In 1964, the rules governing loans from Danmarks Nationalbank were tightened by means of a penal interest rate charged on credit to banks which exceeded the limits set for loans on bonds and for rediscounting of Bs/E. In those years, the Bank addressed frequent appeals to commercial banks and savings banks to hold back on lending.

The budget surpluses and the Nationalbank's monetary policy did not succeed in slowing down the expansion of domestic credit to a sufficient degree. One reason was that the contraction of liquidity did not induce banks to respond in the manner expected. They preferred to go on expanding their lending operations in spite of a continuing deterioration of their cash position. The effects of the contractive policy were also weakened by the access for banks to refinance their lending to importers and exporters by means of loans obtained abroad. Another factor pulling in the same direction was that public utility corporations (telephone companies and power stations) raised substantial loans in foreign capital markets. These borrowing operations, which gradually ran into large amounts, led to a temporary embargo on public foreign borrowing in mid-year 1964.

This was the background against which Danmarks Nationalbank concluded a deposit agreement with the commercial banks in the beginning of 1965. The aim of this agreement was to ensure that credit should not be expanded at a rate that would enhance the risk of economic imbalance. The banks accepted this aim because they felt that a voluntary

agreement was preferable to a more severe application of the Nationalbank's traditional instruments of monetary policy or, possibly, legislation on variable cash reserves.

The main provision of the agreement required banks to tie 20 per cent of increases in their deposits in a special account with Danmarks Nationalbank or in foreign banks under the rules governing funds held abroad. Another important provision was that if a bank increased its net debt to foreign correspondents the whole amount of the increase had to be tied in the Nationalbank.

The Nationalbank undertook to maintain the banking system's liquidity at a reasonable level or, in other words, to refrain from squeezing the banks too hard, and from any action designed to control the purposes for which credit was granted.

An agreement serving the same aim was concluded with the savings banks.

These agreements were later amended in various respects. In 1971 they were suspended in view of the strained credit situation and the below mentioned credit ceilings. The agreements will be explained in more detail in Section II, paragraph II below.

In the summer of 1965 the agreements with the commercial banks and the savings banks were followed up by agreements concluded with the bond-issuing institutes. Under these agreements, temporary restrictions were imposed on bond issues, partly because these were growing rapidly and exerted strong upward pressures on bond yields, and partly because further strains were expected on the bond market after the credit restraints agreed with the commercial banks and the savings banks.

In practice, the restrictions were implemented by means of quotas established for bond-issuing institutes' offers for loans. The quotas were based on the amounts of loans granted during the period from 1 April 1964 to 31 March 1965. These quotas were later raised several times. In 1968, the quota system - which became known as the bond rationing - was practically abolished for new building projects, and the rationing was abolished entirely in 1971.

From 1965 onwards, the emphasis on the instruments applied in monetary policy was thus shifted to quantitative measures. This placed the Nationalbank in a better position to support bank liquidity, also by open market purchases of bonds. In the following period the Bank supported the bond market by substantial purchases, partly because the supply of bonds was extraordinarily large in the period immediately following the conclusion of the agreements with the bond-issuing institutes, and partly in order to prevent the tight fiscal policy from generating excessive strains on bank liquidity. After mid-1965, bond yields remained fairly stable for a couple of years, and the official discount rate remained unchanged from mid-1964 to late 1967.

As noted above, the bond rationing was introduced as a temporary measure because rigid ceilings on the lending operations of the mortgage credit institutes would not be desirable for any long period. The dismantling of bond rationing started in 1968 when economic activity, including building, slowed down.

During the three years it had been in force, the bond rationing made institutes unable to cope with the full demand for loans - probably with the effect that building activity was dampened somewhat. Studies of the market suggested that only limited numbers of prospective borrowers turned to the unorganised market for mortgage deeds, but they may have found certain other substitutes. In any case, a large back-log of applications for mortgage loans developed up to 1968 when the queue of applicants was estimated to represent between kr.4 billion and kr.5 billion. When the rationing was lifted, borrowing operations and the resulting supplies of bonds increased steeply, so that the Nationalbank had to intervene and support the market by large-scale purchases in order to prevent a slump.

The aim of the bond rationing - to dampen the supply of bonds - was maintained through a mortgage credit reform which was enacted in the spring of 1970. The new Mortgage Credit Act imposed restrictions on maturities as well as on the percentages of credit allowed on the estimated values of properties.

After the deposit agreements concluded with the commercial banks and the savings banks in early 1965, the annual rate of

growth in bank lending (which had reached about 18 per cent) declined practically from month to month until it had fallen to about 8 per cent in the spring of 1966. From the autumn of 1966, however, commercial and savings bank lending showed a new sharp upturn which, in the early months of 1967, restored the rate of increase in commercial bank lending to its former level of 16-17 per cent. After that time the situation became fairly satisfactory again, but another undesirable expansion set in from the spring of 1969 when the Bank's bond purchases had added substantial amounts to the liquid funds held by commercial banks. Their lending rose again: in the autumn of 1969 it reached its former level of 17-18 per cent.

The situation in 1969 became particularly strained as a result of the currency unrest experienced in the spring of that year, which hit the krone very hard. The official discount rate, which had been raised from 6 to 7 per cent in March, was raised again in May, this time to 9 per cent. It has since been an aim of monetary policy to keep the domestic interest level in the upper reaches of international rates in order to protect the foreign-exchange position. From May 1969 the Nationalbank also reduced its support to the bond market to a lower level, and from September the Bank took a neutral position on the market, thereby letting the full contractive effects of government operations penetrate to bank liquidity.

In the negotiations between Danmarks Nationalbank and the organisations of the commercial banks and the savings banks in the autumn of 1969 the parties agreed that the domestic credit expansion had been too strong. A new form of credit restraint was therefore adopted on the basis of the credit commitments undertaken by commercial banks and savings banks - see pp. 51-53 below. This co-operation was formalised in February 1970 when quotas were established for the lending operations of all major commercial banks and savings banks except building loans for non-profit housing and student dwellings. This credit ceiling, which was fairly close to the credit commitments actually granted, was since extended to the end of 1972 and raised by a total of 11 per cent (plus individual increases in a few cases). The utilisation of credit lines in commercial banks has proved to stay at a fairly constant level of approximately 65 per cent.

As a result of the introduction of the credit ceiling the rate of growth in commercial and savings bank lending slowed down continuously until the beginning of 1972. By that time the rate of increase in commercial bank lending had fallen below 3 per cent, but it has since gone up again. - A more detailed explanation of the credit ceiling will be found in Section IV, paragraph I below.

The instruments of monetary policy applied in the last 5-10 years (other than those discussed above) will be considered in the following pages.

Section I Refinancing

Paragraph I Official discount rate

Danmarks Nationalbank has previously discounted modest amounts of Bs/E for private firms, but today it does practically no banking business with private persons or firms.

Commercial banks may rediscount bills in the Nationalbank for up to any amount, but only trade bills (covering commercial transactions) are eligible; financial bills are not acceptable for rediscounting. The bills must be of prime quality which means that satisfactory credit information must be available about the names appearing on the bill; the Bank does not examine every bill but makes random checks.

Accurate data are not available to determine to what extent the portfolios of Bs/E held by banks satisfy these requirements, but the volume of bills rediscounted in periods of scarce liquidity suggests that about one third of the portfolios is rediscountable. At end-1971 bank portfolios of Bs/E aggregated close on kr.2.5 billion of which about kr.800 million would thus have been eligible for rediscounting in the Nationalbank.

Interest is charged at the rediscount rate, which in recent years has been identical with the official discount rate. Bills may be rediscounted for any period up to 90 days. Interest is normally charged for a minimum period of five days.

In addition to the official discount rate and the re-

discount rate, Danmarks Nationalbank charges minimum and maximum lending rates of respectively 0.5 per cent and 1.0 per cent above the official discount rate. The Bank also charges certain special rates which, together with the official discount rate and the other interest rates charged for different categories of loans, are listed in a table in paragraph II below.

The official discount rate affects not only loans obtained by banks in the Nationalbank but also the interest rates applied by commercial banks and savings banks; these rates normally follow movements in the official discount rate.

In this context, the principal interest rates are those allowed by banks on the most important forms of deposits. These rates are governed by an agreement on maximum interest rates concluded by commercial banks and savings banks. As this agreement restricts competition, it is subject to supervision by the Monopoly Control Authority which, in the case of financial institutions, is the Government Inspector of Commercial Banks and Savings Banks. In recent years, the inter-bank interest rates agreement has been the subject of critical comments, but it has been kept in force in view of the extraordinarily scarce availabilities of liquid funds. The parties to the agreement are the Federation of Danish Banks and the Association of Savings Banks. The agreement is therefore binding only on the members of these organisations; on the other hand, these members represent the vast majority of commercial banks and savings banks. A few banks, which have broken away from the agreement and the organisations, offer higher interest rates for long-term deposits than those allowed under the agreement. This is not very important because the break-away banks hold only a small part of total deposits. There are no national agreements on lending rates but these generally follow movements in the rates allowed on deposits.

In practice, changes in the official discount rate will thus entail approximately equivalent changes in the deposit and lending rates of commercial banks and savings banks.

In recent years it has been a major aim of the Nationalbank's policy in regard to the official discount rate to keep the Danish interest level within the upper reaches of

the international level in order to ease the financing of the big deficits on the external balance. At the same time, credit availabilities in Denmark have been limited through the squeeze on bank liquidity and through the credit ceiling agreed with the commercial banks and the savings banks.

Paragraph II    Nationalbank credit facilities available to banks

Apart from the collateral security which is normally required for loans there are no restrictions on the amount of credit which commercial banks and savings banks may obtain in the Nationalbank.

Commercial banks and savings banks may borrow only against their own holdings of bonds and shares, but they can raise loans against three-month deposit certificates and credit certificates held for account of customers.

The Bank can adjust the total amount of credit available to the banking system by changing the rules governing such credit, for instance by raising or lowering the discountable value of securities. The Bank can also make credit more or less attractive by changing the rate of interest charged for loans.

Interest is normally charged for a minimum period of five days except for the below mentioned revenue credits. For the refinancing of building loans, also mentioned below, interest is charged for minimum periods of 14 days.

In the autumn of 1964, the Bank introduced a penal rate of 6 per cent from October 1 for rediscounted Bs/E and for loans obtained against ordinary bonds and shares exceeding a quarterly limit of one fourth of the borrowing bank's total capital and reserves for a period of up to 20 days - for the fourth quarter: up to 30 days. The reason for the slightly easier terms allowed for the fourth quarter at that time was that liquidity was scarcest in that quarter. In view of the tight liquidity the penal interest was suspended as from 1 April 1971.

Danmarks Nationalbank's discounting and lending terms at end-September 1972

| Collateral security | Discountable value | Interest | Special conditions |
|---|---|---|---|
| **A. General rules** | | | |
| 1. Prime bills of exchange for goods and services, including Bs/E covering hire-purchases of capital goods for industrial uses | 100 per cent of face value | Rediscount rate | |
| 2. Nationalbank 3-month deposit certificates | 100 per cent of face value | Official discount rate | |
| 3. Nationalbank credit certificates | 85 per cent of face value | Official discount rate | |
| 4. Exchange-listed bonds, exclusive of Ship Credit B-bonds | 60 per cent of market value at buying price | Maximum lending rate | |
| 5. Exchange-listed shares | 50 per cent of market value at buying price | Maximum lending rate | Only shares in companies with a share capital of not less than kr.10 million, and only if quoted at prices above par |
| 6. Assets listed under items 2-5 and 7, as security for revenue credit | Values shown under items 2-5 and 7 | Official discount rate less 1 per cent | Maximum discountable value: Tax payments received from public authorities for remittance to Treasury by banks. Such loans mature on the 6th and 21st day of each month |

| Collateral security | Discountable value | Interest | Special conditions |
|---|---|---|---|
| B. Temporary facilities | | | |
| 7. Ship Credit B-bonds | 75 per cent of face value | Official discount rate plus 1 per cent, maximum 6 per cent | |
| 8. Promissory notes issued under special scheme for building loans | Of declines recorded in del credere accounts for building loans after end-March 1969: Until end-March 1973: 20 per cent | Maximum lending rate | Interest is charged for a minimum of 14 days |
| 9. Contracts for building loans for construction of non-profit housing and student dwellings | Of net lending: Until end-March 1973: 60 per cent. Until end-March 1974: 35 per cent | Same rate as the borrowing bank charges for under-lying building loan | Minimum: 14 days' interest. 6 per cent excess interest is charged for loans against progress payments which have previously been discounted and repaid |

Rediscounting of Bs/E has been explained in paragraph (1). The Nationalbank's deposit certificates will be dealt with on pp. 42-43 below.

Banks were previously very reluctant to rediscount bills of exchange, presumably because the amount of such rediscounted Bs/E must be disclosed in the published monthly balance sheets which would reveal to the general public that they had had to resort to credit in the Nationalbank, while other types of loans from the Nationalbank were booked in the balance sheets together with loans obtained from other financial institutions. In recent years, banks have overcome their reluctance and availed themselves of this rediscounting facility to a large extent. One reason is the liquidity squeeze, but banks have probably also been influenced by the lower rate of interest charged for this facility compared with the interest they have to pay for loans against bonds and shares which are otherwise the banks' most important potential source of liquid funds.

Banks also rely heavily on the credit facility which is available against deposit certificates.

Loans against credit certificates are based on an arrangement adopted in 1960 to ease bank financing of big and long export credits by enabling banks to convert these credits into negotiable instruments available for sale on the market or as collateral security for loans in the Nationalbank.

A bank granting a large export credit for Danish goods for a period exceeding **two years from the time of delivery** can obtain credit certificates from the Nationalbank for that part of the credit which runs for more than two years (but not more than five years) after delivery. These time limits do not apply to credits granted for exports to developing countries under public guarantees. For the credit certificates received, the bank will issue a certificate of indebtedness to the Nationalbank and transfer or surrender any collateral security received for the underlying export credit.

The bank may hold credit certificates as cash reserves, sell them on the market or borrow against them in the Nationalbank. Certificates are returned or their face values repaid to the Bank as and when the export credit is paid off. The

Bank charges interest on credit certificates at the same rate as that of the certificates - at present: 5½ per cent p.a.

The facility has been utilised primarily to cover long--term credit for exports to developing countries. Of the amount of credit certificates outstanding at end-July 1972, kr.129 million, such export credits accounted for roughly kr.100 million.

Loans against bonds are obtained especially when liquidity is extraordinarily scarce. Loans against shares are not important, because bank holdings of shares are relatively small.

Revenue credits derive from transfers made by government institutions through commercial banks to the Treasury's account in the Nationalbank. Such transfers may represent customs and excise duties or amounts collected by post offices. The Treasury's account is credited as soon as the Nationalbank has received advice of the transfer, but the bank is allowed a respite for its remittance to the Nationalbank. Revenue credits cannot run for more than two weeks because banks have to remit the amounts to the Nationalbank on the 6th and 21st of each month. As noted above, interest is charged on such credits at 1 per cent below the official discount rate. This low rate of interest is regarded as compensation for the administrative work done by the bank in connection with the receipt and subsequent remittance of these payments. On the other hand, the remittances required twice a month are intended to prevent banks from using revenue credits as a source of permanent credit at low cost.

The existing arrangement for the financing of deliveries of new ships is explained on pp. 11-12 above. During the first three years of its existence - between the autumns of 1963 and 1966 - this arrangement was based on an undertaking by the Bank to refinance commercial bank holdings of Ship Credit bonds of the B-series on particularly favourable terms, provided that such B-bonds were bought from borrowers at par. (A-bonds cover loans obtained on ordinary open market conditions). B-bonds carried 6 per cent interest, and in practice the interest rate charged by the Nationalbank for refinancing was also 6 per cent.

As this arrangement could have undesirable repercussions on monetary policy because commercial banks could, in case of need, use B-bonds as collateral for loans in the Nationalbank, the arrangement was modified on the lines described on pp.11-12. Under the modified arrangement the bonds (now termed C-bonds) were taken over by the Nationalbank. If desired, the Nationalbank could then unload these bonds on the market - admittedly at a loss, but such sales would enable the Bank to neutralise any additions to the money supply which this arrangement might entail.

Under the terms of the arrangement the rediscountable value of B-bonds was to be gradually reduced from the original 100 per cent to a minimum of 75 per cent.

In the last few years, redemptions have reduced the commercial banks' holdings of B-bonds very considerably. They stood at kr.218 million by the end of July 1972.

In 1969, Danmarks Nationalbank opened two temporary credit facilities which enabled commercial banks and savings banks to refinance part of their building loans.

These facilities were provided because in late March 1969 mortgage credit institutes, by agreement with the Nationalbank, discontinued the system of "advance mortgage financing", which had been introduced in 1939 to enable builders to protect themselves against declines in the market prices of bonds during the period of construction. The system was only used on a large scale during the last years of its existence.

Under this system, mortgage credit institutes could grant advance mortgage credit against bank guarantees, thereby providing long-term financing of new buildings already from the start of building operations. The guarantee was issued by the bank which had granted the building loan, and the bonds issued for the mortgage loan were deposited in that bank. These bonds were normally sold in step with the advances made by the bank to finance the building operations. Advances were charged to the building loan account, and the sales proceeds of bonds were credited to a del credere account, so that the drain of building loans on the bank's liquid funds was very small. Banks could even adapt the sale of advance

mortgage bonds to the liquidity situation: During periods of scarce liquidity they would sell the bonds as soon as possible and vice versa when liquidity was ample. The advance mortgage system was thus not utilised in the way originally intended. Instead, it gave added impetus to fluctuations in bond prices.

The liquidation of the advance mortgaging system did not affect total bank liquidity, because deposits in del credere accounts would merely be replaced by other deposits; for individual banks, however, the liquidation could result in additions to its total commitments.

In order to ease the banks' adaptation to the liquidation, Danmarks Nationalbank introduced in May 1969 a facility which enabled them to borrow from the Bank in step with declines in the balances held in del credere accounts after the end of March 1969. Banks could originally borrow 80 per cent of the decline by discounting promissory notes in the Nationalbank. The facility is being phased out: From 1 April 1972 to 31 March 1973 banks may still borrow 20 per cent of the decline, but the facility will lapse on 1 April 1973.

By mid-1972 the facility available to commercial banks and savings banks totalled kr.300 million.

As liquidity grew scarcer during the summer of 1969 and as the refinancing facility made only fairly small contributions to the credit available to banks, the latter were reluctant to grant building loans to the large volume of non-profit housing construction. In response to a government request the Nationalbank therefore introduced a temporary refinancing facility for building loans granted after 1 July 1969 to new non-profit housing projects. Later, student dwellings also became refinanceable under this facility. Refinancing was originally obtainable for 75 per cent of the underlying building loans; the percentage was later reduced to 60; from 1 April 1973 to 31 March 1974 it will be 35, and the facility will lapse on 1 April 1974.

By mid-year 1972, about kr.1.25 billion was available to commercial banks and savings banks under this refinancing facility, but since banks have to pay the same interest as they charge for their building loans little use has been made of the facility.

## Section II Control of commercial and savings bank liquidity, etc.

### Paragraph I Liquidity ratios prescribed by law

The statutory requirements for commercial and savings bank liquidity are intended only to ensure that banks will always be able to meet their commitments.

As a main rule, every bank must keep an adequate cash reserve, commensurate with its general position.

In addition, the law lays down certain minimum requirements.

A commercial bank must hold cash in hand, safe, easily marketable and uncommitted securities and credit facilities representing not less than 15 per cent of liabilities which the bank must meet on demand or at shorter notice than one month, regardless of any reservations made as to withdrawals. Moreover, such liquid funds must represent not less than 10 per cent of the bank's total debts and guarantee commitments. Certain deductions are allowed in the calculation of debts and guarantee commitments, such as guarantees which are covered by deposits with the bank, and 50 per cent of other guarantees.

Another rule prescribes that a commercial bank must hold particularly liquid funds in an amount of not less than 2 per cent of its liabilities. In addition, banks accepting sight deposits from other domestic banks must hold additional liquid assets representing 15 per cent of such deposits.

A savings bank's liquid assets - cash in hand and absolutely safe, easily marketable and uncommitted securities - must always represent not less than 15 per cent of liabilities which are payable on demand or at shorter notice than one month, regardless of any reservations made as to withdrawals. In addition, such liquid assets, plus any other absolutely safe claims on Danish commercial banks and savings banks, must represent not less than 8 per cent of a savings bank's total liabilities.

There are no statutory rules requiring commercial banks and savings banks to hold cash reserves that can be varied for purposes of credit policy.In the period of excess money during and after the last war,cash in hand was subject to temporary regulation

from 1942 to 1949. In 1953, Danmarks Nationalbank proposed a revision of the Commercial Bank Act with the aim, amongst other things, of introducing rules on variable cash reserves. This proposal was not enacted. The question was raised again in 1962, but nothing came of it. In 1965, the Nationalbank concluded agreements with the commercial banks and the savings banks serving the same aims as variable reserves - see above pp.24-26 and below pp.40-41.

As noted above, the Commercial Bank Act and the Savings Bank Act are now under revision. Bills to amend the two Acts will probably be tabled in a near future. They are expected to amend the rules governing liquidity and the below mentioned rules on solvency.

Paragraph II Solvency

The Commercial Bank Act protects depositors by stipulating certain requirements as to the size of individual engagements or individual transactions in relation to a bank's total assets, and stipulating a certain minimum proportion between a bank's total capital and reserves and total liabilities. As a general rule,a bank is not allowed to grant credit to a customer or undertake guarantee commitments for him in a total amount that will make the bank's total claims on and guarantee commitments undertaken for that customer (other than certain specially secured claims) exceed 35 per cent of the bank's total capital and reserves at the beginning of its financial year.

There are also certain limitations on the extent to which banks may buy shares, including shares in other banks.

A bank's equity must represent not less than one tenth of its total debts and guarantee commitments and not less than kr.400,000. In the calculation of debts and guarantee commitments deductions are allowed in the same way as for the calculation of liquid assets. Finally, total guarantee commitments, other than those for which special security has been given, must not exceed 75 per cent of a bank's total capital and reserves.

The main provision of the rules governing the solvency of savings banks prescribes that loans must generally be secured by adequate collateral security. Loans

without collateral security must not exceed kr.10,000 and the total of such loans must not exceed 10 per cent of a savings bank's equity at the beginning of its financial year. Loans granted to central government or local government authorities are exempt from this limitation.

The Savings Bank Act also imposes certain restrictions on a savings bank's acquisition of shares.

Finally, a savings bank's equity must represent not less than 4 per cent of its liabilities.

**Paragraph III** Danmarks Nationalbank's deposit agreements with commercial banks and savings banks

Background information on the deposit agreements concluded by Danmarks Nationalbank with the organisations of commercial banks and savings banks in 1965 is given above - see pp. 25-26.

Under the agreement with the commercial banks the latter undertook to tie 20 per cent of any increase in their deposits after a reference date (generally end-January 1965), either by paying such increases into a special account in the Nationalbank or by improving their net foreign-exchange position. Any deterioration in the foreign-exchange position in relation to the reference point was to be tied in the Bank.

Deposits and releases were to be calculated on a monthly basis, beginning at end-March 1965. Every six months the Bank would meet with the Federation of Danish Banks to consider whether the performance of the economy motivated any change in the percentage to be deposited; decisions were subject to mutual agreement.

The agreement with the savings banks was similar to that which was concluded with the commercial banks except that savings banks were allowed - as a counterpart of the access for commercial banks to meet deposit commitments by improving their foreign-exchange positions - to place up to one half of their deposit commitments in third-mortgage bonds or long--term third-mortgage loans on new housing projects, while the other half was to be tied in a special account in the Nationalbank.

In August 1968, deposit commitments were reduced from

20 to 10 per cent of increases in deposits. In May it was raised to 20 per cent of increases recorded from end-August 1968 to end-April 1969 and to 30 per cent of increases after the latter date. In April 1971, deposit commitments were discontinued for increases recorded after end-November 1970. In June 1971, 20 per cent of the tied deposits was released; the balance was released in October 1971.

Over the years, the deposit agreements were amended significantly. In the course of the period 1967-1969 commercial banks and savings banks could meet their commitments by depositing exchange-listed bonds in the Nationalbank, while the access for commercial banks to meet their commitments by improving their net foreign-exchange positions was heavily curtailed - see Annex 1.

By the end of November 1970, tied deposits reached close on kr.3½ billion. Commercial banks initially met most of their commitments by improvements in their net foreign-exchange positions. Later, they met their commitments mainly by deposits of bonds in the Nationalbank.

Although the deposit commitments have been suspended and the deposits have been released, the deposit agreements as such have not been terminated. They can be reactivated if necessary. In that event, the parties have agreed to revert to the original texts of the agreements except for the rules governing net foreign-exchange positions, which, since 1 December 1971, have been governed by the Foreign-Exchange Regulations, and except for the original access for savings banks to make their deposits in bonds, etc. In consequence, future deposits will have to be made in tied accounts and will thus reduce bank holdings of primary liquidity. By the end of September 1972, practically all commercial banks (representing 99 per cent of the commercial banks' balance sheet total) and 237 savings banks (representing 98 per cent of all savings bank deposits) had acceded the deposit agreement.

## Section III — Regulation of the money and capital market and of external transactions

### Paragraph I — Intervention on the money and capital market

#### 1. Money market

The Danish money market is narrow. The most important

short-dated securities are the three-, six- and nine-month deposit certificates issued by Danmarks Nationalbank. The issue of three-month deposit certificates began in 1958. In the previous year the Treasury had discontinued its sales of Treasury bills. Six- and nine-month deposit certificates were introduced in May 1972. Idle cash funds are also placed in exchange-listed bonds with short periods to maturity. Finally, commercial banks and savings banks have established a day-to-day market on which interest rates have shown big fluctuations.

The Nationalbank's three-month deposit certificates may be bought only by commercial banks, savings banks and stock-exchange brokers, but they are freely negotiable on the market. In practice, however, these certificates are rarely traded.

The Bank sells deposit certificates every Wednesday at a rate of interest which is fixed on the previous day in the light of the conditions prevailing on the money and capital market and of the rate of interest obtainable on international money markets; this rate has, however, not at any time exceeded the rate of interest allowed on three-month deposits in commercial banks and savings banks. Frequent changes were made in the rate of interest allowed on three-month deposit certificates in the first years after their introduction. In the last couple of years changes have been less frequent and have mostly been made in connection with changes in the official discount rate.

Commercial banks, savings banks and stock-exchange brokers may use deposit certificates as collateral for loans in the Nationalbank - see p. 32 above.

Six- and nine-month certificates were introduced because commercial banks and savings banks had bought large amounts of mortgage credit bonds in the second half of 1971 and the early months of 1972. These purchases had contributed to the long-term financing of building projects outside the established credit ceiling and they had also resulted in extraordinary additions to the money supply. Finally, commercial banks and savings banks obtained additional assets through their bond purchases, and these assets could be used as security for credit in the Nationalbank.

These undesirable repercussions on monetary policy induced the Bank to offer commercial banks and savings banks six- and nine-month credit certificates that could serve as alternatives to bond purchases. The certificates, which can also be used to dampen fluctuations in liquidity, are available for sale to commercial banks and savings banks every day. They cannot be discounted, but they may at any time be resold to the Bank at a discount. The rate of interest is fixed by the Nationalbank. The present yield of six-month certificates is 7.0 per cent p.a. and of nine-month certificates 7.9 per cent p.a.

Commercial banks and others also use exchange-listed bonds with short periods to maturity as money market paper. Statistical data are not available about the amount of such bonds in circulation. The bonds issued by the Ship Credit Fund, which fall due for payment on specified dates, one, two, three or more years ahead, are widely used as money market paper, especially by commercial banks. Originally, these bonds are taken up by the Nationalbank— see p. 36. The volume of such transactions may be illustrated by the fact that in 1971 the Nationalbank resold more than kr.0.5 billion of bonds issued by the Ship Credit Fund.

As mentioned on p. 20 above, commercial banks and savings banks have developed a day-to-day market to even out ultra-short fluctuations in cash funds: Commercial banks and savings banks holding idle funds will lend such funds to other commercial banks and savings banks which need them. The interest allowed on these funds varies widely in step with changes in liquidity and credit availabilities in the Nationalbank. The daily turnover, which may run into between kr.0.5 billion and kr.1 billion, also shows large variations. Borrowing operations on the day-to-day market thus enable individual commercial banks and savings banks to augment their gross liquidity, thereby increasing their lending capacity to a certain extent, while banks holding idle funds earn interest on such funds. Danmarks Nationalbank has not so far intervened on this market.

## 2. Capital market

As explained on pp. 14-15 bonds are by far the most important

factor on the capital market, while shares are of minor significance.

At end-June 1972 the nominal value of bonds in circulation was some kr.106 billion of which mortgage credit bonds accounted for some kr.94 billion, local government bonds for kr.4 billion, Ship Credit bonds kr.4 billion, government bonds kr.3 billion, and other bonds kr.1 billion. The market is thus dominated by mortgage credit bonds, while the amount of government bonds in circulation is modest.

The net supply of bonds reached kr.14 billion in nominal value, representing kr.10 billion in market value, in 1971. For comparison, it may be noted that the combined direct lending of commercial banks and savings banks increased by kr.2 billion in the same year.

Because of the relatively easy access to capital on the bond market this market thus provides by far the greater part of total capital availabilities in Denmark - see p.11 above.

In periods when prices have been rising at a fast rate - including the prices of real property - and when the economy has also otherwise been affected by pressures of demand, this wide access to credit has caused problems on the bond market. During the 1960s, these problems were aggravated by extensions of the fields of lending operations of mortgage credit institutes to cover practically all categories of real property, including business and industrial property as well as local government property.

In view of the free access to mortgage credit loans, which are normally disbursed to borrowers in bonds - see above p.11 - and of the free price formation on the bond market, this market is the principal indicator of any imbalances arising on the capital market as a whole.

The bond market is therefore an important mechanism through which the Nationalbank can exert influence on movements in interest rates and in money supply and bank liquidity.

In some periods, the Bank's open market operations have been on a large scale. Between the mid-sixties and the spring of 1969 the Bank bought large amounts of bonds to curb upward trends in interest rates and even out fluctuations in bond prices that would otherwise have varied widely as a result

of big swings in bond issues. Since then, the Nationalbank has generally let the market find its own price level because the Bank's intervention has been guided mainly by considerations of liquidity.

In the last couple of years, the Bank's purchases have especially served the purpose of re-channelling into the banking system some of the money absorbed by way of government operations, so that banks would not have to rely on Nationalbank loans as the only source of compensation for the government's absorption of liquid funds.

During the three-year period from the beginning of May 1969 to end-April 1972 the Nationalbank's net purchases of bonds aggregated some kr.1¼ billion. This was the net outcome of the following movements: The Bank took over current issues of Ship Credit Bonds in an amount of kr.3 billion, while its sales of such bonds and its net sales of other bonds totalled kr.1¾ billion.

In addition to banks and insurance companies private buyers also take up large amounts of bonds on the market.

## Paragraph II    Regulation of external transactions

The existing foreign-exchange regulations are based on an Executive Order issued by the Ministry of Commerce on 20 June 1961, with subsequent amendments.

The regulations are administered by the Ministry of Commerce and Danmarks Nationalbank.

More detailed provisions have been laid down in special rules governing authorised foreign-exchange dealers (mostly commercial banks). The administration of the rules has been delegated to a large extent to the foreign-exchange dealers who, among other things, are responsible for controlling that all payments to and from Denmark conform to the provisions of the foreign-exchange legislation.

In accordance with Denmark's international obligations, notably as a member of the OECD and the IMF, and preparatory to our entry into the European Communities, the Danish foreign--exchange regulations were liberalised to a certain extent during the 1960s. In May-June 1969, on the other hand, Denmark's

foreign-exchange situation induced the authorities to make the foreign-exchange restrictions more stringent in certain respects.

1. Foreign-exchange regulations

(a) Current payments

Payments of goods and services are generally free, provided that they fall due not more than two years (for ships, aircraft, major deliveries of machinery and plant: five years) after the end of the month in which the goods were delivered or the services performed.

These rules were modified in 1969. The main provisions of the amended rules are that imported goods and services may be paid up to 14 days in advance of the final due date, and prepayment may be effected up to 14 days (for major capital goods: up to one year) before delivery.

Payments of exported goods and services may be freely accepted within such due dates as are normal for the trade or sector concerned.

(b) Direct investments

**Inward and outward direct investments are as a general rule subject to permission from the foreign-exchange authorities. Such investments are allowed within a total amount of kr.40,000 per year and enterprise under a general permission for enterprises engaging in manufacturing, distribution, small industries, hotel or transport business.**

Inter-group loans are normally also subject to permission, but inward and outward loans are permissible for up to kr.200,000 per calendar year; inward inter-group loans are subject to the rules indicated in item (e) below.

In compliance with Denmark's obligations vis-à-vis the OECD the foreign-exchange authorities have adopted a liberal practice for the granting of permissions for direct investment and for inter-group loans for terms of not less than five years.

Since the currency crisis in 1969 Danmarks Nationalbank, when granting permissions for outward investments exceeding kr.1 million, has appealed to the investors to finance as much as possible of such investment by foreign loans for terms of at least three years.

(c) Issues

Few permissions have been granted for securities issued by Danish enterprises to be floated in foreign markets. A few large local government units and the chartered telephone companies have, however, been allowed to raise loans abroad within certain limits fixed by the government. Issues of foreign securities in Denmark are not allowed.

(d) Portfolio investments

Both inward and outward portfolio investments are normally subject to permission from the Nationalbank.

Special rules apply to foreign-exchange dealers and insurance companies who are allowed a wider measure of freedom to make inward and outward portfolio investments in securities other than short-term paper.

In 1971, Danmarks Nationalbank established quotas for sales to non-residents of Danish bonds which are included in the Stock-Exchange List of daily quotations. This quota arrangement was an initial step towards the further liberalisation of capital movements to which Denmark is committed after our entry into the European Communities.

Of the quota of kr.100 million for the calendar year 1971 only kr.35 million had been taken up by the end of the year.

A quota of kr.100 million for the calendar year 1972 had been sold already by the end of the first quarter of the year. Additional quotas were therefore established, viz. kr.40 million for the second quarter, kr.35 million for the third quarter, and, in October 1972, kr.50 million for the fourth quarter of 1972.

Proceeds from resold bonds may be used for reinvestment in Danish bonds within a short period after the resale.

Purchases and sales of money market paper are normally not allowed for non-residents. Foreign short-term paper may normally be bought and sold by Danish commercial banks and stock-exchange brokers. Such purchases and sales may also be made by shipping companies and insurance companies insofar as they are necessary in their foreign business.

(e) Commercial loans and credits and financial loans

Danish firms are generally free to raise commercial loans and credits abroad, provided that such debts fall due for payment within one year - for ships, aircraft and major deliveries of machinery and plant: within five years.

Since 1968, Danish enterprises which do not engage in financial business, deal in real property or engage in certain kinds of building and civil engineering activity have been free to raise loans abroad in amounts of not less than kr.100,000 and not more than kr.1 million (after 1971: kr.5 million) per calendar year and enterprise, provided that the loans run for not less than five years and are repayable by not more than one fifth a year.

Since May 1969, interest and instalments on loans and credits of all kinds may be paid up to 14 days before the final due date stipulated when the loan or credit was contracted.

Danmarks Nationalbank has permitted foreign-exchange dealers to grant loans and credits to non-residents on certain specified conditions, especially for the financing of import and export transactions of Danish enterprises.

(f) Residents' accounts abroad and non-residents' accounts in Denmark

The external assets and liabilities of foreign-exchange dealers are governed by special rules. In other cases, permission from Danmarks Nationalbank is required for accounts maintained abroad except for small collections accounts. Special permissions have been granted to shipowners, insurance companies, other enterprises and private persons for whom such accounts are considered necessary.

The Nationalbank has issued a general permission for all authorised banks to open accounts in Danish kroner for private non-residents, provided that balances in excess of kr.75,000 are transferred automatically to foreign accounts at the end of each quarter. This limitation does not apply to present or former citizens of Denmark. These rules are under revision as a result of Denmark's entry into the European Communities.

## 2. Impact of international capital movements on economic policy

In the postwar years Denmark has gradually liberalised international capital movements, although it will be seen from the review of the Danish foreign-exchange regulations under item A above that significant restrictions are still maintained on capital movements such as portfolio investments, financial loans and credits.

To a country with a large volume of foreign trade even minor changes in leads and lags, and in credit terms, may cause large-scale fluctuations in the flow of funds. Such a country will therefore be extremely vulnerable in situations of turbulence in currency markets and large-scale fluctuations in interest rates and liquidity in money markets.

During the sixties, regarded as a whole, Denmark's position was also affected by the fact that growing deficits on the current external balance were financed by capital imports which consisted in large part of short-term loans for the financing of imports and exports. Repayment of such loans can make heavy demands on Denmark's international liquidity which, if measured by international yardsticks, is of an extremely modest order. Seeing that the internal monetary policy must of necessity take account of these interdependent factors, the monetary authorities have generally endeavoured to keep domestic interest rates within the upper reaches of the international interest level. On the other hand, the private capital imports resulting from this policy have weakened the domestic effects of the severe monetary policy, even if the net effect has restrained the domestic credit expansion to a certain extent.

## 3. Regulations governing the net foreign-exchange position of commercial banks

Up to 1965, banks were generally free to raise loans abroad. This access to foreign credit enabled the banks to counteract the Nationalbank's endeavours to keep liquidity scarce.

Under the terms of the above mentioned deposit agreement, however, commercial banks undertook to tie in the Nationalbank an amount equivalent to any increase in their net foreign

indebtedness. This undertaking put an effective stop to the commercial banks' borrowing operations in foreign markets, but the effect on liquidity was weakened by the fairly wide access for private business and industry to finance imports and exports by foreign credit - see item A above - and by the rule allowing banks to freely negotiate and guarantee such credit.

Another clause in the deposit agreement allowed banks to meet their deposit commitment by improving their net foreign-exchange position. During the years 1965-1968, there was a tendency for banks to place growing proportions of their liquid funds abroad, and this tendency became very pronounced in 1968 when bank liquidity was ample and interest rates were rising fast abroad and falling in Denmark.

While the level of the banks' net foreign assets was rising, the range of fluctuations in these assets widened from month to month. As these movements interfered with the Nationalbank's placements of the central Danish foreign-exchange reserves from time to time, the Bank in 1969 asked the commercial banks to reduce their holdings of foreign exchange to the average level recorded for the first half of 1968. In addition, the deposit agreement was amended to the effect that banks could no longer meet their deposit commitments by improvements in positive net foreign-exchange positions.

When the requirement for tied deposits was suspended in 1971 - see above - other rules had to be introduced to regulate the lower limit of the net foreign assets of commercial banks. These rules were incorporated in the new foreign-exchange regulations, which also amended the temporary regulations governing the upper limit of such assets.

Under the new regulations, which entered into force on 1 December 1971, no bank's net commercial holdings of foreign exchange may be below zero or above an amount equivalent to 15 per cent of its total capital and reserves with a minimum of kr.2 million. Commercial holdings comprise all assets held in foreign exchange and krone deposits of foreign correspondents, shipowners and insurance companies.

4. Nationalbank intervention in the forward market for foreign exchange

Since 1968, foreign-exchange dealers have reported their forward transactions in foreign exchange with residents to Danmarks Nationalbank. The turnover on the forward market has been rising and is now of a considerable magnitude.

Since much of Denmark's foreign trade is settled in kroner, foreign business firms also want to hedge against changes in the par value of the krone. This is reflected in large forward transactions between Danish banks and their foreign correspondents.

The demand for forward currency has generally been far in excess of supply, and commercial banks have experienced difficulties in hedging against the exchange risk they incur by selling more forward currency to customers than they buy. In such circumstances, the cost of hedging operations may become unacceptably high.

As explained in item 2 above, it has been an important aim of monetary policy to ensure that funds are available to finance the deficit on the balance of payments. Seeing that capital imports depend among other things on the difference between the international interest level plus the cost of hedging and the Danish interest level, a steep rise in the cost of hedging operations may reduce the volume of capital imports.

In the last couple of years, Danmarks Nationalbank has therefore intervened in the forward currency market from time to time by selling forward currency to banks. This intervention has also served to protect the spot market thereby protecting also the foreign-exchange reserve against excessive drains.

## Section IV — Direct restrictions on credit

### Paragraph I — General quantitative restrictions

1. Credit ceiling

As explained on p. 28, Danmarks Nationalbank and the commercial banks concluded an agreement in February 1970 by which a credit ceiling was imposed on bank lending.

The agreement was based on credit commitments, i.e. the total amount of existing loans and loan commitments, because these are subject to direct control while banks cannot, in the short run, control the degree to which credit lines are utilised.

In previous periods of excessive expansion of bank lending - most recently in 1969 - banks explained their inability to comply with appeals from the Nationalbank by pointing to their lack of control over the utilisation of credit lines. From the point of view of monetary policy this was not a satisfactory situation. In the course of negotiations held in the autumn of 1969 the major banks therefore agreed to send the Bank monthly reports of their lending commitments. For the **time being, lending commitments were to serve as a guideline for the co-operation of the Nationalbank and the commercial banks.**

The reports also enabled the Bank to follow the degree of utilisation of credit lines which, in the following months, was seen to remain at a fairly constant level of 65 per cent for all the reporting banks taken together. This degree of utilisation has changed very little since then.

In February 1970 the Nationalbank and the commercial banks agreed to formalise the guidelines adopted in the autumn of 1969: Credit ceilings were established for each of the major banks on the basis of its lending commitments at end--February 1970 or the average of such commitments between end-September 1969 and end-February 1970.

Loans granted for non-profit housing construction and, later, construction of student dwellings were exempted from the credit ceiling because these building activities are regulated in other ways, although the need for building credit has been growing as a result of the rising cost of building. These categories of loans represent about one tenth of total lending.

The major banks which send in detailed monthly reports on their lending activities account for 90 per cent of total commercial bank lending. The smaller banks have undertaken to follow the same line.

A similar agreement was concluded with the major savings banks whose credit ceiling, however, covers only short- and

medium-term loans, while longer-term loans are outside the scope of the credit ceiling.

This arrangement was to be in force only for a temporary period, because the credit ceiling was not considered desirable as a more permanent instrument of monetary policy, among other reasons because it would tend to rigidify the structure of the banking system. Trends in the economy have, however, induced the parties to prolong the agreement - most recently until the end of 1972.

The agreement has now been in force for more than 2½ years. In the course of that period, the credit ceiling has moved upwards by general increases aggregating 11 per cent, and individual commercial banks and savings banks have obtained additional raises representing about one half of the general raises.

As noted above, the credit ceiling has proved to be effective inasmuch as the rate of expansion in recorded commercial bank and savings bank lending has been moderate.

2. Restrictions on local government borrowing

The Mortgage Credit Act of 10 June 1970, which entered into force on 1 July 1970, also restricted the access for local government authorities to finance their building operations by mortgage credit. The Ministry of the Interior has issued additional regulations to restrain local government borrowing. By agreement with the organisations of local government authorities these regulations have since been supplemented by formal credit ceilings for every local government authority.

Paragraph / II Selective credit regulations

1. Refinancing of non-profit housing projects and construction of student dwellings

Reference is made to Chapter II, Section I, paragraph II.

2. Ship Credit Fund bonds

Reference is made to Chapter I, section I, paragraph II, item 1 (e) and to Chapter II, section I, paragraph II .

3. Export credit scheme

Through the Export Credit Council the government may

guarantee exporting enterprises domiciled in Denmark against losses on foreign debtors, etc. (commercial risks) and losses on foreign claims which cannot be transferred to Denmark because of financial or political obstacles in the debtors' home countries (political risks). The Export Credit Council may also assist Danish enterprises in the financing of export transactions by guaranteeing bank credit obtained for purposes of export.

The Export Credit Council was established under the Denmark's Trade Fund Act of 1960 which superseded former legislation that had been in force for many years. The members of the Export Credit Council represent trade organisations, Danmarks Nationalbank and the relevant government departments. The Minister of Commerce has promulgated rules for the Council's activities.

Under the above mentioned Act guarantees and sureties may be issued within a total amount of, at present, kr.11 billion. On 31 March 1971 the Council's commitments aggregated kr.7.1 billion distributed over 1,225 exporters. The Council's commitments are secured by Denmark's Trade Fund whose assets totalled kr.298 million on 31 March 1971, equal to 4.2 per cent of its liabilities.

The premiums charged for export credit are intended to keep the arrangement self-sustaining: In the long run, premiums have to cover administrative and other costs as well as compensations.

The credit certificates issued by Danmarks Nationalbank serve to ease bank financing of long and big export credits - see above p.34.

*Deposit Agreements: Main features 1965-1971*

In February 1965, all banks (except three small banks) entered into Deposit Agreements with Danmarks Nationalbank, under which each bank undertook to tie 20 per cent of increases recorded in customers' deposits after a specified reference date (normally: end-January 1965) *either* by deposit in a blocked account with the Nationalbank *or* by improving its net foreign-exchange position. If the external position deteriorated after the reference date, the full amount of any such deterioration was to be tied in the Nationalbank.

In March 1965, most savings banks entered into similar Deposit Agreements, but savings banks could meet up to one half of their deposit commitments by placing a corresponding amount in third-mortgage bonds or in long-term third-mortgage loans for new housing projects; the balance was to be tied in a blocked account with the Nationalbank.

The texts of the Deposit Agreements were reprinted as Annexes to the Annual Report for 1964. Subsequent amendments to the Deposit Agreements were described in the Bank's Annual Reports for the years in which they were made. The most important amendments, and the dates on which they took effect, are listed below.

| | |
|---|---|
| January 1966 | Undisclosed net foreign-exchange items to be included in calculations of deposit commitments. |
| January 1967 | Deposit commitments in respect of increases in deposits received after end-November 1966 may be met by tying Exchange-listed bonds with up to 10 years to maturity. Increases in del credere account balances for building loans were exempted from deposit commitments |
| February 1968 | 12-month deposits were exempted from deposit commitments. |
| March 1968 | All deposit commitments may be met by tying Exchange-listed bonds with up to 10 years to maturity. |
| August 1968 | Deposit commitments were reduced from 20 per cent to 10 per cent of increases in deposits received by banks after end-August 1968. |
| May 1969 | Deposit commitments were raised from 10 per cent to 20 per cent of increases in deposits received between end-August 1968 and end-April 1969, and to 30 per cent for increases in deposits received after end-April 1969. The access for banks to meet deposit commitments by improving their net foreign-exchange positions was confined to improvements from deficit positions to zero. The range of bonds acceptable as tied deposits was extended to comprise bonds with up to 30 years to maturity. |
| October 1970 | Banks were allowed to borrow up to 50 per cent of amounts held in tied deposits against collateral security in such amounts. This facility was originally made available only for the period 10 January – 9 April 1971, but in January 1971 it was extended by another month. |
| April 1971 | Deposit commitments suspended for increases in deposits received after end-November 1970. |
| June 1971 | 20 per cent of tied deposits released from end-June 1971. |
| October 1971 | Remaining tied deposits released on 1 October 1971. |

The Deposit Agreements were suspended and may be reactivated if and when this becomes necessary. If so, the original tenor of the Agreements will apply. This means that reductions subsequently agreed in the basis on which deposit commitments was to be calculated will no longer be allowable and that banks will not be able to meet their commitments by depositing bonds. The rules agreed on foreign-exchange balances will not be applicable either, because such balances are now governed by the Foreign-Exchange Regulations in force after 1 December 1971. In future, therefore, any deposits to be tied in the Nationalbank must be paid in cash into blocked accounts with the Bank.

The co-operation existing between Danmarks Nationalbank and the commercial and savings banks is still based on the Deposit Agreements. By end-February 1972, the Agreements had been ratified by all commercial banks (except three), which represent 99 per cent of the total of bank balance sheets, and by 237 savings banks representing 98 per cent of all deposits held by savings banks.

## Aims of monetary and foreign-exchange policy

Monetary and foreign-exchange policy serve the aims of general economic policy: High rates of economic growth and high levels of employment, equilibrium on the balance of payments and maintenance of fairly stable prices.

As in other countries, it has been difficult to reconcile these aims. In Denmark the problems have been aggravated by a structural weakness in our external economic relations. This weakness was due above all to the difficulties experienced ever since the mid-fifties in the farming industry's efforts to expand its exports, which at that time still accounted for two thirds of our total merchandise exports. It was necessary, therefore, to embark upon a far-reaching structural reorganisation of economic life in order that the resources released from agriculture could be used to build up a competitive manufacturing industry. This reorientation in itself rendered a high and rising level of economic activity desirable which, in turn, could make it justifiable to finance part of the structural reorganisation by means of foreign loans and, in that phase, to accept deficits on the current account of the balance of payments.

The structural policy was successful in the sense that industrial development made rapid progress and the share of manufacturing industry in total merchandise exports increased at a fast rate. But the vigorous industrial expansion and the consequent urbanisation also generated tensions on the labour market and the capital market and led to steep increases in housing construction and in public expenditure on traffic, education, agricultural support and social security. Moreover, the general and fast rise in output and in living standards called forth strong demands for improvements in standards of public services and in transfer incomes.

Another corollary of this situation in the national economy was that tendencies developed towards latent or actual demand pressures with concomitant risks of price increases and disequilibrium on the external balance.

In these circumstances the main emphasis of economic policy was placed on a restrictive fiscal policy designed to curb the growth in private consumption in order to pave the way for diversion of capital and manpower to exporting and import-replacing industries. This policy has been hampered by a rapid growth in public spending, although the central government budget has consistently been in surplus with the result that the national debt has declined very appreciably. Local governments, on the other hand, have shown growing budget deficits over a long period. In recent years this trend has been countered, partly by controls imposed on local government borrowing and partly by direct intervention in the budgetary policies of local governments. In addition, fiscal policy has been reinforced by measures of incomes policy on several occasions.

Against this background it has been necessary to pursue a monetary policy serving, on one hand, to ensure availabilities of capital to finance the business and industrial investments required for structural reorganisation and, on the other hand, to support the demand management pursued by way of fiscal policy, and, further, to prevent credit terms in Denmark from getting out of line with those prevailing on the Eurodollar market.

The realisation of these different aims has come up against difficult problems in two respects:

In the domestic economy the large borrowing requirements of local governments, the rapid growth in housing construction (sustained by subsidies), and the highly developed bond market, which provides wide and ready access to capital for owners of real property, have made it difficult to facilitate the borrowing operation of business and industry without triggering off concurrent and excessive expansions in the other spheres of activity mentioned above. Attempts have been made to resolve this dichotomy by controlling the borrowing operations of local governments and by restricting the access to mortgage credit.

These problems have also affected the policy pursued in regard to capital imports: a wide range of control measures has been maintained on capital movements, partly to keep capital exports in check and partly to avoid capital imports

that would be conducive to local government operations and housing construction in particular, and to borrowing operations on the bond market in general. The necessary capital imports have therefore had to be effected primarily in the form of government loans, direct investments, and foreign short- and medium-term financing of the business sector's import and export transactions.

In this situation, which has led to a substantial increase in the short-term foreign debt of the business sector, it has also been necessary - not least during the last few years of unrest in international currency markets - to place growing emphasis on the efforts to prevent speculative capital movements from jeopardising Denmark's modest reserve of foreign exchange. In pursuance of these aims of monetary policy, a restrictive stance has been adopted with regard to the domestic interest level as well as to credit availabilities in Denmark. In foreign-exchange policy this set of problems has thrown the desirability of stable exchange rates into relief and induced the government to raise loans abroad in order to strengthen the currency reserve. It has also been found necessary to tighten the rules governing settlements of private debt to foreign creditors before maturity and, from time to time, to intervene in the forward market for foreign exchange.

## Supervision of local government borrowing

There are two levels of local government administration in Denmark, viz. about 270 boroughs and 14 counties. The City of Copenhagen and the Borough of Frederiksberg are self-contained local government units and therefore not parts of any county. The present number of boroughs is the result of a large-scale amalgamation of local government districts which took effect on 1 April 1970.

Boroughs and counties have wide powers of self-government in economic affairs. They levy their own taxes on income and property and may float loans on the market to finance their investment activities. Their relative importance within the public sector may be illustrated by the fact that in recent years total local government investments have run at somewhat higher levels than central government investments.

The Mortgage Credit Act of 10 June 1970 restricted the access for local government authorities to raise mortgage loans on real property. Under the amended rules, local government properties such as hospitals, administration buildings, etc.,where the real security lies only in the taxes levied by the local government authority, cannot be financed by mortgage credit, while mortgage loans on property serving more commercial purposes - power stations, gasworks, district heating, waterworks, etc. - cannot exceed 40 per cent of the value and must be amortised over not more than 20 years.

Another general rule is that with a few exceptions local government borrowing transactions are subject to approval by the supervising authority. Counties and the local governments of Copenhagen and Frederiksberg are supervised by the Minister of the Interior. Boroughs are supervised by a board set up in each county, consisting of the county governor (chairman) and four other members elected by the county council from among its members. In recent years, the supervision of local government borrowing has been tightened also through the activities of the supervisory authorities.

From and after the fiscal year 1971/72 the tightening has been effected by means of ceilings imposed by the Ministry

of the Interior on the total borrowing of every local government authority in each fiscal year. Before the ceilings were fixed - in pursuance of authority vested in the Ministry to issue rules for the exercise of supervisory authority - the total of the ceilings was the subject of consultations between the Ministry and the organisations of local government authorities. Under the statutory provisions governing the financial activities of local government authorities the latter may freely raise loans for periods of up to three years, but such loans also come within the above mentioned ceilings. The purposes of these rules were to ensure an increasing degree of local self-financing and to curb the rise in local government expenditure on investments.

The effects of the restrictions imposed on local government borrowing operations may be illustrated by the following table of movements in local government indebtedness:

| Million kroner<br>End-March | Debt<br>outstanding | Increase on<br>preceding<br>12-month period |
|---|---|---|
| 1968 | 9,580 | 1,498 |
| 1969 | 11,741 | 2,161 |
| 1970 | 13,963 | 2,222 |
| 1971 | 16,290 | 2,327 |
| 1972 | 16,964 | 674 |

# Tabular Annex

Table 1

Primary money supply

| Year-end | Cash in hand and Giro deposits[1)] | Deposits in National-bank | Uncommitted 91 days' deposit certificates, credit certificates and special series of Ship Credit bonds | Commercial banks' net foreign assets | Total |
|---|---|---|---|---|---|
| | Millions of kroner | | | | |
| 1958 | 3,421 | 312 | 344 | 456 | 4,533 |
| 1959 | 3,713 | 271 | 265 | 323 | 4,572 |
| 1960 | 3,868 | 277 | 133 | 1 | 4,279 |
| 1961 | 4,374 | 255 | 175 | - 166 | 4,638 |
| 1962 | 4,709 | 249 | 250 | - 548 | 4,660 |
| 1963 | 5,093 | 261 | 488 | - 339 | 5,503 |
| 1964 | 5,521 | 242 | 496 | - 680 | 5,579 |
| 1965 | 6,019 | 283 | 548 | - 260 | 6,590 |
| 1966 | 6,687 | 435 | 544 | - 113 | 7,553 |
| 1967 | 7,089 | 564 | 459 | 8 | 8,120 |
| 1968 | 7,810 | 457 | 904 | 602 | 9,773 |
| 1969 | 8,593 | 489 | 655 | 42 | 9,779 |
| 1970 | 7,795 | 282 | 567 | 4 | 8,648 |
| 1971 | 7,982 | 49 | 1,107 | - 264 | 8,874 |

1) From 1970: Excluding Treasury's and Nationalbank's Giro deposits.

Table 2

Factors affecting primary money supply

| | Total changes in primary money supply (+ = increase - = decrease) | Of which: changes affected by: increase (+) or decrease (-) in Denmark's international liquidity [1] (net) | payments from (+) or into (-) government accounts with Nationalbank [2] | increase (+) or decrease (-) in Nationalbank's lending and holdings of bonds, shares, etc. [3] | Changes in Post Giro accounts [4] (+ = increase - = decrease) |
|---|---|---|---|---|---|
| | Millions of kroner | | | | |
| 1958 | + 796 | + 780 | - 208 | + 149 | + 75 |
| 1959 | + 39 | + 602 | - 660 | + 57 | + 40 |
| 1960 | - 293 | - 114 | - 367 | + 145 | + 43 |
| 1961 | + 359 | - 189 | + 384 | + 43 | +121 |
| 1962 | + 22 | - 543 | - 139 | + 577 | +127 |
| 1963 | + 843 | + 1,695 | - 554 | - 332 | + 34 |
| 1964 | + 76 | + 810 | - 1.533 | + 671 | +128 |
| 1965 | + 1,011 | + 12 [5] | - 541 | + 1,396 | +144 |
| 1966 | + 963 | + 219 | - 871 | + 1,435 | +180 |
| 1967 | + 567 | - 252 [6] | + 50 | + 579 | +190 |
| 1968 | + 1,653 | - 51 | + 563 | + 804 | +337 |
| 1969 | + 6 | - 559 | - 1,267 | + 1,445 | +387 |
| 1970 | - 1,131 | + 29 | - 1,436 | + 680 | -404 |
| 1971 | + 226 | + 846 | - 1,090 | + 323 | -147 |

1) Excluding allocations of Special Drawing Rights.

2) Excluding net Treasury receipts from sales of coin. Corrections have also been made for:

(a) payments to and from IMF;

(b) transfer to Nationalbank of Ministry of Finance accounts with IMF in 1969;

(c) government purchase from Nationalbank in 1967 of bonds representing kr. 1,000 million in market value, placed at disposal of Government Building and Housing Fund;

(d) government purchase from Nationalbank in 1971 of bonds representing kr. 214 million in market value for account of the Social Pension Fund.

3) Exclusive of advances on 91-day deposit certificates, corrected for the bond sales mentioned in Note 2 (c) and (d). From November 1968: including Nationalbank's sales of 1-5 year deposit certificates.

4) From and after 1970: only Post Giro deposits other than Treasury's and Nationalbank's deposits.

5) From and after 1965, commercial banks' foreign-exchange position includes foreign assets and liabilities which were previously booked under domestic items. The change is affected by the inclusion of these items, which represented a net foreign-exchange debt of kr. 129 million.

6) Excluding a net addition to official liquidity of kr. 200 million deriving from the change in the par value of the krone.

Table 3.

Liquid funds held by business and households

| Year-end | Cash in hand | Assets in Post Giro accounts[1] | Sight deposits and demand deposits held in current accounts with commercial banks and major savings banks | Other demand deposits with commercial banks and major savings banks | Total | Time deposits held in commercial banks and major savings banks | Total |
|---|---|---|---|---|---|---|---|
| | Millions of kroner | | | | | | |
| 1958 | 2,464 | 541 | 3,234 | 3,077 | 9,316 | 8,854 | 18,170 |
| 1959 | 2,713 | 594 | 3,477 | 3,549 | 10,333 | 9,931 | 20,264 |
| 1960 | 2,777 | 633 | 3,576 | 3,674 | 10,660 | 10,829 | 21,489 |
| 1961 | 3,120 | 726 | 4,063 | 3,973 | 11,882 | 11,715 | 23,597 |
| 1962 | 3,266 | 835 | 4,487 | 4,267 | 12,855 | 12,743 | 25,598 |
| 1963 | 3,546 | 865 | 5,518 | 4,707 | 14,636 | 14,173 | 28,809 |
| 1964 | 3,849 | 988 | 6,346 | 5,065 | 16,248 | 15,697 | 31,945 |
| 1965 | 4,136 | 1,055 | 7,211 | 5,677 | 18,079 | 16,962 | 35,041 |
| 1966 | 4,528 | 1,253 | 8,461 | 6,366 | 20,608 | 19,000 | 39,608 |
| 1967 | 4,718 | 1,445 | 9,319 | 7,163 | 22,645 | 20,839 | 43,484 |
| 1968 | 4,847 | 1,747 | 11,494 | 8,369 | 26,457 | 23,256 | 49,713 |
| 1969 | 5,229 | 2,065 | 12,631 | 9,764 | 29,689 | 25,232 | 54,921 |
| 1970 | 4,870 | 1,670 | 11,666 | 10,584 | 28,790 | 27,478 | 56,268 |
| 1971 | 4,903 | 1,849 | 12,415 | 12,457 | 31,624 | 30,011 | 61,635 |

1) From and after 1970: Excluding Treasury's and Nationalbank's Giro deposits.

Table 4.

*Factors affecting the liquid funds held by business and households*

| | Surplus on government accounts (-)[1] | Surplus on current external account | Net capital imports for private sector, local governments and public utilities | Rise in lending | | Bond purchases by: | | | | Rise in bank holdings of uncleared cheques | Other factors | | Change in liquid funds |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Commercial banks | Savings banks | Commercial banks | Major savings banks | Post Giro Office[3] | Nationalbank | | Total | Of which: Increases in total capital and reserves of Nationalbank and banks[3] | |
| | Millions of kroner | | | | | Millions of kroner | | | | | | | |
| 1958 | - 437 | 867 | 208 | 428 | 420 | 369[2] | 39[2] | 9 | 20 | 62 | 100 | - 100 | 2,085 |
| 1959 | - 700 | 110 | 339 | 1,524 | 645 | 39[2] | 41[2] | 5 | - 74 | 54 | 111 | - 146 | 2,094 |
| 1960 | - 419 | - 407 | 248 | 1,466 | 572 | -188 | - 89[2] | 135 | 25 | 105 | - 223 | - 235 | 1,225 |
| 1961 | 418 | - 755 | 586 | 1,328 | 449 | 56 | 25 | 67 | 50 | 106 | - 222 | - 302 | 2,108 |
| 1962 | 56 | -1,657 | 929 | 1,659 | 569 | 159 | 21 | 117 | 372 | - 53 | - 171 | - 251 | 2,001 |
| 1963 | - 416 | 165 | 1,306 | 1,029 | 587 | 209 | 213 | 120 | 130 | 125 | - 257 | - 274 | 3,211 |
| 1964 | -1,356 | -1,363 | 2,025 | 2,413 | 846 | - 73 | 121 | 99 | 433 | 229 | - 238 | - 504 | 3,136 |
| 1965 | - 609 | -1,218 | 1,260 | 1,580 | 768 | 114 | - 95 | 138 | 1,374 | 105 | - 321 | - 451 | 3,096 |
| 1966 | - 936 | -1,453 | 1,778 | 2,846 | 1,209 | 460 | 27 | 78 | 839 | 124 | - 405 | - 476 | 4,567 |
| 1967 | 114 | -2,004 | 1,732 | 1,911 | 959 | - 45 | - 15 | 94 | 1,349 | 187 | - 406 | - 364 | 3,876 |
| 1968 | 851 | -1,616 | 1,332 | 2,174 | 815 | 353 | 392 | 137 | 2,229 | 261 | - 699 | - 305 | 6,229 |
| 1969 | - 760 | -3,081 | 2,184 | 4,292 | 1,318 | 88 | 190 | 218 | 1,648 | 173 | -1,062 | -1,135 | 5,208 |
| 1970 | -1,566 | -4,077 | 3,758 | 1,520 | 1,335 | 632 | 0 | 164 | 379 | -168 | - 630 | - 784 | 1,347 |
| 1971 | 507 | -3,174 | 2,611 | 1,107 | 920 | 1,872 | 567 | 161 | 1,137 | 243 | - 584 | - 296[x] | 5,367 |

1) Addition to (-) or reduction of the Treasury's net assets in the Nationalbank adjusted for:
(a) net central government borrowing abroad;
(b) changes in Giro deposits corrected for purchases of bonds by the Post Giro Office and, from 1970, for Treasury deposits in Giro account;
(c) net sale of coins; and
(d) up to June 1969, payments to and drawings against the IMF.

2) Including shares.
3) Addition (-) to total capital and reserves, corrected for loss/gain on changes in market value of bonds and shares and certain other movements in net worth, and for increases in book values of real property.

Table 5

Relationship between money supply and GDP

| | 1<br>Primary money supply | 2<br>Secondary money supply | 3<br>GDP, less repairs and maintenance | 4<br>1 in per cent of 3 | 5<br>2 in per cent of 3 |
|---|---|---|---|---|---|
| | Millions of kroner | | | Per cent | |
| 1958 | 4,533 | 18,170 | 34,322 | 13.2 | 52.9 |
| 1959 | 4,572 | 20,264 | 38,085 | 12.0 | 53.2 |
| 1960 | 4,279 | 21,489 | 41,098 | 10.4 | 52.3 |
| 1961 | 4,638 | 23,597 | 45,616 | 10.2 | 51.7 |
| 1962 | 4,660 | 25,598 | 51,387 | 9.1 | 49.8 |
| 1963 | 5,503 | 28,809 | 54,705 | 10.1 | 52.7 |
| 1964 | 5,579 | 31,945 | 62,529 | 8.9 | 51.1 |
| 1965 | 6,590 | 35,041 | 70,251 | 9.4 | 49.9 |
| 1966 | 7,553 | 39,608 | 77,132 | 9.8 | 51.4 |
| 1967 | 8,120 | 43,484 | 84,540 | 9.6 | 51.4 |
| 1968 | 9,773 | 49,713 | 93,228 | 10.5 | 53.3 |
| 1969 | 9,779 | 54,921 | 105,992 | 9.2 | 51.8 |
| 1970 | 8,648 | 56,268 | 117,338 | 7.4 | 48.0 |
| 1971 | 8,874 | 61,635 | 128,485 | 6.9 | 48.0 |

Table 6-1

Commercial bank liquidity

| Year-end | Primary liquidity | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Cash in hand and Giro | Assets in National-bank | Foreign assets | Foreign liabil-ities | Net foreign assets | Particularly liquid securities 1) | | | Total |
| | | | | | | Discountable value | Discounted in National-bank | Unutilised discountable value | |
| | Millions of kroner | | | | | | | | |
| 1958 | 325 | 296 | 746 | 290 | 456 | 524 | 180 | 344 | 1,421 |
| 1959 | 309 | 259 | 669 | 346 | 323 | 444 | 185 | 259 | 1,150 |
| 1960 | 353 | 267 | 570 | 569 | 1 | 222 | 111 | 111 | 732 |
| 1961 | 408 | 244 | 623 | 789 | - 166 | 348 | 204 | 144 | 630 |
| 1962 | 469 | 240 | 675 | 1,223 | - 548 | 551 | 332 | 219 | 380 |
| 1963 | 525 | 245 | 811 | 1,150 | - 339 | 588 | 100 | 488 | 919 |
| 1964 | 509 | 231 | 747 | 1,427 | - 680 | 654 | 167 | 487 | 547 |
| 1965 | 631 | 224 | 1,250 2) | 1,510 2) | - 260 2) | 880 | 349 | 531 | 1,126 |
| 1966 | 667 | 254 | 1,714 | 1,827 | - 113 | 1,160 | 616 | 544 | 1,352 |
| 1967 | 659 | 383 | 2,169 | 2,161 | 8 | 1,284 | 825 | 459 | 1,509 |
| 1968 | 875 | 354 | 3,260 | 2,658 | 602 | 1,457 | 576 | 881 | 2,712 |
| 1969 | 892 | 352 | 2,612 | 2,570 | 42 | 1,321 | 716 | 605 | 1,891 |
| 1970 | 843 | 208 | 2,735 | 2,731 | 4 | 1,792 | 1,260 | 532 | 1,587 |
| 1971 | 811 | 45 | 2,880 | 3,144 | - 264 | 1,956 | 989 | 967 | 1,559 |

1) Securities which the Nationalbank will discount or buy on specially favourable terms (discountable value of 91-day deposit certificates, credit certificates and bonds of the Ship Credit Fund's special series).

2) From and after 1965: including foreign assets and liabilities booked under domestic items in the commercial banks' balance sheets. At end-1964 these items represented a net debt of kr. 129 million.

Table 6-2

Commercial bank liquidity

| Year-end | Secondary liquidity | | | | | | | Special credit facilities 2) | | | Limita-tions on liquidity under deposit agree-ment |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Other bonds and redis-counted Bs/E 1) | | | 1-5 year deposit certificates | | | Total | | | | |
| | Discount-able value | Dis-counted | Unutil-ised dis-count-able value | Discount-able value | Dis-counted | Unutil-ised dis-count-able value | | Discount-able value | Dis-counted | Unutil-ised dis-count-able value | |
| | Millions of kroner | | | | | | | | | | |
| 1958 | 1,800 | 131 | 1,669 | . | . | . | 1,669 | ... | 6 | ... | . |
| 1959 | 2,100 | 186 | 1,914 | . | . | . | 1,914 | ... | 89 | ... | . |
| 1960 | 1,800 | 302 | 1,498 | . | . | . | 1,498 | ... | 97 | ... | . |
| 1961 | 1,900 | 278 | 1,622 | . | . | . | 1,622 | ... | 134 | ... | . |
| 1962 | 1,700 | 484 | 1,216 | . | . | . | 1,216 | ... | 175 | ... | . |
| 1963 | 2,000 | 279 | 1,721 | . | . | . | 1,721 | ... | 3 | ... | . |
| 1964 | 2,500 | 581 | 1,919 | . | . | . | 1,919 | . | . | . | . |
| 1965 | 2,600 | 548 | 2,052 | . | . | . | 2,052 | . | . | . | 331 |
| 1966 | 2,800 | 999 | 1,801 | . | . | . | 1,801 | . | . | . | 736 |
| 1967 | 2,800 | 446 | 2,354 | . | . | . | 2,354 | 50 | 48 | 2 | 1,010 |
| 1968 | 3,500 | 537 | 2,963 | (701) | . | (701) | 2,963 | . | . | . | 1,364 |
| 1969 | 4,100 | 903 | 3,197 | 454 | 84 | 370 | 3,567 | 193 | 94 | 99 | 1,988 |
| 1970 | 4,900 | 961 | 3,939 | . | . | . | 3,939 | 813 | 131 | 682 | 2,297 |
| 1971 | 7,400 | 1,119 | 6,281 | . | . | . | 6,281 | 1,378 | 0 | 1,378 | . |

1) Estimated value for the purpose of tied deposits and discountable value of bond holdings other than the particularly liquid securities listed under primary liquidity, and rediscountable Bs/E estimated at one third of portfolios.

2) Up to and including 1963: including advances against ship's mortgages and against export credits. Unutilised refinancing facilities against ship's mortgages represented: kr. 450 million at end-1958, kr. 450 million at end-1959, kr. 300 million at end-1960, kr. 200 million at end-1961, and kr. 23 million at end-1962. From and after 1969: reported rediscountable assets held under the Nationalbank's temporary facilities for bank lending to finance housing construction, etc.

Table 7

Government debt

| End-March | Domestic debt | | | | | | Foreign debt | | | Total debt |
|---|---|---|---|---|---|---|---|---|---|---|
| | Bonds | Savings certificates and compulsory savings | Treasury bills | Debt to Nationalbank | Post Giro Office | Total | Bonds | IMF | Total | |
| | Millions of kroner | | | | | | | | | |
| 1958 | 4,563 | 682 | 6 | 2,123 | 428 | 7,802 | 1,076 | 101 | 1,177 | 8,979 |
| 1959 | 4,913 | 468 | - | 1,929 | 529 | 7,839 | 1,089 | - 123 | 966 | 8,805 |
| 1960 | 4,887 | 358 | - | 1,543 | 420 | 7,208 | 1,153 | - 234 | 919 | 8,127 |
| 1961 | 4,652 | 359 | - | 953 | 503 | 6,467 | 1,248 | - 239 | 1,009 | 7,476 |
| 1962 | 4,425 | 344 | - | 1,491 | 395 | 6,655 | 1,334 | - 239 | 1,095 | 7,750 |
| 1963 | 4,262 | 317 | - | 983 | 346 | 5,908 | 1,645 | - 239 | 1,406 | 7,314 |
| 1964 | 4,054 | 660 | - | 112 | 377 | 5,203 | 1,709 | - 239 | 1,470 | 6,673 |
| 1965 | 3,879 | 830 | - | -1,116 | 252 | 3,845 | 1,877 | - 239 | 1,638 | 5,483 |
| 1966 | 3,745 | 721 | - | -1,613 | 366 | 3,219 | 1,989 | - 472 | 1,517 | 4,736 |
| 1967 | 3,586 | 599 | - | -2.579 | 438 | 2,044 | 1,920 | - 473 | 1,447 | 3,491 |
| 1968 | 3,443 | 467 | - | -1,510 | 423 | 2,823 | 2,140 | - 477 | 1,663 | 4,486 |
| 1969 | 3,319 | 328 | - | -1,635 | 506 | 2,518 | 2,413 | - 653 | 1,760 | 4,278 |
| 1970 | 3,215 | 122 | - | -3,679 | 730 | 388 | 3,191 | . [1] | 3,191 | 3,579 |
| 1971 | 3,087 | 83 | - | -6,788 | 420 | -3,198 | 3,699 | . | 3,699 | 501 |
| 1972 | 2,916 | - | - | -8,295[2] | . [2] | -5,379 | 5,292 | . | 5,292 | - 87 |

1) At end-June 1969 Denmark's IMF quota of $163 million, equal to kr. 1,223 million, was transferred from the Ministry of Finance to Danmarks Nationalbank, and the Bank took over the Ministry's liabilities vis-a-vis the IMF amounting to kr. 570 million. The difference between the two items, kr. 653 million, was credited to the Treasury's account in the Bank.

2) From and after end-June 1971 the Post Giro's balance has been deducted from the Treasury's current account in the Bank.

Table 8

Danish bonds and shares held by commercial banks, savings banks, insurance companies and pension funds
(Book values)

| Year-end[1] | Commercial banks [2] | Savings banks [2] | Insurance companies and pension funds |
|---|---|---|---|
| | Millions of kroner | | |
| 1958 | 1,902 | 1,435 | 5,121 |
| 1959 | 2,001 | 1,476 | 5,582 |
| 1960 | 1,853 | 1,387 | 6,041 |
| 1961 | 1,917 | 1,409 | 6,396 |
| 1962 | 2,179 | 1,434 | 6,872 |
| 1963 | 2,623 | 1,653 | 7,638 |
| 1964 | 2,560 | 1,779 | 8,207 |
| 1965 | 2,742 | 1,688 | 8,911 |
| 1966 | 3,395 | 1,723 | 9,754 |
| 1967 | 3,558 | 1,725 | 10,652 |
| 1968 | 4,255 | 2,124 | 11,847 |
| 1969 | 4,406 | 2,346 | 13,368 |
| 1970 | 5,271 | 2,360 | 14,737 |
| 1971 | 7,563 | 2,926 | ... |

1) The figures given for insurance companies and pension funds represent accounting years, but these are mostly identical with calendar years.

2) Excluding deposit certificates sold to commercial banks and savings banks and credit certificates held by commercial banks. From 1961 and 1969, respectively, the figures do not include holdings of deposit certificates listed in the balance sheets of commercial banks and savings banks. From 1971, the figures do not include credit certificates listed in the balance sheets of commercial banks.

Table 9

Nationalbank holdings of bills of exchange, and other advances

| Year-end | Domestic Bs/E | | Advances | | | Total |
|---|---|---|---|---|---|---|
| | Total | Of which: under temporary facility | on securities | guaranteed by central govt. | Current account [1] | |
| | Millions of kroner | | | | | |
| 1958 | 29 | . | 180 | 15 | 137 | 361 |
| 1959 | 37 | . | 185 | 16 | 284 | 522 |
| 1960 | 63 | . | 182 | 15 | 324 | 584 |
| 1961 | 103 | . | 250 | 14 | 319 | 686 |
| 1962 | 176 | . | 489 | 13 | 414 | 1,092 |
| 1963 | 62 | . | 126 | 13 | 272 | 473 |
| 1964 | 154 | . | 302 | 12 | 345 | 813 |
| 1965 | 56 | . | 388 | 12 | 514 | 970 |
| 1966 | 147 | . | 759 | 13 | 767 | 1,686 |
| 1967 | 32 | . | 971 | 14 | 340 | 1,357 |
| 1968 | 12 | . | 612 | 15 | 502 | 1,141 |
| 1969 | 190 | 84 | 891 | 18 | 726 | 1,825 |
| 1970 | 96 | 85 | 1,439 | 20 | 876 | 2,431 |
| 1971 | 53 | 1 | 991 | 20 | 1,082 | 2,146 |

1) Mostly revenue credits - see p. 35.

Table 10

Nationalbank holdings of securities
(Book values)

| Year-end | Bonds of Ship Credit Fund's special series | Other bonds and shares [1] | Total holdings of securities |
|---|---|---|---|
| | Millions of kroner | | |
| 1958 | . | 556 | 556 |
| 1959 | . | 464 | 464 |
| 1960 | . | 472 | 472 |
| 1961 | . | 478 | 478 |
| 1962 | . | 839 | 839 |
| 1963 | . | 1,044 | 1,044 |
| 1964 | - | 1,290 | 1,290 |
| 1965 | - | 2,581 | 2,581 |
| 1966 | - | 3,408 | 3,408 |
| 1967 | 350 | 3,322 | 3,672 |
| 1968 | 894 | 5,290 | 6,184 |
| 1969 | 1,455 | 5,415 | 6,870 |
| 1970 | 1,837 | 4,976 | 6,813 |
| 1971 | 2,358 | 5,734 | 8,092 |

1) Holdings of shares are small.

Table 11

Official discount rate and lending rates charged by Nationalbank

| Date effective | Official discount rate | Rediscount rate | Lending rates | | | |
|---|---|---|---|---|---|---|
| | | | Advances on | | Refinancing and advances on bonds and shares | |
| | | | 91-day deposit certifi-cates | credit certifi-cates | Lowest rate | Highest rate |
| | Per cent | | | | | |
| ( 1 Jan 1958) | 5 1/2 | 5 1/2 | . | . | 6 | 6 1/2 |
| 19 Apr | 5 | 5 | . | . | 5 1/2 | 6 |
| 11 Jun | " | " | 5 | . | " | " |
| 15 Aug | 4 1/2 | 4 1/2 | 4 1/2 | . | 5 | 5 1/2 |
| 19 Sep 1959 | 5 | 5 | 5 | . | 5 1/2 | 6 |
| 26 Jan 1960 | 5 1/2 | 5 1/2 | 5 1/2 | . | 6 | 6 1/2 |
| 28 Sep | " | " | " | 6 1/2 | " | " |
| 20 Apr 1961 | " | " | " | 7 | " | 7 |
| 27 " | " | " | " | 6 | " | " |
| 23 May | 6 1/2 | 6 1/2 | 6 1/2 | 6 1/2 | 7 | 7 1/2 |
| 19 Aug 1963 | 6 | 6 | 6 | 6 | 6 1/2 | 7 |
| 13 Nov | 5 1/2 | 5 1/2 | 5 1/2 | 5 1/2 | 6 | 6 1/2 |
| 11 Jun 1964 | 6 1/2 | 6 1/2 | 6 1/2 | 6 1/2 | 7 | 7 1/2 |
| 19 Dec 1967 | 7 1/2 | 7 1/2 | 7 1/2 | 7 1/2 | 8 | 8 1/2 |
| 19 Mar 1968 | 7 | 7 | 7 | 7 | 7 1/2 | 8 |
| 13 Jun | 6 1/2 | 6 1/2 | 6 1/2 | 6 1/2 | 7 | 7 1/2 |
| 29 Aug | 6 | 6 | 6 | 6 | 6 1/2 | 7 |
| 31 Mar 1969 | 7 | 7 | 7 | 7 | 7 1/2 | 8 |
| 12 May | 9 | 9 | 9 | 9 | 9 1/2 | 10 |
| 20 Jan 1971 | 8 | 8 | 8 | 8 | 8 1/2 | 9 |
| 15 Apr | 7 1/2 | 7 1/2 | 7 1/2 | 7 1/2 | 8 | 8 1/2 |
| 10 Jan 1972 | 7 | 7 | 7 | 7 | 7 1/2 | 8 |
| 28 Jun | 8 | 8 | 8 | 8 | 8 1/2 | 9 |
| 3 Oct | 7 | 7 | 7 | 7 | 7 1/2 | 8 |

Rules governing loans from the Nationalbank against securities

| Date effective | Deposit certificates | | Credit certifi-cates | Bonds issued by financial institutes[1] | Ship Credit bonds special series | Other bonds | | Shares |
|---|---|---|---|---|---|---|---|---|
| | 91-day | 1-5 year | | | | Ordinary advances | Advances under revenue credits | |
| | Discountable value in per cent of | | | | | | | |
| | nominal value | nominal value | nominal value | buying price | nominal value | buying price | buying price | nominal value / buying price |
| (1 Jan 1958) | . | . | . | . | . | 85[2] | 85[2] | 50[2] |
| 11 Jun | 100 | . | . | . | . | " | " | " |
| 1 Apr 1959 | " | . | . | 85 | . | " | " | " |
| 8 " | " | . | . | " | . | " 3) | " 3) | " 3) |
| 12 May 1960 | " | . | . | " | . | 70 | " | " |
| 28 Sep | " | . | 85[4] | " | . | " | " | " |
| 20 Apr 1961 | " | . | " 5) | " | . | " | " | " |
| 21 Mar 1962 | " | . | " | 80 | . | 60 | 75 | " |
| 21 May | " | . | " | 75 | . | 50 | 65 | " |
| 30 Sep 1963 | " | . | " | " | 100 | " | " | " |
| 18 Nov 1964 | " | . | " | " | " | 75 | 75 | " |
| 2 Jan 1968 | " | . | " | " | 95 | " | " | " |
| 2 Jan 1969 | " | . | " | " | 90 | " | " | " |
| 23 May | " | 75 | " | " | " | " | " | " |
| 2 Jan 1970 | " | " | " | " | 85 | " | " | " |
| 2 Jan 1971 | " | . | " | " | 80 | " | " | " |
| 15 Dec | " | . | 90 | 90 | 90 | 90 | 90 | 60 |
| 10 July 1972 | " | . | 85 | 60 | 75 | 60 | 60 | 50 |

1) The Industrial Finance Institute, the financial institutes approved under the Housing Construction Act of 27 December 1958, the Mortgage Fund for Danish Agriculture, Denmark's Ship Credit Fund, and the Mortgage Credit Institute of the Faroe Islands.

2) Advances against collateral security in:

(a) bonds included in the Stock-Exchange List of official daily quotations, except premium lottery bonds and second mortgage credit bonds;

(b) shares in certain specified companies accepted as collateral security for 50 per cent of nominal values with a minimum margin of 30 points.

3) Second-mortgage credit bonds became acceptable as collateral security, which now comprises all bonds included in the Stock-Exchange List of official daily quotations except premium lottery bonds. The rules governing loans against shares were also amended: All shares included in the Stock-Exchange List of official daily quotations of shares in companies with a share capital of kr. 10 million and more are acceptable as collateral security for loans of up to 50 per cent of the buying price (previously: of the nominal value). Shares quoted below par are not acceptable.

4) Credit certificates became acceptable as collateral security for loans to commercial banks, savings banks and stock-exchange brokers. These certificates are discountable for one third of the loan as soon as they have been received from the Nationalbank, for another third one year after receipt, and for the last third two years after receipt.

5) All credit certificates were made discountable after receipt from the Nationalbank.

Table 13

Interest rates of the principal commercial banks

| Date effective | Advances | Deposits | | | | | |
|---|---|---|---|---|---|---|---|
| | | Sight | Ordinary pass books | Time deposits | | | |
| | | | | 3-month | 6-month | 9-month | 12-month |
| | Per cent | | | | | | |
| (1 Jan 1958) | 6 - 7 1/2 | 1/2 | 3 | 4 | 4 1/2 | 5 | . |
| 19 Apr | 5 1/2- 7 | " | " | " | " | " | . |
| 16 Aug | 5 - 6 1/2 | " | " | 3 1/2 | 4 | 4 1/2 | . |
| 19 Sep 1959 | 5 1/2- 7 | " | " | " | " | " | . |
| 26 Jan 1960 | 6 - 7 1/2 | " | " | 4 | 4 1/2 | 5 | . |
| 23 May 1961 | 7 - 8 1/2 | 1 | 3 1/2 | 5 | 5 1/2 | 6 | . |
| 19 Aug 1963 | 6 1/2- 8 | " | 3 1/4 | 4 3/4 | 5 1/4 | 5 3/4 | . |
| 13 Nov | 6 - 7 1/2 | 3/4 | 3 | 4 1/4 | 4 3/4 | 5 1/4 | . |
| 1 May 1964 | " | " | " | " | 5 1/4 | . | . |
| 11 Jun | 7 - 8 1/2 | 1 | 3 3/4 | 5 1/4 | 6 1/4 | . | . |
| 19 Dec 1967 | 8 - 9 1/2 | 1 1/2 | 4 3/4 | 6 1/4 | 7 1/4 | . | . |
| 19 Feb 1968 | " | " | " | " | " | . | 7 1/4 1) |
| 19 Mar | 7 1/2- 9 1/2 | 1 1/4 | 4 1/4 | 5 3/4 | 6 3/4 | . | 6 3/4 2) |
| 13 Jun | 7 - 9 | 1 | 3 3/4 | 5 1/4 | 6 1/4 | . | 6 1/4 2) |
| 29 Aug | 6 1/2- 8 1/2 | 3/4 | 3 1/4 | 4 3/4 | 5 3/4 | . | 6 1/2 |
| 31 Mar 1969 | 7 1/2- 9 1/2 | 1 1/4 | 4 1/4 | 5 3/4 | 6 1/2 | . | 7 1/2 |
| 12 May | 9 1/2-11 1/2 | 2 | 5 1/4 | 7 | 7 3/4 | . | 8 1/2 |
| 5 Jun 1970 | " | 2 1/4 | 6 | 8 | . | . | 9 |
| 20 Jan 1971 | 8 1/2-10 1/2 | 1 3/4 | 5 | 7 | . | . | 8 1/2 |
| 15 Apr | 8 -10 | 1 1/2 | 4 1/2 | 6 1/2 | . | . | " |
| 10 Jan 1972 | 7 1/2- 9 1/2 | 1 1/4 | 4 | 6 | . | . | 8 |
| 28 Jun | 8 1/2-10 1/2 | 1 3/4 | 5 | 7 | . | . | 9 |
| 3 Oct | 7 1/2- 9 1/2 | 1 1/4 | 4 | 6 | . | . | 8 |

1) Plus 3/4 per cent savings bonus p.a.
2) Plus 1 per cent savings bonus p.a.

Table 14

Foreign-exchange position of commercial banks

| Year-end | Assets | Liabilities | Foreign-exchange position, net |
|---|---|---|---|
| | Millions of kroner | | |
| 1958 | 746 | 290 | 456 |
| 1959 | 669 | 346 | 323 |
| 1960 | 570 | 569 | 1 |
| 1961 | 623 | 789 | - 166 |
| 1962 | 675 | 1,223 | - 548 |
| 1963 | 811 | 1,150 | - 339 |
| 1964 | 747 | 1,427 | - 680 |
| 1965 | 1,250 1) | 1,510 1) | - 260 1) |
| 1966 | 1,714 | 1,827 | - 113 |
| 1967 | 2,169 | 2,161 | 8 |
| 1968 | 3,260 | 2,658 | 602 |
| 1969 | 2,612 | 2,570 | 42 |
| 1970 | 2,735 | 2,731 | 4 |
| 1971 | 2,880 | 3,144 | - 264 |

1) From and after 1965: including foreign assets and liabilities booked as domestic items in the banks' balance sheets. At end-1964 these items represented a net debt of kr. 129 million.

# R E F E R E N C E S


1. Danmarks Nationalbank, Report and Accounts
   (available in English)

2. Danmarks Nationalbank, Monetary Review
   (in English)

3. Report on the activities of Danish commercial banks
   (published in Danish by the Government Inspector of Commercial Banks and Savings Banks)

4. Report on the activities of Danish savings banks
   (published in Danish by the Government Inspector of Commercial Banks and Savings Banks)

5. Economic Survey of Denmark (available in English)
   (published by the Government's Secretariat for Economic Policy)

6. Statistiske Efterretninger (i.e. statistical news)
   (published in Danish by Danmarks Statistik (National Bureau of Statistics))

7. Statistisk Årbog (i.e. statistical yearbook)
   (published in Danish, with English translations of headings and explanatory notes, by Danmarks Statistik (National Bureau of Statistics))

8. Børsen og Kapitalmarkedet, Betænkning I
   (i.e. the Stock Exchange and the capital market, Report I)
   No. 456 - 1967, published by a committee set up by the Ministry of Commerce to revise the organisation of and rules governing the stock exchange

9. **Erik Hoffmeyer:** Strukturændringer pa penge- og kapitalmarkedet (i.e. structural changes on the money and capital market) Copenhagen 1960

10. Erling Olsen og Erik Hoffmeyer: Dansk Pengehistorie 1914-1960
    (i.e. monetary history of Denmark) Copenhagen 1968

11. Niels Thygesen: The Sources and the Impact of Monetary Changes. An Empirical study of Danish Experiences 1951-1968 (in English) Copenhagen 1971

12. OECD: The capital market, international capital movements, restrictions on capital operations, in Denmark; published in English 1970.

# P A R T  T W O

## MONETARY POLICY INSTRUMENTS

## IN

## I R E L A N D

## CHAPTER ONE

## Ireland: Institutional and Structural Aspects of the Monetary System

### Section I - The Institutions

Para I. The Monetary Authority

The Central Bank of Ireland formulates and executes monetary policy in Ireland within the framework of national economic policy. The monetary policy function of the Central Bank is set out in Section 6 of the Central Bank Act, 1942 which gave the Bank

> "the general function and duty of taking (within the limit of the powers for the time being vested in it by law) such steps as the Board may from time to time deem appropriate and advisable towards safeguarding the integrity of the currency and ensuring that, in what pertains to the control of credit, the constant and predominant aim shall be the welfare of the people as a whole."

This statement of the general function and duty of the Bank is followed in the Act by a subsection empowering the Minister for Finance, whenever he thinks proper, to require the Governor of the Bank or the Board "to consult and advise with him in regard to the execution and performance by the Bank of the general function and duty imposed on the Bank"[1]. Broadly speaking the 1942 Act gave the Central Bank some, but not all, of the characteristic functions of a central bank. It took over from the Currency Commission responsibility for the note-issue and for management of part of the external assets of the economy and was empowered to act as lender of last resort and to take deposits from banks. Amending legislation in later years and the Central Bank Act, 1971 in particular, by giving additional powers to the Bank, considerably increased the capacity of the Bank to achieve the broad objectives set out in previous legislation.

A number of important changes giving more formal control to the Bank over the banking system were introduced under the 1971 Act. The Central Bank was made the licensing authority for banks, and provision was made for the transfer of the Exchequer Account to the Bank. From a monetary policy

---

[1] Section 6(1) and (2).

viewpoint an important result of the 1971 Act was that formal powers were given to the Bank to require a holder of a banker's licence to maintain a specified ratio between assets and liabilities[2]. These powers strengthened the position of the Bank particularly by providing an alternative instrument of monetary control in addition to those of moral suasion and quantitative guidelines formerly employed by it.

The Central Bank Acts of 1942 and 1971 in effect give the Central Bank a large measure of autonomy. The relationship of the Central Bank to the Government in the area of monetary policy is reflected in Section 6 of the 1942 Act[3]. In practice the relationship between Government and the Central Bank rests as much on mutual confidence as on statutory provisions. It is sustained by frequent consultations between the Minister for Finance and the Governor of the Central Bank on all aspects of economic policy, by a frank interchange of information and comment in the policy field and by the fact that the Government have an official representative on the board of the Bank. This has provided the basis for a sufficient consensus on the broad aims of economic policy from one period to another for the Central Bank to be able to determine its monetary policy in a way which conforms to national economic policy. Subject to this broad conformity, the Bank decides what kind of monetary policy is appropriate and how to make it effective.

---

[2] Section 23(1).

[3] Section 6(1) In addition and without prejudice to the functions, powers and duties vested by law in the Commission immediately before the appointed day and to such functions, powers, and duties as are specifically conferred or imposed by this Act on the Bank, the Bank shall have the general function and duty of taking (within the limit of the powers for the time being vested in it by law) such steps as the Board may from time to time deem appropriate and advisable towards safeguarding the integrity of the currency and ensuring that, in what pertains to the control of credit, the constant and predominant aim shall be the welfare of the people as a whole.

(2) The Minister may, on such occasions as he shall think proper, request the Governor on behalf of the Board or the Board to consult and advise with him in regard to the execution and performance by the Bank of the general function and duty imposed on the Bank by the foregoing sub-section of this section, and the Board shall comply with every such request.

**Para II** Monetary and Financial Institutions

Before examining the principal institutions and their characteristics it may be useful to provide a brief description of the salient features of the Irish economy. Ireland has a population of three million people, a gross national product of £2,237 million ($5,570 million) in 1972 and an income per head which, though some 50 per cent. below that of most industrialised West European countries, places it among the thirty richest nations in the world[4]. The economy is characterised by a large and rapidly expanding public sector, with public capital formation accounting for somewhat more than half of total investment. It is also subject, to an exceptional degree, to external influences; exports and imports represent some 38 per cent. and 40 per cent., respectively, of gross national product. The openness of the economy is also expressed in the close connections between persons and firms in Ireland and abroad. Much of the country's external trade - some 61 per cent. of exports and over 51 per cent. of imports - is with Northern Ireland and Great Britain. External transactions with the United Kingdom and the USA and Canada yield a net surplus, as compared with an excess of payments to Continental Europe and the rest of the world. Agriculture accounts for about one-quarter of total employment, almost one-fifth of total output and about 40 per cent. of all merchandise exports. As in most European countries, industry has substantially outgrown the agricultural sector, and in recent years industrial expansion has been the mainspring of economic growth. About half of the population now live in urban areas. The use of cheques for effecting payments is widespread in Ireland: as in a number of other European countries, some two-thirds of aggregate money holdings are in the form of credit balances on current accounts, the remainder consisting of notes and coin. The Irish pound and the pound sterling exchange at par and there is free movement of funds between Ireland and the United Kingdom. British currency is freely accepted in the Republic of Ireland, while Irish currency circulates readily in Northern Ireland. There are ongoing arrangements for withdrawal and repatriation of British currency presented to the Irish banks.

---

[4] Comparison is with countries with a population greater than one million.

## The Principal Institutions and their Characteristics

### 1. The Associated Banks

The Associated Banks are the most important category of banks in the Republic of Ireland. The term "Associated" comes from the Central Bank Act, 1942 which gave them a special relationship with the Central Bank. They consist of two major banking groups which are Irish owned, together with two banks which are subsidiaries of British banks. These two externally-controlled banks have most of their branches in Northern Ireland so that the two domestically-controlled groups account for by far the greater part of Associated Bank activities in the Republic. The major proportion of total monetary transactions in the economy is settled by cheques drawn on the Associated Banks. They operate a comprehensive current- and deposit-account service, account for some 70 per cent. of total credit extended within the State by all banks and have an extensive branch network, with some 750 branches throughout the Republic of Ireland. At end-June 1973 their domestic resources in the form of current and deposit accounts amounted to £1,026 million or 80 per cent. of total bank resources while their domestic lending totalled £1,022 million (of which £313 million was to the Government) and accounted for 70 per cent. of total domestic lending by the banks.

### 2. The non-Associated banks

Banks other than the Associated Banks are classified as non-Associated banks. The non-Associated banks engage in commercial banking, in merchant banking and in consumer finance. They consist of subsidiaries of the Associated Banks, branches of North American Banks, subsidiaries and affiliates of British banks and a number of other Irish banks together with two banks from other EEC countries. At the time of writing there are 38 non-Associated banks in Ireland. In some respects the non-Associated banks tend to complement rather than compete vigorously with the Associated Banks. As a group they do not operate current accounts to any substantial extent and have relatively few branches as compared with the Associated Banks. At end-June 1973 their domestic resources in the form of current and deposit accounts were £275 million or some 20 per cent. of total bank resources,

while their domestic lending amounted to £415 million or nearly 30 per cent. of total domestic lending by the banks.

The non-Associated banks are categorised under four broad groupings. Six Merchant Banks constitute the first broad group, four of them being subsidiaries either of Associated Banks or of foreign banks. These banks deal mainly in wholesale banking. The scale of their operations is considerable and they offer a wide range of specialised financial services. In general they accept large deposits and their lending - principally to larger commercial firms - is tailored to each customer's requirements, sometimes taking the form of a bulk sum for a given period, sometimes related to the cash flow expectations of the customer. Their other activities range from advice on methods of financing and on mergers and takeovers, to the management of portfolios on behalf of large investors such as pension funds. At end-June 1973 the domestic resources in the form of current and deposit accounts of Merchant Banks totalled £135 million while their domestic lending amounted to £111 million. These banks hold short-term assets rather than cash for liquidity purposes and play a major part as a supplier of funds in the Dublin inter-bank market.

The second broad grouping of non-Associated banks consists of five North American Banks, one of which is a joint venture with a domestically-controlled bank group. A large part of their business is servicing corporate customers, particularly branches of American manufacturing firms located in Ireland. Their activities are in some respects similar to those of the Merchant Banks but they compete more closely than the latter with the Associated Banks in providing a full commercial banking service. Their domestic lending substantially exceeds their domestic resources in the form of current and deposit accounts, the difference being financed by borrowing on the Dublin inter-bank market and from external sources. At end-June 1973 their domestic resources totalled £53 million while their domestic lending was £107 million.

The third category of non-Associated banks consists of eleven Industrial Banks whose business is mainly instalment credit. The smaller Industrial

Banks mainly provide hire purchase loans, principally for consumer durable goods, but the larger banks in this category offer facilities and services covering industrial loans, export/import finance, equipment leasing, finance for industrial building, bridging loans, company finance, block discounting and the financing of contracts. However, lending for consumer purposes constitutes a considerable part of instalment credit extended even by the larger Industrial Banks. A number of the larger Industrial Banks have branches in the major urban areas, but not on a large scale. At end-June 1973 their domestic lending amounted to £173 million and accounted for over two-thirds of total instalment credit but their domestic resources in the form of deposits were only £68 million, so that a substantial proportion of their funds comes from abroad.

The fourth category of non-Associated banks consists of a miscellaneous group of 16 banks, including two banks from other EEC countries. They form a small part of the banking system, their lending being £26 million or less than 2 per cent. of total domestic lending.

3. Hire Purchase Finance Companies

Hire purchase finance companies are not licensed banks but in common with the Industrial Banks their principal business is the extension of instalment credit. The Industrial Banks engage in a considerable amount of other lending as well, whereas the hire purchase finance companies do not. These companies derive their resources from loans made to them by their own banking affiliates or from the commercial banks and are prohibited from accepting deposits. There are approximately 40 such companies and at end-June 1973 total domestic credit extended by them was £25 million.

4. Building Societies

The building societies are an important part of the financial sector. They are the largest single providers of mortgage finance for housing in Ireland, providing some 70 per cent. of such finance. Although the building societies have primarily long-term assets they solicit and incur short-term liabilities in the form of shares and deposits. Of the 23 building societies only six are relatively large. The larger societies

have branches in most of the larger urban areas. At end-June 1973 their total lending amounted to £141 million while their shares and deposits were £158 million.

5. Assurance Companies

There are 54 companies - ten of them Irish - engaged in insurance business in Ireland. Fifteen of these are life assurance companies while the remainder are engaged in a particular class, or a number of classes, of general insurance. The life assurance companies are important collectors of savings to the extent that they have an excess of premiums over claims whereas those firms engaged in general insurance are, broadly speaking, concerned with making annual payments in respect of claims and expenses roughly equal to total receipts. At end-1971 total liabilities of life assurance companies to Irish residents amounted to £293 million. Much of this is invested in Ireland and the assurance companies are of increasing importance in Irish financial markets.

6. Credit Unions

The growth of the credit union movement in Ireland since the movement's inception in the late 'fifties has been rapid. The latest official figures relate to 315 credit unions registered at end-1970 and show total shares and deposits of some £10.4 million at the end of 1970. Unofficial estimates put the value of total shares and deposits of the movement at approximately £24 million by the end of February 1973. The number of members was estimated to be 277,000 at the same date.

7. Other Financial Institutions

Other important financial institutions are the Savings Banks (the Post Office Savings Bank and the five Trustee Savings Banks), the Agricultural Credit Corporation Limited and the Industrial Credit Company Limited. The Savings Banks (mainly through Post Offices) have some 1,400 branches throughout the country. The bulk of their business is the provision of time-deposit facilities but withdrawals on demand up to £30 are permitted. A current-account service is provided by the Trustee

Savings Banks. Funds accruing to the Post Office (or State) Savings Bank and the Trustee Savings Banks are made available to the Minister for Finance. At end-June 1973 total deposits with Savings Banks amounted to £215 million[5]

Both the Agricultural Credit Corporation and the Industrial Credit Company were established by the State. The Agricultural Credit Corporation provides capital for financing agricultural development. Its liabilities consist of deposits from the public, funds supplied by the Exchequer and the balance being provided by borrowing abroad. At end-June 1973 deposits with the Agricultural Credit Corporation totalled £44 million while its lending amounted to £61 million.

The Industrial Credit Company operates as an industrial development bank and provides capital for industry by medium- and long-term loans, direct share investment, industrial hire purchase and leasing facilities. Most of the company's financial requirements are obtained from the Minister for Finance, either by share investment or repayable advances although it also takes deposits and has resort to some foreign borrowing. At end-June 1973 its lending amounted to £23 million.

## 8. The Money and Financial Markets

Considerable progress has been made in the development of money and financial markets in recent years in Ireland. By the end of 1969 Ireland's external monetary reserves, a substantial proportion of which was previously held by the commercial banks were centralised in the Central Bank. Steps were also taken by the Central Bank to provide a more extensive market for short-term deposits. The range of deposits accepted by the Central Bank was considerably widened and the rates paid on these deposits were made more competitive with rates available elsewhere in the economy.

Much has also been done by the Central Bank and the Department of Finance in recent years to promote the activation of the Government bond market and the encashability of Exchequer Bills. The Bank now holds a portfolio of a number of Government stocks, each in sufficient quantities

---

[5] Excludes National Instalment-Saving and Savings Certificates.

to enable it to deal with banks in amounts large enough for their needs. The Bank actively supports the market by fixing prices at which it is prepared to buy or sell securities. Deals and switches involving the banks are frequent and there exists a high degree of confidence in the marketability of Government stocks. Close liaison is maintained between the Central Bank and the Department of Finance with a view to maintaining a suitable and orderly price structure over the full range of maturities and to ensure, at the short end, that issues and maturities fit institutions' needs as far as possible. There is now a frequent issue - on a monthly basis - of Exchequer Bills by the Bank on behalf of the Minister for Finance. These developments have important implications for the future, particularly the influence of substantial dealings in Government securities on bank liquidity.

In addition to these measures taken by the Central Bank and the Department of Finance, a market for short-term funds - the Dublin inter-bank market - has evolved in recent years. The inter-bank market developed spontaneously with the growth in the number of non-Associated banks. While the Associated Banks deal in this market the main participants are the non-Associated banks. Compared with the Associated Banks, these banks, particularly the Merchant Banks and North American Banks, do not enjoy the same degree of continuity in the flow of domestic savings to them or in their domestic lending. Some banks draw temporarily on the inter-bank market to mobilise the necessary funds for lending to customers while others find that their liquidity becomes excessive at times and they lend to other banks in Dublin instead of placing funds in London or with the Central Bank. Deposits in the inter-bank market are repayable at call, two and seven days' notice, and for fixed periods ranging from seven days to twelve months. Most activity is centred in the call to one month range. The growth in the market has been rapid and the establishment of three moneybrokers in Dublin in recent years has stimulated inter-bank lending. Because the inter-bank market is competing with London investment outlets, the rates offered in the market reflect conditions in London and other money markets abroad. In general, rates in Dublin tend to be somewhat higher than in

London and this has probably contributed to the rapid growth of the market. Total inter-bank balances on the market at end-June 1973 amounted to some £110 million.

Activity has increased considerably in recent years on the Irish capital market. Irish companies are characteristically private limited companies rather than public companies with a stock exchange quotation and new capital tends to be raised by means other than capital issues to the public. New issues by the Government and the State-bodies have generally dominated the new-issue market, with well over two-thirds of new capital raised by issues of marketable securities being raised by the public authorities in almost every year during the past twenty years. The number of Irish public companies whose shares are traded on the Irish Stock Exchange is about 140. In 1972 some £69 million new capital was raised by new issues of marketable securities of which £40 million was raised by the Government by way of a National Loan, £12 million by a State-body, the Electricity Supply Board, and some £17 million by industrial and commercial concerns in the private sector.

## Section II - Liquidity

As in other countries Ireland receives additional supplies of money from two main sources, namely, receipts from abroad (in the form of capital flows and export earnings) and from the banking system. Monetary flows from these sources provide much of the liquidity required to raise the level of national expenditure in any given year. Monetary policy is aimed principally at influencing the amount of liquidity, that is, the money supply whether narrowly or broadly defined. In applying monetary policy the authorities principally seek to control the growth in the monetary aggregates, that is, the money supply, both in the narrow and wider sense, and total domestic credit extended by the banking system. Data for the money supply and for domestic credit extended by the banking system are shown in Appendix Tables 1 and 2, respectively. The narrow money supply (M1) consists of Irish currency outstanding (excluding Associated Banks' holdings) plus

current accounts with the Associated Banks while the widest definition of the money supply (M3) includes, in addition, deposit accounts with Associated and non-Associated banks. As can be seen from the table below the money supply widely defined constitutes by far the greater part of total holdings of money and other liquid assets in the community. Although some of the assets in this table are easily convertible into money, variations in the money supply and bank credit are the most important monetary aggregates in the context of the implementation of monetary policy.

MONEY AND OTHER LIQUID ASSETS: TOTAL HOLDINGS[a]

£ million

| | Liabilities of Banks | | | | | Deposits in Other Financial Institutions | | | | Liquid Claims on the Government | | | | | | | Total Money and Liquid Assets |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Currency[b] | Assoc. Banks Current A/cs. | Assoc. Banks Deposit A/cs. | Non-Assoc. Banks Deposits[d] | Total | Hire Purchase Finance Companies | Building Societies (incl. Shares) | State-sponsored Financial Institutions[g] | Total | POSB Deposits (incl. TSBs)[j] | National Instalment Saving | Exchequer Bills[k] | Savings Certificates | Prize Bonds | Tax Reserve Certificates | Total | |
| **31 Dec.** | | | | | | | | | | | | | | | | | |
| 1960 | 76.7 | 132.6 | 210.7 | n.a. | n.a. | n.a. | 16.3 | - | n.a. | 101.6 | .. | 13.8 | 31.4 | 16.7 | - | 163.5 | n.a. |
| 1961 | 82.6 | 140.5 | 226.2 | n.a. | n.a. | n.a. | 17.1 | - | n.a. | 107.5 | .. | 16.4 | 33.5 | 19.0 | - | 176.4 | n.a. |
| 1962 | 86.6 | 152.8 | 242.4 | n.a. | n.a. | n.a. | 19.6 | 2.6[h] | n.a. | 114.6 | .. | 16.8 | 35.6 | 21.1 | - | 188.1 | n.a. |
| 1963 | 93.0 | 171.9 | 242.3 | n.a. | n.a. | n.a. | 23.3 | 2.9[h] | n.a. | 120.1 | .. | 15.8 | 38.6 | 23.4 | 0.9 | 198.8 | n.a. |
| 1964 | 106.1 | 191.6 | 257.4 | n.a. | n.a. | n.a. | 28.5 | 3.0[h] | n.a. | 126.4 | .. | 17.6 | 42.8 | 26.9 | 1.0 | 214.7 | n.a. |
| 1965 | 109.6 | 198.6 | 274.2 | n.a. | n.a. | n.a. | 32.9 | 5.2[h] | n.a. | 129.3 | .. | 12.6 | 45.5 | 28.9 | 1.1 | 217.4 | n.a. |
| 1966 | 116.1 | 220.4 | 306.0 | 48.6 | 691.1 | 0.5 | 37.7 | 5.8[h] | 44.0 | 130.5 | .. | 8.8 | 51.5 | 29.8 | 1.3 | 221.9 | 957.0 |
| 1967 | 124.4 | 234.4 | 353.2 | 66.1 | 778.1 | 0.6 | 44.8 | 6.9 | 52.3 | 137.5 | .. | 10.3 | 55.7 | 30.7 | 2.1 | 236.3 | 1,066.7 |
| **1968** | | | | | | | | | | | | | | | | | |
| Mar | 123.1 | 242.6 | 371.2 | 68.8 | 805.7 | 0.5 | 46.3[f] | 6.5 | 53.3 | 138.4 | .. | 11.6 | 56.6 | 30.0 | 1.9 | 238.5 | 1,097.5 |
| June | 123.6 | 229.6 | 389.8 | 79.4 | 882.4 | 0.6 | 47.9[f] | 6.3 | 54.8 | 138.5 | .. | 7.7 | 57.3 | 30.7 | 2.0 | 236.2 | 1,113.4 |
| Sept. | 126.4 | 257.5 | 409.8 | 89.0 | 882.7 | 0.7 | 49.2[f] | 6.4 | 56.3 | 139.4 | .. | 9.0 | 58.1 | 30.4 | 2.0 | 238.9 | 1,177.9 |
| Dec. | 131.0 | 251.1 | 429.6 | 95.1 | 906.8 | 0.9 | 50.8 | 6.2 | 57.9 | 140.8 | .. | 7.6 | 58.6 | 31.0 | 2.1 | 240.1 | 1,204.8 |
| **1969** | | | | | | | | | | | | | | | | | |
| Mar. | 131.2 | 267.2 | 434.3 | 110.7 | 944.0 | 0.9 | 52.1[f] | 6.4 | 59.4 | 147.0 | .. | 5.3 | 59.5 | 30.5 | 1.6 | 243.9 | 1,247.3 |
| June | 129.9 | 251.5 | 453.9 | 108.9 | 944.2 | 1.4 | 53.9[f] | 7.0 | 62.3 | 149.0 | .. | 4.2 | 59.5 | 31.3 | 1.6 | 245.6 | 1,252.1 |
| Sept. | 131.4 | 258.5 | 468.8 | 122.1 | 980.8 | 1.4 | 56.8[f] | 7.1 | 65.3 | 151.8 | .. | 4.0 | 59.7 | 30.9 | 1.5 | 247.9 | 1,294.0 |
| Dec. | 137.4 | 256.2 | 485.5 | 132.5 | 1,011.6 | 1.4 | 59.2 | 7.7 | 68.3 | 152.9 | .. | 3.4 | 59.5 | 31.5 | 1.7 | 249.0 | 1,328.9 |
| **1970** | | | | | | | | | | | | | | | | | |
| Mar. | B.D. | B.D. | B.D. | 138.6 | B.D. | 1.2 | 61.8[f] | 8.6 | 71.6 | 156.4 | .. | 3.3 | 59.6 | 31.0 | 1.8 | 252.1 | B.D. |
| June | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | .. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. |
| Sept. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. |
| Dec. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. |
| **1971** | | | | | | | | | | | | | | | | | |
| Mar. | B.D. | B.D. | B.D. | 150.0 | B.D. | 1.7 | 79.8 | 12.2 | 93.7 | 183.2 | 1.9 | 5.7 | 60.0 | 31.1 | 1.1 | 283.0 | B.D. |
| June | 156.9 | 241.3 | 560.5 | 149.8 | 1,108.5 | 1.8 | 86.0 | 15.2 | 103.0 | 185.9 | 3.2 | 5.5 | 60.1 | 32.8 | 3.1 | 290.6 | 1,502.1 |
| Sept. | 162.4 | 246.8 | 587.9 | 160.3 | 1,157.4 | 1.1 | 93.6 | 17.5 | 112.2 | 188.4 | 4.6 | 6.5 | 61.5 | 33.4 | 7.3 | 301.7 | 1,571.2 |
| Dec. | 172.6 | 259.0 | 599.4 | 158.1 | 1,188.1 | 1.4 | 103.4 | 20.0 | 124.8 | 193.1 | 5.6 | 3.4 | 62.6 | 33.9 | 8.1 | 306.9 | 1,619.8 |
| **1972** | | | | | | | | | | | | | | | | | |
| Mar | 172.4 | 277.4 | 583.5 | 157.1 | 1,190.4 | 0.9 | 111.9 | 24.4 | 137.2 | 200.0 | 6.9 | 4.9 | 63.3 | 34.3 | 5.6 | 315.0 | 1,642.6 |
| June | 174.4 | 273.6 | 603.0 | 184.1 | 1,235.1 | 0.6 | 121.9 | 28.7 | 151.2 | 204.4 | 8.2 | 4.4 | 64.1 | 34.6 | 5.6 | 321.3 | 1,707.6 |
| Sept. | 179.9 | 297.2 | 632.8 | 203.0 | 1,312.9 | 0.3 | 131.3 | 31.7 | 163.3 | 208.2 | 9.4 | 3.9 | 65.0 | 35.0 | 5.8 | 327.3 | 1,803.5 |
| Dec. | 191.3 | 310.3 | 654.6 | 210.1 | 1,366.3 | 0.3 | 140.8 | 36.1 | 177.2 | 211.4 | 10.4 | 8.2 | 65.6 | 35.5 | 3.6 | 334.7 | 1,878.2 |
| **1973** | | | | | | | | | | | | | | | | | |
| Mar. | 193.0 | 320.1 | 687.0 | 272.8 | 1,472.9 | 0.2 | 147.4 | 42.6 | 190.2 | 215.6 | 11.6 | 5.0 | 66.2 | 35.6 | 2.1 | 336.1 | 1,999.2 |
| June | 197.8 | 307.0 | 718.7 | 275.4 | 1,498.9 | 0.2 | 158.2 | 45.5 | 203.4 | 215.3 | 12.7 | 2.7 | 66.3 | 35.6 | 2.0 | 334.6 | 2,037.4 |

a This table excludes non-resident deposits with the non-Associated banks. Other non-resident holdings are included.
b Consisting of Legal Tender Notes, Irish coin and Consolidated Bank Notes outstanding, exclusive of Associated Bank holdings.
c Including government accounts.
d Including current accounts but, from March 1971 onwards, excluding non-Associated banks' inter-bank balances.
f Estimates based on data issued by the Department of Local Government.
g Including Farm Credit Bonds.
h The figures relate to the following March.
j Including Ordinary Accounts and 6½% Investment Bonds in the Post Office Savings Bank, Ordinary, Investment and Current Accounts in the Trustee Savings Banks.
k Excluding amounts held by the Associated Banks and Departmental Funds.

Note: 1. As and from June 1971, offset or contra balances - which at that date amounted to some £73 million - have been excluded from Associated Banks' current accounts. The full disclosure of profits and reserves as and from March 1972 has had a downward effect - of the order of £40 million - on their deposit accounts. These data are therefore not directly comparable with those published for earlier periods.

2. The letters B.D. in the table indicate that data are not available because of a bank dispute.

## CHAPTER TWO

## The Objectives of Monetary Policy

### Para I General Objectives and the "Policy Mix"

The objectives of monetary policy in Ireland are similar to those of national economic policy, that is, a high rate of growth of output and employment consistent with a tolerable rate of price increase and a sustainable external payments position. As monetary policy measures alone are unable to achieve this set of objectives, a complementary combination of monetary, fiscal and prices and incomes policies is being used to achieve the policy targets. The combined operation of these three policies is designed to meet the objectives of economic policy. Incomes policy is calculated to lead to a more moderate rate of price increase thus facilitating the growth of employment and output by making Irish goods and services more competitive. Employment and output are also promoted by appropriate fiscal and monetary policies which do not facilitate excessive income and price increases and undesirable deficits in the balance of payments. Thus, monetary policy is regarded as only one part of overall economic management.

It is recognised that monetary policy is subject to a number of significant limitations. This is particularly so if it is called upon to perform functions that are quite outside its province or if it is not well integrated within the general framework of economic policy. While severe monetary restraint could probably reduce or perhaps eliminate inflation over a period of time this could only be done by a significant cutback in economic activity and a consequent increase in unemployment. Regard must be had to the socio-political climate which is far less tolerant of deflationary adjustment policies than formerly. Moreover, the Irish authorities themselves because of the existing high level of unemployment are particularly concerned with the impact on employment that might result. Socio-political changes in general have, of course, implications for the monetary policy environment in Ireland. It is recognised that the acceptance at effective political level of the need for

social improvements has implications for fiscal policy, which in turn must influence the stance of monetary policy, if fiscal and monetary policy are to be well integrated.

**Para II** Specific Monetary Policy Objectives

Since the broad objectives of economic policy are somewhat remote from the instruments under Central Bank control, the Bank must focus its attention on influencing the volume of expenditure through intermediate target variables; monetary policy has its effect on the volume of expenditure by operating on the various monetary aggregates, such as total bank credit and the money supply, which influence the level of consumption and investment. In controlling monetary aggregates such as the money stock it is recognised in Ireland that monetary policy is a blunt instrument whose effects are non-discriminatory. Thus, a monetary policy stance of such effectiveness as to eliminate excess demand from the most inflationary sectors of the economy might need to be so restrictive as to halt economic growth altogether. Its effects are also subject to variable and, sometimes, lengthy time-lags so that it may not be really appropriate for month-to-month or quarter-to-quarter fine tuning. However, it can provide a generally expansive, restrictive or neutral environment over longer periods.

Monetary policy is formulated not only in a framework involving domestic considerations but also in the context of the international environment. Particular regard is paid to policy in relation to official external reserves, the exchange rate and capital flows. The question of the appropriate level of reserves to be held is especially important in Ireland's case where foreign trade as a proportion of total output is a high one by reference to other countries. For many years the reserves have been equivalent to about six months' imports. This is a fairly high ratio by international standards but it is by no means exceptional, especially having regard to the factors mentioned above. An adequate level of reserves also provides the degree of confidence necessary in attracting desirable capital inflows, for example, long-term direct investment flows.

Ireland maintains a fixed exchange rate with its major trading partner, the United Kingdom, and like other countries is obliged to keep fluctuations

in its balance of payments within the limits set by its external reserves supplemented by any appropriate foreign borrowing. An important objective, therefore, of monetary policy is the avoidance of large deficits on the balance of payments. The exchange rate of the Irish pound has traditionally been maintained at parity with the pound sterling and consequently the rates of exchange with non-sterling currencies are equal to or within the margins prevailing between sterling and those other foreign currencies. The Irish authorities have the power to alter the exchange rate and the parity relationship is maintained as a matter of free and deliberate choice.

As regards capital flows between Ireland and the rest of the world account is taken of the size and desirability of such flows in formulating and implementing monetary policy. Because of the close economic and financial ties between this country and the U.K. there is free mobility of capital between the two areas[4]. In general flows of funds between Ireland and other countries are subject to exchange control regulations which are described later on page 24. As far as capital flows between the Ireland and the U.K. are concerned, attempts to control such flows centre around inflows through the banking system. The Central Bank by regulating inflows through the banks over a period of time seeks to influence the size of the total net capital inflows into the country and thus total injections into the economy from abroad.

The degree to which Ireland can pursue an independent policy in respect of bank interest rates is limited. As in the case of other countries, interest rates in Ireland cannot be isolated from developments in interest rates abroad. However, the close economic and financial ties between the two countries mean that interest rates prevailing in the United Kingdom have particular importance for Ireland. Although small differentials can exist in bank interest rates it is not possible without heavy outflows for any substantial divergence to persist because of the free mobility of funds between the two areas. Consequently, bank interest rates have generally been kept at a level competitive with rates prevailing in the U.K. and elsewhere.

---

[4] In addition to the U.K. no restrictions apply to the movement of funds between the Channel Islands, Isle of Man and Gilbralter. These areas together with the U.K. and Ireland are known as the Scheduled Territories.

Within this framework, the Bank's objective in the past has been to moderate fluctuations in Irish interest rates, so as to minimise the effects of external fluctuations - and particularly of increases in external rates - on the Irish economy. Movements in interest rates in Ireland have tended to be less frequent or of a smaller magnitude than in Britain. Also, when changes occur in the U.K., a period of time is generally allowed to elapse so that an assessment may be made of the underlying trend of rates and hence of the desirability of effecting a change in our rates. It has been possible for a margin to exist between Irish interest rates and those in Britain, and in particular for some rates in Ireland to be moderately lower than those prevailing elsewhere, without precipitating a major outflow of capital. This tendency towards some lower rates in Ireland has generally been appropriate in view of the developmental needs of the economy. It is, however, a tendency that cannot be pushed too far without its coming into conflict with the need to encourage a continuing and adequate net inflow of capital.

## CHAPTER THREE

## The Instruments of Monetary Policy

### Section I - General Purpose Instruments

**Para I** There have been a number of important developments in the way monetary policy has been applied by the Central Bank in recent years. In general, credit control has been one of the principal tools used in Ireland and has contributed towards the achievement of the overall policy objectives by influencing aggregate expenditure through changes in the availability and use of money and to some extent the cost of it. The method of implementing credit control has developed fairly rapidly over the past decade. In 1965 the Central Bank issued to the Associated Banks what was to be the first of a series of letters of advice on credit policy. These letters set guidelines for the expansion of domestic credit by the Associated Banks. They related generally to a full year, but were subject to review from time to time in the light of economic developments and of changes in outstanding bank credit and resources. Until April 1969 the credit advice of the Central Bank was directed exclusively towards the Associated Banks but in that year the Bank also issued its advice to the non-Associated banks. The business of these banks had expanded substantially over a relatively short period of time, much of it being financed by funds from abroad. In view of the expansionary effects of such inflows on domestic demand, their limitation to an appropriate aggregate became an important objective of monetary policy. The non-Associated banks were also asked not to allow any increase in the level of non-productive credit extended by them. In 1971 quantitative limitations on their lending similar to those set for the Associated Banks were introduced.

It was recognised by the Central Bank that quantitative restrictions on commercial bank lending, if pursued for long periods of time, could hamper competition between banks and lead to inequities and possible misallocation of resources. They also could encourage attempts to circumvent the credit ceilings, thereby leading to pressures to extend the scope of quantitative restrictions. The enactment of the Central Bank Act, 1971 enabled the Bank to prescribe ratios between liquid assets and liabilities

of the banks, thereby providing it with a new statutory instrument of monetary control. Towards the end of 1972 arrangements were completed to introduce the new method of control in the form of liquidity ratios, which are now fully operational. This new system is directed at influencing the growth in the money supply rather than directly controlling bank lending. Liquidity ratios are set so as to permit an increase in the money supply and credit that is considered appropriate to prevailing economic conditions. The ratios are subject to review and, if necessary, to alteration from time to time over the course of the credit policy year in the light of major economic trends. The system allows for competition between banks for resources and can be effective only when actual liquidity is at or below the prescribed minimum. A detailed description of the ratios prescribed is given on pages 21 to 22 of this paper.

**Para II** Rediscounting and Refinancing Policy

The Central Bank is the lender of last resort and thus the main direct source of liquidity for the banks. Rediscounting by the Bank must be seen in the context of this function. Legislation relating to the provision of Central Bank credit is set out in Section 7 of the Central Bank Act, 1942[5]. The legislation provides for rediscounting and the making of loans and advances, on the security of bills of exchange, to banks or other credit institutions carrying on business wholly or partly within the State.

As regards the type of assets eligible for rediscounting the Bank is empowered to rediscount Exchequer Bills, bills of local authorities and bills of exchange, including bills drawn for agricultural purposes. Conditions are laid down in the 1942 Act as to the type of bill eligible for rediscounting in terms of the quality of the bill and the maximum period of maturity. To be eligible Exchequer Bills and bills of local authorities must mature in not more than twelve months from their date of issue while bills which are deemed first class commercial bills must mature in not more than six months (excluding days of grace) from their date or in the case of agricultural bills in not more than twelve months (excluding days of grace).

[5] Section 7(e) (f) (g) (h) (i) (j).

Bills of exchange must be deemed by the Board of the Bank to be first class commercial bills to be eligible for rediscounting. The Central Bank is also empowered to make loans and advances to banks or other credit institutions on the security of bills of the type mentioned above.

The Central Bank has generally confined its rediscounting function to rediscounting Exchequer Bills for the Associated Banks although on occasion it has rediscounted bills of exchange for these banks. To date it has not provided rediscount facilities for other banks or credit institutions. The Central Bank Act, 1971 by making the Central Bank the licensing authority for banks reinforces the appropriateness of confining rediscounting facilities to the licensed banks.

As explained elsewhere interest rates in Ireland are strongly influenced by those in Britain. The Central Bank minimum rediscount rate has not been used by the authorities to influence domestic interest rates. It follows market rates and is fixed by reference to the discount rate on the issue of Exchequer Bills and is not designed to influence that rate. The Exchequer Bill rate is, in turn, set by the Minister of Finance and tends to be influenced by official short-term rates in Britain. The two main short-term interest rates are, therefore, closely related to similar rates abroad.

Where rediscount facilities are required by banks experiencing seasonal and temporary pressures it is the Bank's normal practice not to set the rediscount rate at a penal level. The Bank can, however, change the rate from day to day and also charge a higher rate than the minimum published. Thus the Central Bank may apply and has applied penal rates when the objectives of monetary policy required it as, for example, when the growth of bank lending has been excessive particularly in relation to the increase in bank resources. Accordingly, there is a considerable flexibility in applying the actual rediscount rate as circumstances change. The rate, at or above the minimum, at which the Bank rediscounts bills has important implications for the implementation of monetary policy. An appropriate rate gives banks an incentive to manage their affairs under the liquidity ratio system in a manner that is consistent with the requirements of

monetary policy. Such matters as the reasons for rediscounting, the magnitude and duration of rediscounts and the rates of interest in the money market are taken into account in fixing the rediscount rate.

Access to Central Bank credit is in all circumstances a privilege, and the Bank retains discretion to grant or refuse a request for rediscounting even if all the legal requirements as regards eligibility of bills are fulfilled. Licensed banks are strongly encouraged to regard the Bank as lender of last, rather than first, resort. The Bank discourages banks from using its rediscounting facility on a continuous basis or as a source for financing long-term lending. Appropriate rediscount rates discourage frequent calls on Central Bank credit and, thus, provide an incentive to the banks to

Exchequer Bills Rediscounted at the Central Bank

£000

| Year ended 31 March | Total Rediscounted | Maximum holding at any one time | Held at 31 March |
|---|---|---|---|
| 1960 | - | - | - |
| 1961 | 8,000 | 3,000 | - |
| 1962 | 8,620 | 7,870 | 500 |
| 1963 | 11,010 | 4,000 | - |
| 1964 | 8,200 | 2,500 | - |
| 1965 | 38,615 | 10,205 | 2,940 |
| 1966 | 35,610 | 15,190 | - |
| 1967 | 10,495 | 6,145 | - |
| 1968 | 1,000 | 1,000 | - |
| 1969 | 6,140 | 3,640 | 3,640 |
| 1970 | 36,915 | 17,760 | 17,760 |
| 1971 | 114,015 | 29,210 | 17,665 |
| 1972 | 14,890 | 17,665 | - |
| 1973 | 124,685 | 63,930 | 59,515 |

Note: The Central Bank has not rediscounted Bills of Exchange since November 1959.

manage their affairs without resorting to the Central Bank. The table above shows the extent of rediscounting of Exchequer Bills at the Central Bank in recent years.

**Para III** Solvency and Liquidity Ratios

There are basically two approaches to the question of solvency ratios; the first, a global one, derives a single, overall measure of solvency,

while the second is concerned with matching specific groups of assets and liabilities. The first of these methods is that which has been adopted as appropriate to Irish conditions. Thus, in Ireland, 10 per cent. of a bank's risk assets (assets other than cash, Central Bank balances, bank balances, money at call or short notice and Government Bills, securities and guarantees) must be covered by free resources (capital and reserves, less fixed and intangible assets). In addition, a specific 100 per cent. provision is made for inferior quality assets such as bad or doubtful debts, even though these may well be recoverable in practice. This approach ensures that banks have a reasonable amount of their "Own" or Shareholders' Funds available for the purposes of covering any future losses that might occur from their risk asset business.

The introduction of liquidity ratios for licensed banks towards the end of 1972 is of more importance from the point of view of monetary policy. For the purpose of calculating the ratios, the resources or liabilities to which liquid assets are related are described as Relevant Resources. These comprise the sum of all domestic liabilities of a bank in the form of credit balances on current accounts, deposit accounts and other accounts (including amounts due to other licensed banks); to these are added the net external liability position, whereas balances with or lending to all other licensed banks in Ireland are deducted. The assets that are taken into account in calculating a bank's ratio are its holdings of notes and coin, balances with the Central Bank (including statutory deposits), Central Bank Reserve Bonds and its portfolio of Irish Government paper, including Exchequer Bills. The overall liquidity requirement is comprised of two parts, a primary liquidity ratio and a secondary liquidity ratio. The assets included in calculating a bank's primary ratio are its holdings of notes and coin, Central Bank balances (including statutory deposits) and Reserve Bonds issued by the Central Bank while the assets in the secondary ratio are its holdings of Irish Government paper. As at September 1973 the Associated Banks were required to maintain an overall ratio of 43 per cent., of which the primary ratio is a minimum of 13 per cent. and the secondary ratio is a minimum of 30 per cent. The Merchant Banks and North American Banks maintain an

overall ratio of 20 per cent. comprising a primary ratio of 10 per cent. and a secondary ratio of 10 per cent. All other banks have a 10 per cent. primary ratio, the liquid assets in their case being all held in the form of primary liquid assets.

By specifying changes in liquidity ratios the Central Bank is able to influence the growth in monetary aggregates. An increase in liquidity ratios reduces the resources of the banks available for non-Government lending while a decrease in the ratios provides additional resources for lending. The ratios are subject to review and to alteration from time to time in the light of major developments in monetary and economic trends. In February 1973 the liquidity requirements for all banks were raised in order to slow down the rate of increase in the monetary aggregates. A notable feature of the new system is that the amount available for lending to the Government, in normal circumstances, will be mainly determined by the growth in the banks' resources.

**Para IV** Changes in Interest Rates

An account was given on page 16 of the relationship between interest rates in Ireland and elsewhere, resulting particularly from the close financial and economic ties between Ireland and the U.K. Money market rates closely follow those in the U.K., with the Irish rates generally somewhat higher than those prevailing in London. As far as the non-Associated banks are concerned changes in their lending and deposit rates are closely related to the current cost of funds on the inter-bank market. Accordingly non-Associated bank interest rates are directly determined by market forces. Interest rates of other financial institutions, including the Associated Banks, are administered rates which are altered from time to time in the light of changing conditions by the appropriate authorities. Thus, the interest rates of the Post Office and Trustee Savings Banks are changed directly by the Minister for Finance while those of the building societies are changed only after consultation with the appropriate Government departments. Appendix Table 3 shows the structure of selected interest rates at end-June 1973.

In practice a change in Associated Bank interest rates is normally associated with a similar movement in British rates. However, the procedure adopted in any particular situation will differ according to the manner in which the need for a change in rates manifests itself. Thus, the requirements of monetary policy may call for a rise in interest rates, or alternatively, an unexpected reduction in the external reserves may herald the need for an increase in rates so as to protect the resources of the banks. In such cases the Central Bank will initiate discussions regarding the desirability of an increase in rates. On the other hand the Associated Banks may apprehend the effect on their resources and liquidity of a differential between their interest rates and those obtaining in Britain and in the non-Associated banks. In either event, the ensuing discussions between the Central Bank and the Associated Banks centre, on the one hand, on the desirability of protecting the resources and liquidity of the banks, and of ensuring the availability of credit for productive purposes throughout the country and, on the other, on the need to determine the underlying need for a change in rates, to ensure that the level of rates is, as far as possible, in keeping with overall economic objectives, and such as to maintain the official external reserves at the appropriate level. The effects of any change on the banks' profitability are also taken into account.

Only when the Central Bank is satisfied that the requirements of the economy in general warrant a change in interest rates, will it recommend or favour an adjustment. The nature and magnitude of any such proposed change will, as already indicated, take account of the desirability of ensuring that over time the profitability of the Associated Banks is neither favourably nor adversely affected. The Central Bank's views, of which the Minister for Finance is kept informed, are then considered by the Associated Banks and, usually following further discussion with the Central Bank, agreement is reached on the change to be made in interest rates.

Para V Quantitative Global Restrictions on Credit

It was not possible hitherto to implement monetary policy other than by quantitative controls of virtually uniform application. The introduction of a system of credit control involving the use of liquidity ratios should give scope for more competition by relating bank lending capacity to success in attracting deposits and should also promote greater efficiency in the allocation of funds among borrowers. It remains necessary, however, to assess the aggregate change in the money stock that is appropriate to prevailing economic conditions. The notion of a quantity in the global sense is still regarded as important and liquidity ratios are determined in the light of the growth in monetary aggregates which it is desired from time to time to achieve.

## Section II - Instruments for Specific Purposes

Para I Exchange Control

Ireland operates a comprehensive system of exchange control vis-a-vis countries other than the United Kingdom and other parts of the "Scheduled Territories"[6]. Very wide powers to control payments to, receipts from and other transactions with residents of such countries are given to the Minister for Finance in the Exchange Control Acts. The system of control is operated by the Central Bank to which the Minister for Finance has delegated the powers required for the supervision of day-to-day transactions. There are no exchange control restrictions on transfers of funds between Ireland and the United Kingdom and there are no exchange control powers in this regard. There are no restrictions either on transactions between Ireland and the other parts of the "Scheduled Territories". Each part of the "Scheduled Territories" operates broadly the same controls vis-a-vis third countries. Irish exchange control is used primarily to protect the foreign currency reserves of the Scheduled Territories in aggregate.

Accordingly Ireland constitutes with Britain a virtually integrated capital area within which there is freedom of movement of funds. Because

[6] Ireland, the United Kingdom, the Channel Islands, Isle of Man and Gilbralter now constitute the area known as the Scheduled Territories.

of a substantial net inflow of funds in recent years the free movement of funds between Ireland and Britain has operated in a way which is in line with the needs of a developing economy. The freedom for funds to move between the two countries provides a basis for confidence in which long-term finance for Irish economic development is more readily available.

As mentioned earlier attempts to control capital flows between Ireland and the United Kingdom centre around the banking system. Inflows through the banks are limited to an appropriate aggregate in the light of the objectives of monetary policy. This has generally been done by conveying to the banks the Central Bank's view through its statements on monetary policy. In February 1973 in addition to requesting the banks to bring about no net inflows the Central Bank required that 50 per cent. of any net inflows that occurred in 1973 should be deposited with the Central Bank. Such deposits are not included when calculating primary liquidity ratios.

**Para II** Selective Control of Domestic Credit

In addition to controlling the growth in monetary aggregates the Central Bank attempts to influence the purposes for which credit is used. The Bank is generally concerned that available credit resources are applied to the national advantage in terms of production and employment. Monetary policy statements by the Bank have from time to time requested that bank lending be channelled into uses which are directly productive, in terms of output and employment, and not into non-productive purposes such as projects of a speculative nature or ones that increased the price of existing assets rather than creating new assets. On occasion the Bank has requested the banks not to add, by their personal loan policies, to consumer demand particularly if this would leave insufficient resources available for investment.

A new structure of interest rates for Associated Bank lending to different categories of borrowers was introduced in April 1972. The new system of term lending represents a gradual replacement of the overdraft system by a three-tiered system of lending, incorporating overdrafts, term

loans and loan accounts. Under the new system, overdrafts continue to be available as seasonal working accounts, where amounts overdrawn are repaid within a year. Term loans are granted for specific purposes and are repayable by negotiated amounts within fixed periods. In addition, finance is made available in the form of loan accounts where the term of the borrowing exceeds seven years, or cannot be determined beforehand.

Under the term lending system, there are three categories of borrowers (AAA, AA and A). Loans and advances in the AAA category relate to:

1. Government, Local Authorities and Government-guaranteed borrowers;
2. Large-scale limited companies satisfying certain profit criteria; and
3. Schools, charities, churches and hospitals.

The "AA" category relates to consumers in the Primary and Construction, Manufacturing and Services sectors. The "A" category relates to all other categories of borrowers, including personal borrowings. In September 1973 term lending incorporated the following interest rate structure:

| Category | Overdrafts and Term Loans for a Period of One Year of Less | Term Loans | | | Loans Over 7 Years |
|---|---|---|---|---|---|
| | | 1 - 3 Years | 3 - 5 Years | 5 - 7 Years | |
| AAA | 11.00 | 11.50 | 12.00 | 12.50 | 13.00 |
| AA | 11.75 | 12.25 | 12.25 | 12.75 | 13.75 |
| A | 12.50 | 13.25 | 14.00 | 14.50 | 15.25 |

Objectives of Monetary Policy in Ireland

1 Monetary policy in Ireland is formulated in the context of national development programmes and of the aims in relation to these as indicated in annual central Government budgets and other statements of Government policy. As in other countries, these aims include balanced and sustainable economic development, the achievement of a high level of employment, price stability and reasonable external equilibrium.

2 A combination of measures is used to further these national objectives, including the size and make-up of public budgets, monetary and incomes policies. Monetary policy is, therefore, settled on the basis that it should harmonise with and complement the other policies. The Central Bank of Ireland, which is the body charged with responsibility for the formulation of monetary policy, operates against this background through measures to influence the volume of expenditure by the regulation of the various monetary aggregates such as total bank credit and the money supply.

3 In pursuit of these objectives an assessment is first made each year of the principal factors influencing the economy, including such considerations as the actual and tolerable rates of price increase, the levels of imports and exports and the rates of growth of output and employment. Next a comparison is made between the current outturn for the economy indicated by the assessment and that to be preferred on the grounds of economic policy as a whole. In the third stage monetary policy is determined in the light of the official objectives of economic policy for the year ahead.

4 Credit regulation is one of the principal tools used to realise the objectives of monetary policy. For some years past the Central Bank has issued guidelines to the banks on the

amount of credit to be made available and on the size of capital inflows from abroad through the banking system. It has been an aim to have priority given to the allocation of credit for productive purposes. Because there is free movement of funds between Ireland and the United Kingdom, the scope for the use of interest rates as a tool of monetary policy is limited. While there is divergence from time to time between the interest rates in the two countries, it is generally necessary that Irish rates be kept in line with the United Kingdom rates, though some differential to suit Irish conditions is possible.

5 It has been found that direct limits on bank lending and on inflows from abroad if maintained for long periods of time hamper competition between the banks and lead to inequities and possible misallocation of resources. They also encourage attempts to circumvent the ceilings specified, thereby leading to pressures for the extension of the scope of the quantitative restrictions. It is now an objective to avoid these shortcomings as far as possible and towards this end the Central Bank has prescribed a system of liquidity ratios for the banks so as to give better regulation of monetary aggregates.

6 The prescription of a ratio by the Central Bank between selected assets and the liabilities of the banks gives scope for competition and a correspondingly greater efficiency in the allocation of scarce resources among borrowers. The overall liquidity requirement is comprised of two parts, a primary and secondary liquidity. The assets included in calculating a bank's primary ratio are its holdings of currency notes and coin, balances with the Central Bank and Central Bank reserve bonds, while the assets in the secondary ratio are holdings of Irish Government securities.

7 An important aim in the implementation of monetary policy is the development of the financial and public security markets which have existed only on a small scale. In recent years the external monetary reserves, a substantial proportion of which was previously held by the commercial banks, have been centralised in the Central Bank, thus enabling that Bank to provide support for the development of a domestic money market.

8 Steps have also been taken by the Central Bank to provide a more extensive market for short-term deposits. The range of deposits accepted has been considerably widened and the rates paid on these deposits have been made more competitive. Issues of Government Exchequer Bills are also being made more frequently and measures have been taken to improve the marketability of short-dated Government securities.

9 Substantial progress has, therefore, been made in the improvement of financial and public security markets. Further improvement is envisaged.

Ireland

Controls exercised over Local Authorities in the field of credit

Introduction

1 The basic regional division or unit in Ireland for the purposes of local administration is the County. The local authorities charged with the administration of the Counties are known as County Councils. In addition, there are separate local authorities for cities, the larger towns and urban districts. In all there are eighty seven local authorities in these categories in the country. These bodies are responsible for the administration of various important services such as the provision of public housing, sanitary services and roads and the regulation of physical planning. Their main sources of revenue at present are central government grants and rates - the latter being a tax levied annually on property owners on the basis of a valuation formula.

Local authority deposits

2 Each local authority is obliged to appoint a commercial bank as its treasurer and to deposit its receipts with it.

Borrowing: General

3 Local Authority borrowing is governed by section 4 of the Local Government No 2 Act 1960. Under this Act, a local authority intending to borrow funds must obtain the prior sanction of the Minister for Local Government.

Current Borrowing

4 Normally short-term borrowing by a local authority is made from the commercial bank acting as its treasurer. The net position on each local authority's accounts fluctuates in line with the pattern of the authority's payments and receipts.

In general, at times when payments of loan charges to the Government fall due the authorities are net borrowers from the banks. These charges (see paragraph 6) usually fall to be paid in May and November each year. On the other hand, an authority is likely to have some surplus liquidity at times when rates are received by it.

5 Subject to the agreement of the individual bank, the Minister for Local Government sets an overdraft limit for each local authority. This overdraft sanction is given quarterly by the Minister in respect of likely borrowing to meet current expenditure. Bank loans to the local authorities are provided at a preferential interest rate - which at present is 1½% lower than the ordinary overdraft rate applied to private sector borrowers.

Capital Borrowing

6 The levels of capital expenditure of local authorities are determined in the context of the overall Public Capital Programme drawn up annually by the Central Government. The main borrowing source of the local authorities for capital purposes is the Central Government Exchequer which advances loans through the Local Loans Fund. An interest rate approximately equivalent to the current market rate is charged on these loans but the burden of interest is substantially offset in the main categories by the payment of subsidies.

7 The local authorities raise a small proportion of their capital requirements by way of long term loans from the banks, assurance companies and other financial institutions. In addition, and subject to the individual approval of the Minister for Local Government, a local authority may obtain interim financing for capital purposes in the form of a bank overdraft.

This will normally be a short term arrangement and the overdraft will be redeemed by a longer term loan from the Local Loans Fund or other source.

8 Up to the mid 1950's individual local authorities borrowed by means of stock issues. Since then this form of borrowing has become unattractive.

Statistical Material

9 Tables giving some relevant statistics for local authority receipts, expenditures and borrowing are attached as follows:

> Table 1 gives a breakdown of aggregate local authority receipts and expenditure for the year ended 31 March, 1972. Table II shows the level of bank advances to the local authorities on specified dates. The figures are global and include cumulative long-term capital-loans (see Item 3, Table I), short-term capital overdrafts (see paragraph 7) and overdrafts on current account (see paragraphs 4 & 5).

Other Local Bodies

10 The information given in paragraphs 2-9 above relates to the local authorities of the categories mentioned in paragraph 1. There are, in addition, specialised authorities comprising Regional Health Boards, Vocational Education Committees and County Committees of Agriculture. These are financed mainly by grants and loans from the State and local authorities. Borrowing is subject to the sanction of the appropriate Minister of State. Like the local authorities these specialised bodies keep their accounts with the commercial banks.

Table I

Local Authority Receipts and Expenditure - Year Ended 31 March 1972

| Receipts | | | £ million |
|---|---|---|---|
| 1 | Government | | 90.3 |
| | of which | | |
| | Local Loans Fund | ( 37.6 | |
| | Grants | ( 52.7 | |
| 2 | Rates | | 60.2 |
| 3 | Long term loans from banks, assurance companies and other financial institutions | | 1.2 |
| 4 | Other (Rent, fees etc.) | | 26.7 |
| | | | 178.4 |
| **Expenditure** | | | |
| | Capital (as per Public Capital Programme) | | 40.2 |
| | Other (including expenditure on roads) | | 138.2 |

Table II:

Level of Bank Advances (Main Commercial Banks) to Local Authorities - £ million

| 15 February 1972 | 10 May 1972 | 15 August 1972 | November 1972 | February 1973 |
|---|---|---|---|---|
| 14.626 | 10.573 | 15.722 | 11.041 | 14.707 |

Sources

Table I: Compiled in the Department of Finance on the basis of information supplied by the Department of Local Government.

Table II: Central Bank Quarterly Bulletin, Spring 1973.

APPENDIX T.¥F¿K I

MOXïïY SUPPLY

| Date | Currency Outstanding [a] | Associated Banks: Current Accounts [b] | Associated Banks: Deposit Accounts | Non-Associated Bank Deposits [c] | Selected Measures of Money Supply: M1 | M1 Year-to-year Change - % | M2 | M2 Year-to-year Change - % | M3 | M3 Year-to-year Change - % |
|---|---|---|---|---|---|---|---|---|---|---|
| | £ million | £ million | £ million | £ million | £ million | | £ million | | £ million | |
| Average for Year | 1 | 2 | 3 | 4 | 5=1+2 | 6 | 7=1+2+3 | 8 | 9 | 10 |
| 1966 | 110.3 | 205.4 | 288.7 | 44.2 | 315.7 | + 7.8 | 604.4 | + 8.2 | 647.2 | .. |
| 1967 | 115.6 | 214.1 | 325.9 | 56.9 | 329.7 | + 4.4 | 655.6 | + 8.5 | 709.6 | + 9.6 |
| 1968 | 123.7 | 232.7 | 390.2 | 74.2 | 356.4 | + 8.1 | 746.6 | +13.9 | 815.6 | +14.6 |
| 1969 | 131.5 | 245.0 | 451.9 | 99.8 | 376.5 | + 5.6 | 826.4 | +11.0 | 918.3 | +12.6 |
| 1970 | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. |
| 1971 | 139.6 | 240.9 | 574.9 | 155.6 | 400.5 | B.D. | 975.4 | B.D. | 1,120.6 | B.D. |
| 1972 | 173.8 | 277.5 | 612.9 | 184.5 | 451.3 | +12.7 | 1,064.2 | + 9.1 | 1,234.6 | +10.2 |
| **1971** | | | | | | | | | | |
| Apr. | 155.9 | 234.6 | 559.0 | 149.1 | 390.5 | B.D. | 949.5 | B.D. | 1,084.9 | B.D. |
| May | 156.5 | 226.2 | 557.4 | 153.5 | 382.7 | B.D. | 940.1 | B.D. | 1,083.5 | B.D. |
| June | 157.5 | 241.3 | 560.5 | 149.8 | 398.8 | B.D. | 959.3 | B.D. | 1,097.7 | B.D. |
| July | 159.2 | 229.4 | 561.9 | 152.3 | 388.6 | B.D. | 950.5 | B.D. | 1,089.1 | B.D. |
| Aug. | 159.4 | 238.1 | 568.7 | 157.2 | 397.5 | B.D. | 966.2 | B.D. | 1,112.8 | B.D. |
| Sept. | 161.8 | 246.8 | 587.9 | 160.3 | 408.6 | B.D. | 996.7 | B.D. | 1,144.4 | B.D. |
| Oct. | 162.9 | 246.5 | 589.5 | 162.2 | 409.4 | B.D. | 998.9 | B.D. | 1,150.8 | B.D. |
| Nov. | 163.9 | 247.4 | 590.1 | 158.0 | 411.3 | B.D. | 1,001.4 | B.D. | 1,147.5 | B.D. |
| Dec. | 172.2 | 258.0 | 599.4 | 158.1 | 430.2 | B.D. | 1,029.6 | B.D. | 1,174.7 | B.D. |
| **1972** | | | | | | | | | | |
| Jan. | 164.4 | 253.6 | 602.7 | 152.8 | 418.0 | B.D. | 1,020.7 | B.D. | 1,168.9 | B.D. |
| Feb. | 165.6 | 246.5 | 609.0 | 155.9 | 412.1 | B.D. | 1,021.1 | B.D. | 1,169.5 | B.D. |
| Mar. | 172.3 | 277.4 | 583.5 | 157.1 | 449.7 | B.D | 1,033.2 | B.D. | 1,179.0 | B.D. |
| Apr. | 167.4 | 263.0 | 588.8 | 163.9 | 430.4 | +10.2 | 1,019.2 | + 7.3 | 1,172.1 | + 8.0 |
| May | 167.7 | 260.6 | 592.5 | 169.7 | 428.3 | +11.9 | 1,020.8 | + 8.6 | 1,180.0 | + 3.9 |
| June | 173.9 | 273.6 | 603.0 | 184.1 | 447.5 | +12.2 | 1,050.5 | + 9.5 | 1,218.3 | +11.0 |
| July | 173.6 | 272.4 | 601.9 | 197.3 | 446.0 | +14.8 | 1,047.9 | +10.2 | 1,228.1 | +12.8 |
| Aug. | 175.4 | 276.4 | 605.1 | 205.7 | 451.8 | +13.7 | 1,056.9 | + 9.4 | 1,244.6 | + 11.8 |
| Sept. | 179.7 | 297.2 | 632.8 | 203.0 | 476.9 | +16.7 | 1,109.7 | +11.4 | 1,297.9 | +13.[illegible] |
| Oct. | 177.0 | 292.7 | 633.9 | 200.0 | 469.7 | +14.8 | 1,108.6 | +11.0 | 1,293.0 | +12.4 |
| Nov. | 179.9 | 306.0 | 642.3 | 214.4 | 485.9 | +18.1 | 1,128.2 | +12.7 | 1,322.4 | + 15.2 |
| Dec. | 138.9 | 310.3 | 654.6 | 210.1 | 499.2 | +16.0 | 1,153.8 | +12.1 | 1,343.2 | + 14.3 |
| **1973** | | | | | | | | | | |
| Jan. | 184.9 | 307.8 | 657.9 | 230.0 | 492.7 | +17.9 | 1,150 | +12.7 | 1,364.4 | +16.9 |
| Feb. | 185.6 | 287.0 | 661.2 | 249.4 | 473.5 | + 14.9 | 1,134.7 | +11.1 | 1,372.0 | + 17.3 |
| Mar. | 192.9 | 320.1 | 687.0 | 272.8 | 513.0 | +14.1 | 1,200.0 | + 16.1 | 1,459.8 | +23.8 |
| Apr. | 190.2 | 292.4 | 694.5 | 279.7 | 482.4 | +12.1 | 1,176.9 | +15.5 | 1,441.1 | + 23.0 |
| May | 190.2 | 291.4 | 704.8 | 265.8 | 481.6 | +12.4 | 1,186.4 | + 16.2 | 1,440.3 | + 22.1 |
| June | [illegible] | 307.0 | 718.7 | 275.4 | 503.9 | +12.6 | 1,222.6 | +16.4 | 1,482.8 | +21.7 |

a Average of Friday figures of Irish notes and coin outstanding adjusted to exclude holdings by the Associated Banks,

b Adjusted for uncleared cheques and excluding offsets from April 1971 onwards,

c Adjusted for non-Associated banks' inter-bank balances.

M1 = Currency outstanding plus Associated Banks' current accounts.

M2 = Currency outstanding plus Associated Banks' current and deposit accounts.

M3 = Currency outstanding plus Associated Banks' current and deposit accounts plus non-Associated banks' current and deposit accounts less all inter-bank balances.

Notes: 1. As offset or contra balances have been excluded from Associated Banks' current accounts from April 1971 onwards, data for this and subsequent dates are not directly comparable with those for earlier dates.

2. From March 1972 onwards, the Associated Banks' data in this table have been compiled on the basis of full disclosure of Profits and Reserves. Disclosure had a downward effect - of the order of £40 million - on deposit accounts. Consequently from March 1972 onwards, certain items in the table are not directly comparable with those for earlier dates. The year-to-year percentage changes shown in columns 8 and 10 are also affected.

3. The letters B.D. in the table indicate that data are not available because of a bank dispute.

## APPENDIX TABLE 1

## MONEY SUPPLY

| Date | Currency Outstanding [a] | Associated Banks | | Non-Associated Bank Deposits [c] | Selected Measures of Money Supply | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Current Accounts [b] | Deposit Accounts | | M1 | | M2 | | M3 | |
| | £ million | £ million | £ million | £ million | £ million | Year-to-year Change - % | £ million | Year-to-year Change - % | £ million | Year-to-year Change - % |
| Average for Year | 1 | 2 | 3 | 4 | 5=1+2 | 6 | 7=1+2+3 | 8 | 9 | 10 |
| 1966 | 110.3 | 205.4 | 288.7 | 44.2 | 315.7 | + 7.8 | 604.4 | + 8.2 | 647.2 | .. |
| 1967 | 115.6 | 214.1 | 325.9 | 56.9 | 329.7 | + 4.4 | 655.6 | + 8.5 | 709.6 | + 9.6 |
| 1968 | 123.7 | 232.7 | 390.2 | 74.2 | 356.4 | + 8.1 | 746.6 | +13.9 | 815.6 | +14.6 |
| 1969 | 131.5 | 245.0 | 451.9 | 99.8 | 376.5 | + 5.6 | 828.4 | +11.0 | 918.3 | +12.6 |
| 1970 | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. | B.D. |
| 1971 | 159.6 | 240.9 | 574.9 | 155.6 | 400.5 | B.D.7 | 975.4 | B.D. | 1,120.6 | B.D. |
| 1972 | 173.8 | 277.5 | 612.9 | 184.5 | 451.3 | +12.7 | 1,064.2 | + 9.1 | 1,234.6 | +10.2 |
| **1971** | | | | | | | | | | |
| Apr. | 155.9 | 234.6 | 559.0 | 149.1 | 390.5 | B.D. | 949.5 | B.D. | 1,084.9 | B.D. |
| May | 156.5 | 226.2 | 557.4 | 153.5 | 382.7 | B.D. | 940.1 | B.D. | 1,083.5 | B.D. |
| June | 157.5 | 241.3 | 560.5 | 149.8 | 398.8 | B.D. | 959.3 | B.D. | 1,097.7 | B.D. |
| July | 159.2 | 229.4 | 561.9 | 152.3 | 388.6 | B.D. | 950.5 | B.D. | 1,089.1 | B.D. |
| Aug. | 159.4 | 238.1 | 568.7 | 157.2 | 397.5 | B.D. | 966.2 | B.D. | 1,112.8 | B.D. |
| Sept. | 161.8 | 246.8 | 587.9 | 160.3 | 408.6 | B.D. | 996.7 | B.D. | 1,144.4 | B.D. |
| Oct. | 162.9 | 246.5 | 589.5 | 162.2 | 409.4 | B.D. | 998.9 | B.D. | 1,150.8 | B.D. |
| Nov. | 163.9 | 247.4 | 590.1 | 158.0 | 411.3 | B.D. | 1,001.4 | B.D. | 1,147.5 | B.D. |
| Dec. | 172.2 | 258.0 | 599.4 | 158.1 | 430.2 | B.D. | 1,029.6 | B.D. | 1,174.7 | B.D. |
| **1972** | | | | | | | | | | |
| Jan. | 164.4 | 253.6 | 602.7 | 152.8 | 418.0 | B.D. | 1,020.7 | B.D. | 1,168.9 | B.D. |
| Feb. | 165.6 | 246.5 | 609.0 | 155.9 | 412.1 | B.D. | 1,021.1 | B.D. | 1,169.5 | B.D. |
| Mar. | 172.3 | 277.4 | 583.5 | 157.1 | 449.7 | B.D | 1,033.2 | B.D. | 1,179.0 | B.D. |
| Apr. | 167.4 | 263.0 | 588.8 | 163.9 | 430.4 | +10.2 | 1,019.2 | + 7.3 | 1,172.1 | + 8.0 |
| May | 167.7 | 260.6 | 592.5 | 169.7 | 428.3 | +11.9 | 1,020.8 | + 8.6 | 1,180.0 | + 8.9 |
| June | 173.9 | 273.6 | 603.0 | 184.1 | 447.5 | +12.2 | 1,050.5 | + 9.5 | 1,218.3 | +11.0 |
| July | 173.6 | 272.4 | 601.9 | 197.3 | 446.0 | +14.8 | 1,047.9 | +10.2 | 1,228.1 | +12.8 |
| Aug. | 175.4 | 276.4 | 605.1 | 205.7 | 451.8 | +13.7 | 1,056.9 | + 9.4 | 1,244.6 | +11.8 |
| Sept. | 179.7 | 297.2 | 632.8 | 203.0 | 476.9 | +16.7 | 1,109.7 | +11.4 | 1,297.9 | +13.4 |
| Oct. | 177.0 | 292.7 | 633.9 | 200.0 | 469.7 | +14.8 | 1,108.6 | +11.0 | 1,293.0 | +12.4 |
| Nov. | 179.9 | 306.0 | 642.3 | 214.4 | 485.9 | +18.1 | 1,128.2 | +12.7 | 1,322.4 | +15.2 |
| Dec. | 188.9 | 310.3 | 654.6 | 210.1 | 499.2 | +16.0 | 1,153.8 | +12.1 | 1,343.2 | +14.3 |
| **1973** | | | | | | | | | | |
| Jan. | 184.9 | 307.8 | 657.9 | 230.0 | 492.7 | +17.9 | 1,150 | +12.7 | 1,364.4 | +16.9 |
| Feb | 185.6 | 287.0 | 661.2 | 249.4 | 473.5 | +14.9 | 1,134.7 | +11.1 | 1,372.0 | +17.3 |
| Mar | 192.9 | 320.1 | 687.0 | 272.8 | 513.0 | +14.1 | 1,200.0 | +16.1 | 1,459.8 | +23.8 |
| Apr. | 190.2 | 292.4 | 694.5 | 279.7 | 482.4 | +12.1 | 1,176.9 | +15.5 | 1,441.1 | +23.0 |
| May | 190.2 | 291.4 | 704.8 | 265.8 | 481.6 | +12.4 | 1,186.4 | +16.2 | 1,440.3 | +22.1 |
| June | [illegible] | 307.0 | 718.7 | 275.4 | 503.9 | +12.6 | 1,222.6 | +16.4 | 1,482.8 | +21.7 |

a Average of Friday figures of Irish notes and coin outstanding adjusted to exclude holdings by the Associated Banks.
b Adjusted for uncleared cheques and excluding offsets from April 1971 onwards.
c Adjusted for non-Associated banks' inter-bank balances.
M1 = Currency outstanding plus Associated Banks' current accounts.
M2 = Currency outstanding plus Associated Banks' current and deposit accounts.
M3 = Currency outstanding plus Associated Banks' current and deposit accounts plus non-Associated banks' current and deposit accounts less all inter-bank balances.

Notes:
1. As offset or contra balances have been excluded from Associated Banks' current accounts from April 1971 onwards, data for this and subsequent dates are not directly comparable with those for earlier dates.
2. From March 1972 onwards, the Associated Banks' data in this table have been compiled on the basis of full disclosure of Profits and Reserves. Disclosure had a downward effect - of the order of £40 million - on deposit accounts. Consequently from March 1972 onwards certain items in the table are not directly comparable with those for earlier dates. The year-to-year percentage changes shown in columns 8 and 10 are also affected.
3. The letters B.D. in the table indicate that data are not available because of a bank dispute.

APPENDIX TABLE 2

DOMESTIC CREDIT: ALL BANK

£ million

| Date | Associated Banks | | | Non-Associated Banks | | | Associated Banks and non-Associated banks | | | Central Bank | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Govt. | Non-Govt. | Total | Govt. | Non-Govt. | Total | Govt. | Non-Govt. | Total | Ex-chequer Bills | Other (Quoted Irish Govt. Securities[a] |
| **1971** | | | | | | | | | | | |
| Apr. | 219.7 | 479.6 | 699.3 | 13.6 | 225.0 | 238.6 | 233.3 | 704.6 | 937.9 | 7.2 | 19.5 |
| July | 222.8 | 467.7 | 690.5 | 15.3 | 234.0 | 249.3 | 238.1 | 701.7 | 939.8 | 5.9 | 19.2 |
| Oct. | 238.5 | 468.9 | 707.4 | 18.3 | 241.1 | 259.4 | 256.8 | 710.0 | 966.8 | - | 19.1 |
| Dec. | 242.2 | 476.0 | 718.2 | 16.9 | 256.3 | 273.2 | 259.1 | 732.1 | 991.4 | - | 23.9 |
| **1972** | | | | | | | | | | | |
| Jan. | 241.1 | 473.5 | 714.6 | 16.1 | 255.2 | 271.3 | 257.2 | 728.7 | 985.9 | - | 24.4 |
| Feb. | 242.2 | 483.7 | 725.9 | 17.1 | 257.0 | 274.1 | 259.3 | 740.7 | 1,000.0 | - | 26.4 |
| Mar. | 258.9 | 523.9 | 782.8 | 21.0 | 265.6 | 286.6 | 279.9 | 789.5 | 1,069.4 | - | 23.1 |
| Apr. | 259.0 | 507.2 | 766.2 | 21.7 | 269.5 | 291.2 | 280.7 | 776.7 | 1,057.4 | - | 23.9 |
| May | 258.4 | 515.4 | 773.8 | 22.5 | 280.9 | 303.4 | 280.9 | 796.3 | 1,077.2 | - | 24.6 |
| June | 258.4 | 550.1 | 808.6 | 22.1 | 290.7 | 312.8 | 280.5 | 840.8 | 1,121.4 | - | 26.8 |
| July | 258.8 | 537.9 | 796.7 | 22.6 | 294.1 | 316.7 | 281.4 | 832.0 | 1,113.4 | - | 26.3 |
| Aug. | 258.9 | 552.1 | 810.9 | 22.2 | 293.4 | 315.6 | 281.1 | 845.5 | 1,126.5 | - | 27.0 |
| Sept. | 256.0 | 588.7 | 844.7 | 22.5 | 308.1 | 330.6 | 278.5 | 896.8 | 1,175.3 | - | 28.6 |
| Oct. | 253.7 | 580.1 | 833.8 | 22.3 | 311.5 | 333.8 | 276.0 | 891.6 | 1,167.6 | - | 29.8 |
| Nov. | 257.8 | 594.4 | 852.2 | 23.3 | 318.6 | 341.9 | 281.1 | 913.0 | 1,194.1 | - | 27.9 |
| Dec. | 265.5 | 645.8 | 911.3 | 27.1 | 332.9 | 360.0 | 292.6 | 978.7 | 1,271.3 | - | 24.8 |
| **1973** | | | | | | | | | | | |
| Jan. | 265.1 | 633.2 | 898.3 | 28.1 | 346.2 | 374.3 | 293.2 | 979.4 | 1,272.6 | - | 24.7 |
| Feb. | 272.9* | 658.8 | 931.7* | 28.4 | 356.2 | 384.6 | 301.3* | 1,015.0 | 1,316.3* | 45.0 | 28.4 |
| Mar. | 300.9* | 696.3 | 997.2* | 30.4 | 364.5 | 394.9 | 331.3* | 1,060.8 | 1,392.1* | 59.5 | 24.0 |
| Apr. | 301.8* | 678.0 | 979.9* | 30.3 | 368.5 | 398.8 | 332.1* | 1,046.5 | 1,378.7* | 59.5 | 28.0 |
| May | 310.2* | 682.1 | 992.3* | 30.9 | 364.1 | 395.0 | 341.1* | 1,046.2 | 1,387.3* | 51.5 | 20.9 |
| June | 313.0* | 708.6 | 1,021.5* | 30.8 | 384.2 | 415.0 | 343.8* | 1,092.8 | 1,436.5* | 58.9 | 19.6 |

es rediscounts
a in this column do not include the Central Bank's holdings of Irish Government Certificates of Indebtednes and De
per
sociated Banks' figures for non-Government credit are adjusted for cheques in course of collection. End-quarter fig
adjusted for Government cheques outstanding.

APPENDIX TABLE 3

IRELAND - SELECTED INTEREST RATES[a]

| | 1972 | | | | 1973 | | | |
|---|---|---|---|---|---|---|---|---|
| | End-Mar. | End-June | End-Sept. | End-Dec. | End-Mar. | End-Apr. | End-May | End-June |
| **I CENTRAL BANK** | | | | | | | | |
| 1. Rediscount rate | 4.81 | 6.06 | 7.19 | 8.00 | 8.75 | 8.75 | 8.75 | 8.00 |
| 2. Exchequer Bills (public issue) | 4.61 | 5.15 | 6.50 | 7.98 | 8.78 | 7.66 | 7.54 | 7.34 |
| 3. Call money | 4.62 | 6.75 | 6.50 | 7.25 | 8.00 | 8.50 | 10.00 | 6.38 |
| 4. 1 month fixed | 4.88 | 7.38 | 6.88 | 8.12 | 9.75 | 9.00 | 9.50 | 7.62 |
| 5. 3 months fixed | 4.88 | 7.38 | 7.44 | 8.75 | 10.00 | 9.00 | 9.25 | 8.00 |
| **II INTER-BANK MARKET** | | | | | | | | |
| 1. Call money | 6.25 | 8.50 | 7.12 | 7.62 | 16.00 | 9.38 | 10.00 | 12.00 |
| 2. 1 month fixed | 5.88 | 7.75 | 7.25 | 8.75 | 11.12 | 9.62 | 9.75 | 9.75 |
| 3. 3 months fixed | 5.75 | 7.75 | 7.75 | 9.25 | 10.62 | 9.88 | 9.75 | 9.88 |
| **III GOVERNMENT SECURITY MARKET** | | | | | | | | |
| Representative yields[b] on Government Securities | | | | | | | | |
| 1. 3 years to maturity | 6.35 | 8.38 | 8.45 | 8.66 | 9.43 | 9.43 | 8.96 | 9.08 |
| 2. 8 years to maturity | 7.00 | 8.46 | 8.71 | 8.98 | 9.62 | 9.63 | 9.58 | 9.74 |
| 3. 15 years to maturity | 8.38 | 9.81 | 9.46 | 9.46 | 10.01 | 10.00 | 10.04 | 10.18 |
| **IV ASSOCIATED BANKS** | | | | | | | | |
| Deposit Rates: | | | | | | | | |
| Under £25,000[c] | 3.00 | 3.00 | 4.00 | 4.00 | 6.50 | 6.00 | 6.00 | 5.50 |
| £25,000 and over | 4.00 | 4.00 | 5.25 | 5.25 | 7.75 | 7.25 | 7.25 | 6.75 |
| Lending Rates: | | | | | | | | |
| Overdrafts | 7.75/9.25 [d] | 6.50/8.00 | 7.50/9.00 | 7.50/9.00 | 9.75/11.25 | 9.25/10.75 | 9.25/10.75 | 8.75/10.25 [f] |
| Term Loans (1-7 years) | - | 7.00/10.00 | 8.00/11.00 | 8.00/11.00 | 10.25/13.25 | 9.75/12.75 | 9.75/12.75 | 9.25/12.25 |
| Loans (Over 7 years) | - | 8.50/10.75 | 9.50/11.75 | 9.50/11.75 | 11.75/14.00 | 11.25/13.50 | 11.25/13.50 | 10.75/13.00 |
| **V NON-ASSOCIATED BANKS** | | | | | | | | |
| Representative Rates | | | | | | | | |
| Deposit Rates: | | | | | | | | |
| Under £25,000 | - | 3.00/6.50 | 4.00/7.75 | 4.00/9.00 | 6.50/10.00 | n.a. | n.a. | 5.50/9.50 |
| £25,000 and over | - | 5.00/7.50 | 6.00/8.25 | 6.50/9.25 | 7.75/11.00 | n.a. | n.a. | 6.75/10.00 |
| Lending Rates: | | | | | | | | |
| Overdrafts | .. | 6.50/10.00 | 7.50/11.00 | 7.50/11.00 | 9.50/13.00 | n.a. | n.a. | 9.25/13.00 |
| Term Loans (1-5 years) | .. | 6.50/10.00 | 7.50/11.00 | 8.00/11.50 | 10.25/13.00 | n.a. | n.a. | 10.00/13.00 |
| Instalment Credit (flat) incl. personal loans (gross) | .. | 10.00/11.00 | 10.00/11.00 | 10.00/11.00 | 10.50/11.50 | n.a. | n.a. | 10.50/11.50 |
| **VI OTHER FINANCIAL INSTITUTIONS** | | | | | | | | |
| Representative Rates | | | | | | | | |
| 1. Building Societies | | | | | | | | |
| Share accounts[g] | 5.50 | 5.50 | 5.50 | 5.50 | 6.00 | 6.00 | 6.00 | 7.00 |
| Mortgage loans | 9.00 | 9.00 | 9.00 | 9.00 | 10.00 | 10.00 | 10.00 | 10.00 |
| 2. Post Office Savings Bank and Trustee Savings Banks | | | | | | | | |
| Ordinary accounts[c] | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| Investment accounts | 6.50 | 6.50 | 6.50 | 6.50 | 6.50 | 6.50 | 6.50 | 6.50 |
| **VII SHARE PRICE INDEX** (Jan. 1963 = 100)[h] | 183.3 | 238.9 | 288.3 | 279.5 | 292.9 | 281.7 | 282.3 | 278.0 |

a As far as possible, rates given in this table are those prevailing on the last Friday of each period.

b Derived from yield curves based on gross redemption yields.

c The first £70 per annum of interest earned by an individual on money deposited with the Associated Banks or in Ordinary Accounts with the Post Office Savings Bank and Trustee Savings Banks are not subject to income tax. In the case of a married couple, the first £140 per annum of interest are exempted from tax.

d As from 3 August 1973 overdrafts not yet brought within the scope of term lending carry a rate of 10.00 per cent. for overdrafts to the Primary, Construction, Manufacturing and Services Sectors and 11.50 per cent. for overdrafts to the Financial and Personal Sectors.

f Rates vary according to the duration of the lending and the classification of the borrower (under "AAA", "AA" or "A").

g These are the rates paid after income tax has been deducted.

h The Share Price Index is based on official quotations at the Dublin Stock Exchange at the beginning of each month.

# P A R T   T H R E E

## MONETARY POLICY INSTRUMENTS

## IN

## THE UNITED KINGDOM

## Chapter One

## Basic principles of monetary policy

## Section I: Institutional framework and structural conditions

Para

### I The institutional framework

Responsibility for policy

1 Monetary policy in the United Kingdom, like general economic policy, is ultimately the responsibility of Her Majesty's Government. The departmental responsibility within the Government lies with the Treasury. However, policy decisions are preceded by discussion between the Treasury and the Bank of England; and the Bank are able, if appropriate, to offer advice direct to the Chancellor of the Exchequer.

Responsibility for implementation

2 The Bank of England are responsible for implementing monetary policy by such means as action to bring about changes in interest rates, or other intervention in the financial markets. In carrying out this function the Bank keep closely in touch with the Treasury.

Statutory and other provisions

3 These responsibilities, and their division, have evolved over many years and are not closely regulated or defined by statute. No act of Parliament sets out the general aims of economic or monetary policy; and among the acts and charters under which the Bank of England operate, there are no references to duties and responsibilities, save a mention in the Royal Charter of Incorporation of 1694 of a desire 'to promote the publick Good and Benefit of our People'.

4 The Bank of England Act 1946 brought the Bank into public ownership and under public control, and set out the relationship between the Treasury, the Bank and the banking system.

Relationship between Treasury and central bank

5 The Treasury and the Bank of England have a working relationship built up over a very long period. Well before 1946 it was fully accepted that the final decisions in matters of economic policy are taken by ministers. Nevertheless the act of 1946 provided that 'the Treasury may from time to time give such directions to the Bank as, after consultation with the Governor of the Bank, they think necessary in the public interest'. This power of direction, which has never been exercised, is the formal statutory authority by which ultimate control by the Treasury over the Bank's monetary operations may be exercised. (There are miscellaneous provisions in other statutes relating to specific functions such as the note issue and national debt.) The act also introduced public control over appointments to the Court of the Bank, the governing body.

Internal organisation of central bank

6 The Court of the Bank consists of the Governor, Deputy Governor and sixteen other Directors, all of whom are appointed by the Crown on the recommendation of the Prime Minister. The act and the charter give no power of dismissal, but there is provision for disqualification in certain circumstances. The term of office for the Governor and Deputy Governor is five years: for other Directors it is four years, and four Directors retire annually. More than one term may be served. Four (and no more) of the sixteen are normally full-time executive Directors; and it is the Governor, Deputy Governor and these four Directors who exercise executive control of the Bank.

7 Below the Court, the day-to-day administration of the Bank rests primarily with the Heads of Department. Of ten departments in the Bank the principal one is the Cashier's Department; and the Chief Cashier is the chief executive officer of the Bank. It deals with normal banking business, provides the note issue, manages the Exchange Equalisation Account (i.e. the official reserves), conducts the Bank's operations in the money, gilt-edged and foreign exchange markets, and generally executes monetary policy. The Bank's ability to advise the Government on domestic monetary matters derives largely from the department's technical knowledge of, and practical experience in, the markets and its close contact with the commercial banks and other financial institutions. An important contribution is also made by the Bank's Economic Intelligence Department, which collects, analyses and interprets statistical and other information about the monetary situation and the economy as a whole, and participates in policy discussion and forecasting, partly through membership of inter-departmental government committees. Administratively within the Economic Intelligence Department, but independent in its work, is the Economic Section, which provides economic appraisals and conducts studies bearing on the choice of official policies. It also undertakes longer-term research on the fundamental relationships affecting the operation of monetary policy.

**Separation of central bank's note-issuing function**

8 The administrative division of the Bank into ten departments must be distinguished from a division made for accounting and analytical purposes between the Issue Department and the Banking Department. The Bank's activities were divided in this way by the Bank Charter Act of 1844, so as to separate the note-issuing function from all other functions. The accounts of the Issue Department are concerned solely with the note issue (which is now entirely fiduciary) and the backing for it. Thus the department's liabilities are the notes in issue – in circulation with the public, in the commercial banks' tills or held as a reserve by the Banking Department (through which issues of new notes take place). Its assets include holdings of government debt (largely stocks and Treasury bills), promissory notes for the refinance of export lending, and often a small portfolio of commercial bills and local authority bills. In underwriting all new issues of government stock, the Bank usually take most of it into the Issue Department's portfolio on the day of issue and gradually sell it as demand arises; and the Bank rely primarily on the use of the department's assets in undertaking their market operations.

9 The Banking Department's liabilities are mainly customers' deposits, notably those of domestic commercial banks and overseas central banks, and include any special deposits called for by the authorities; the balances kept on government accounts are small. Its assets, apart from a reserve of notes and coin, are mostly government securities (again, largely stocks and Treasury bills) and bills discounted for, and advances to, customers.

**Analytical treatment**

10 For purposes of economic and financial analysis in the United Kingdom, the Issue Department is at present conventionally treated as part of the central government. The Banking Department is treated as part of the banking sector.

**Powers of central bank**

11 The only powers over other institutions given by statute to the Bank of England are contained in the Bank Act of 1946, which provides that

> the Bank, if they think it necessary in the public interest, may request information from and make recommendations to bankers, and may, if so authorised by the Treasury, issue directions to any banker for the purpose of securing that effect is given to any such request or recommendation:
>
> Provided that:–
>
> (a) no such request or recommendations shall be made with respect to the affairs of any particular customer of a banker; and
>
> (b) before authorising the issue of any such directions the Treasury shall give the banker concerned, or such person as appears to them to represent him, an opportunity of making representations with respect thereto.

This power of direction has never been invoked. The Bank exercise their control over banks and other financial institutions, in the execution of monetary policy, by obtaining their voluntary co-operation. In seeking this co-operation the Bank no doubt draw some advantage from the existence, in the background, of the power of direction, and from the desire of financial institutions to retain the Bank's goodwill. At the same time, the Bank and the institutions share the belief that voluntary co-operation is more likely than lega compulsion to produce the desired results, and that, in the longer term, central bank and commercial banks have a common interest in the good ordering of the economy.

**General supervision of banking system**

12 The United Kingdom has no legislation specifically governing the surveillance and control of banks, and no machinery of bank inspection, such as may be found in other countries of the EEC. The power of the Bank of England to issue directions to bankers given by the 1946 act is the only legislative provision for control of a general nature over bankers. Other legislation affects banks incidentally with other companies, or with regard to specific functions:

(a) Unless a bank obtains recognition under Section 123 of the Companies Act 1967 for the purpose of the Moneylenders Acts of 1900 and 1927, or obtains an order of exemption under these acts (which embodies a limitation on the rate of interest chargeable on loans), it would either have to seek a licence as a moneylender and observe the provisions applied to such lenders, or run the risk of being regarded at law as an unlicensed moneylender, in which case the obligations of its debtors would be capable of being annulled.

(b) The Companies Acts of 1948 and 1967 prescribe the activities of companies in general but make certain specific provisions for banks, including control over the use of such words as 'bank', 'banker' or 'banking' in a company's name.

(c) The Protection of Depositors Act 1963 restricts advertising for deposits and provides for supervision of companies so doing. Exemption from these provisions is one of the prime UK banking regulations.

(d) The Prevention of Fraud (Investments) Act 1958 regulates dealing in securities as a business.

The acts in (a) to (d) are administered by a government department, the Department of Trade and Industry.

(e) The Income and Corporation Taxes Act 1970 allows banks to pay and receive interest without deduction of tax providing they satisfy the Inland Revenue that they are 'carrying on a bona fide banking business'.

(f) The Exchange Control Act 1947 provides for the Treasury to appoint banks as authorised dealers in gold or foreign exchange.

The Bank of England provide advice to the government departments concerned on the standing of financial institutions seeking designation as banks under these statutes.

13 Apart from these statutory provisions, surveillance and control of banks is in fact exercised informally by the Bank of England. It rests largely on the spirit of co-operation referred to earlier, and on the vital importance attached by the banks as well as the authorities to the maintenance of good order and a healthy system. The Bank discuss with the Treasury any matters affecting the general structure of the banking system, or otherwise important for the economy in general. One such matter, concerning mergers among the large deposit banks, was referred to the Monopolies Commission in 1968. The Discount Office of the Bank (a part of the Cashier's Department) is primarily responsible for exercising supervision: it inspects the banks' balance sheets and sees that certain prudential ratios are observed (see Chapter II), and it maintains close contacts with individual banks and with associations of banks.

Para

## II Structural conditions

### I Structure of the financial intermediaries

14 *Banks* in the United Kingdom are not subject to any legal or official classification, but for statistical and general analytical purposes they can be described as falling into two broad categories – the deposit banks on the one hand and the accepting houses, overseas banks and other banks on the other. The distinction between the two categories could at one time have been said to be based roughly on the type of business they performed, but specialisation among banks has become much less pronounced in recent years, particularly since the introduction of new arrangements for credit control in September 1971. All banks are treated alike under these arrangements; all must observe a common ratio of reserve assets, and all can be called upon to place special deposits with the Bank of England. These arrangements are described more fully in Chapter II.

(i) The deposit banks

These comprise the London and Scottish clearing banks, the Northern Ireland banks and a few other domestic banks. Together with the National Giro, they provide the country's main money transmission service through extensive branch networks.

The six *London clearing banks* have branches throughout England and Wales. They accept deposits on current (sight) accounts and on deposit (time) accounts (but they do not have special savings accounts distinct from time deposits). Until September 1971, time deposits were predominantly at seven days' notice of withdrawal; since then they have included a growing proportion of deposits at longer term, after these banks entered in their own name into the 'wholesale' markets for inter-bank deposits, certificates of deposit and euro-currencies (business which had previously been conducted through subsidiaries).[1] Interest is paid on deposit accounts but not normally on current accounts. At mid-June 1973 the amount held on current accounts was about £7,500 million, and on deposit accounts about £9,200 million, in each case nearly all in sterling. Among these banks' assets, about 55% were in the form of advances, under 6% in government stocks, and most of the rest were short-term.

The three *Scottish clearing banks* provide much the same service in Scotland and have similar balance sheet structures. Since September 1971 they too have begun to compete in the 'wholesale' markets. At mid-June 1973 their current accounts amounted to some £600 million and their deposit accounts to around £950 million.

The four *Northern Ireland banks* provide a comparable service for Northern Ireland.

*Other deposit banks* comprise five British banks doing the same type of business as the London and Scottish clearing banks and the Northern Ireland banks, but mostly operating on a very much smaller scale.

[1] These markets are described in Chapter II, Section III, § I.1.

(ii) The accepting houses, overseas banks and other banks

This collective title is used to describe a diverse and fast-growing group of banks, currently over 250 in number, which are concentrated in London. They may be divided into three main sub-groups: the accepting houses and British overseas banks, most of which were founded many years ago to finance overseas trade or to provide banking services in the colonies; the foreign banks, some of which have been in London for many years, but others more recently arrived; and the other UK banks, which are mainly either merchant banking subsidiaries of the London and Scottish clearing banks, or consortium banks registered in London, mostly set up since 1965. The activities of these three categories of banks vary widely. Some are the head offices of extensive branch banking systems in Commonwealth and other countries, while others are themselves branches of banks whose head offices are in the Commonwealth or elsewhere overseas. The accepting houses are specialists in bill finance and company finance. The consortium banks and many of the foreign banks, particularly the American banks, are especially active in the euro-currency markets which have developed rapidly in recent years. And many of the banks, both British and overseas, have large investments in the UK local authority temporary money market, and participate in the large markets in inter-bank sterling and currency deposits and in certificates of deposit. Unlike the deposit banks, these banks do not seek to provide a money transmission service, but prefer to deal in large sums of money on behalf of relatively few customers.

At mid-June 1973 the deposits of the accepting houses, overseas banks and other banks amounted to £53,100 million, of which about £37,750 million was in foreign currency. Among their assets, the banks had some £1,700 million in loans to local authorities, £14,000 million with other banks in the United Kingdom, and nearly £33,000 million loans and advances to other customers at home and abroad (mainly in foreign currency).

15 The twelve *discount houses* deal mainly in short-term funds. They act primarily as intermediaries in the money market, borrowing money at call to finance holdings of commercial bills, Treasury bills, short-dated government and local authority stocks and bonds and other, generally liquid, assets. They also hold, and make a secondary market in, certificates of deposit issued by the banks. The greater part of their funds comes from within the banking sector, particularly from the London clearing banks, which in mid-June 1973 provided nearly 44% of the discount houses' £2,500 million total borrowed funds. The discount houses do not offer a general banking service, and take few funds from the general public.

16 A prime function of the discount market is to act as an intermediary between the banks and the Bank of England. Because a large part of their resources is provided by the banks, a shortage of funds in the banking system is quickly transferred to the discount houses, as the banks call for borrowed funds to be repaid. The shortage is relieved by the Bank of England, usually by the purchase of bills, or by lending, as described more fully in Chapter II.

17 The *National Giro* was established by the Post Office in October 1968. Its main function is to provide a cheap and speedy money transmission service and facilities for standing orders, in which respects it competes with the clearing banks. Accounts may be opened at any one of over 23,000 post offices, but overdraft and deposit account facilities are not provided. The Giro has developed comparatively slowly and by mid-June 1973, deposits were nearly £90 million.

18 *The Banking Department of the Bank of England* performs certain central banking functions, holding deposits of the government, other UK banks (principally the London clearing banks, but including special deposits from all banks when called) and overseas central banks; it also has a small amount of other deposit banking business. Its assets were described in paragraph 9 above.

19 The institutions described in paragraphs 14–18 are collectively treated as the banking sector for analytical purposes. The total deposit liabilities at various dates of the different institutions in the banking sector, and of the banking sector as a whole are summarised in Table 14.

The non-bank financial institutions

20 The groups of institutions described below differ quite widely from each other, but they all act as financial intermediaries, drawing funds from various sources and employing them in a variety of ways. The definition of these individual groups is to some extent arbitrary, being related to the provision of regular quarterly statistics, which cover all the largest institutions. Those which rely on the Government for the supply and use of their

funds are excluded (resulting in the exclusion of the state pension scheme and certain departments of the savings banks). The institutions are considered in groups, where their activities are similar.

21 *Insurance companies'* business falls into two main categories life assurance and general insurance. Life assurance liabilities are generally long-term, and assets (mainly financial) are built up over the years to cover them. In contrast general insurance (which covers non-life insurance, such as fire, marine, motor and other accident) is characterised by short-term liabilities. Turnover is considerable, and premiums received in one year are often paid out again fairly soon in the form of running expenses or claims. Invested assets are therefore smaller than those of the life companies. The companies also transact a large amount of business overseas.

22 In 1972 net life assurance premiums written (including some written overseas) totalled some £2,230 million and general insurance premiums £2,600 million. Both forms of insurance have grown considerably in recent years. In holdings of assets, the insurance companies are by far the largest non-bank financial institutions in Britain; at the end of 1972, assets of the life funds totalled over £16,570 million (mainly at book value) and of the general funds nearly £2,530 million. The companies have traditionally invested a large proportion of their funds in fixed interest government and company (mostly equity) securities; in recent years, they have increased their investment in property and reduced their loans and mortgages. A feature of the activities of the life funds during the last few years has been the linking of life policies with specific forms of investment, for example, in equity-linked schemes and property bonds.

23 The *pension funds* (other than those managed by insurance companies and included in the statistics mentioned above) fall into three groups according to their affiliation with the private sector, local authorities, or the rest of the public sector (excluding certain state schemes financed directly out of revenue), all three groups being regarded as 'other financial institutions' for analytical purposes. The private sector pension funds, numbering several thousand, are administered mainly by fairly large industrial and commercial companies and other private businesses, and probably cover about seven million people. There are over five hundred local authority pension funds, covering about two and a half million people, and the other public sector pension funds, run by the National Coal Board and other nationalised industries, cater for about one and a half million people. All the funds operate in similar ways. Like the life assurance companies, they are financed by long-term contractual savings, and invest mainly in the long-term security markets and, to a lesser extent, in property. Their income consists of contributions from employers and employees, and a considerable amount of investment income derived from earlier accumulations. Expenditure goes mainly towards pensions and general running expenses. The excess of income over expenditure is used for further investment. In terms of assets the private sector funds are the largest, holding over £6,175 million at market value between them at the end of 1971, with the local authority funds holding about £1,840 million (at end-March 1972) and the other public sector funds over £2,520 million at end-1971. In recent years the pension funds have grown at a similar rate to the life assurance companies. Their net investment amounted to over £720 million in 1971, and over £900 million in 1972.

24 *Property unit trusts* derive most of their resources from the pension funds. They came into existence when tax changes in 1965 made it much more attractive for tax-exempt pension funds and charities to own and manage property themselves than to buy the shares of property companies. Many of the smaller pension funds and charities lacked the specialist knowledge and skills required to invest directly in property themselves, and property unit trusts were designed to meet their requirements. The assets of the property unit trusts are held in the name of a trustee (commonly a bank) and are managed by a separate committee or company. A beneficial interest in the trust is represented by a unit comprising a proportionate claim on the trust's total net assets. The funds are subscribed almost exclusively by pension funds, with only a small proportion coming from charities, and are invested in property (nearly £190 million by the end of 1972) and liquid assets (over £80 million at the end of 1972). Sales of units slackened off slightly from the middle of 1969 but have since increased substantially, amounting to £45 million in 1971 and £66 million in 1972.

25 The *building societies* are the main source of lending in Britain for house purchase. They borrow money by taking deposits, and lend it on mortgage to house purchasers. Their lending is thus almost entirely long-term but their borrowing is of a much shorter nature. In consequence they keep a substantial part of their assets (usually in the range

15%–18%) in liquid form. The bulk of their assets (about 80%) is in the form of mortgages for both new and existing houses. The usual period for a new mortgage is about twenty-five years but the average period for which a mortgage remains outstanding is somewhere near eight years. There has been a large growth in building society assets over the last few years, particularly the last three. They have increased by about 230% since 1963 to £15,330 million (at book value) at the end of 1972; and net additions to assets in 1972 were as much as £2,266 million. Among non-bank financial institutions, the total assets of the societies are now second in size only to those of the insurance companies. The gross amount of deposits received in 1972 was £5,296 million: after allowing for amounts withdrawn and for interest credited to accounts, there was a net inflow of £2,193 million.

26 *Instalment credit finance houses* specialise in the provision of hire-purchase and other instalment credit for the purchase of consumer durables and for the finance of industrial equipment. As distinct from bank lending, the finance is usually provided for a specific purpose, and the majority of loans are repaid by monthly instalments. About 70% of the houses' assets are in the form of hire-purchase and other instalment credit (mainly for cars and commercial vehicles) but a growing amount is in the form of leasing to industrial companies. The houses' business is in principle determined by the demand for credit, but in recent years it has been restrained by official restrictions in the form of direct limits on total lending, and controls on the terms for minimum down-payments and maximum repayment periods. The direct limits on lending were replaced in September 1971, when houses with deposits over £5 million became liable, like the banks, to maintain a daily reserve assets ratio, and to calls for special deposits. (See Chapter II, Section II §1.) The houses' liabilities consist largely of short-term borrowing in its various forms. For their funds, they rely mostly on deposits, usually from commercial companies or non-clearing banks, but also partly from other financial institutions, persons and overseas residents; a substantial amount also comes from bill finance. Their assets at the end of 1972 amounted to £1,216 million.

27 *Investment trust companies* are limited companies engaged in the investment of capital subscribed by shareholders or borrowed on fixed interest terms. They obtain further resources from profits made on sales of securities, and from retained income. These funds are invested almost entirely in ordinary shares (over a third in overseas shares) with a small amount in short-term assets to meet any immediate requirements. Their assets fell from £4,900 million (at market value) at end-1969 to £4,470 million at end-1970 but increased to £5,750 million at end-1971 and £7,457 million at end-1972. During 1970 they sold nearly £10 million (net) of investments, reflecting the depressed state of the equity market at that time, but invested £105 million in 1971 and £550 million in 1972.

28 *Unit trusts* are set up under trust deeds, the trustee usually being a bank or an insurance company. Members of the public can become beneficiaries under the trust by acquiring units representing a share in the trust's assets, although the trusts are not normally quoted on the Stock Exchange. The trusts are administered not by the trustees but by independent managing companies. Units can be bought by the public from the managers or resold to them at any time, so that the trust grows or diminishes in size according to public demand. A good many new trusts have been created over the last few years when equity markets have risen, and total outstanding assets have expanded to more than seven times their size in 1963. At the end of 1971 the total invested, mainly in the form of UK ordinary shares, amounted to £1,950 million at market value, and it rose to £2,550 million at end-1972. Net sales of units in 1970 amounted to under £100 million (about £90 million less than in 1969) and to under £80 million in 1971, but rose to £240 million in 1972.

29 The ordinary departments of the *trustee savings banks*, are considered to be within the public sector, because they invest their funds entirely in government debt; the special investment departments, however, are treated as non-bank financial institutions. The latter receive deposits up to a maximum of £10,000 per person and pay interest which varies from bank to bank but is currently a maximum of 9%. Net investment in 1971 was £203 million, and rose to £241 million in 1972. The funds of the special investment departments are invested by trustees, subject to the Trustee Savings Bank Act 1969 and to instructions issued by the National Debt Commissioners. This results, at present, in the banks holding at least 20% of their funds in liquid assets, and most of the remainder in local authority securities and government stocks. At the end of 1971 the assets of the special investment departments totalled just over £1,665 million at market value, and at end-1972 £1,830 million.

30 As with the trustee savings banks, the ordinary accounts of the *National Savings Bank,* which operates through most branches of the Post Office, are considered as being within the public sector. In 1966, however, an investment account was established in which up to £10,000 per person can be deposited at a fixed rate (currently 9%). Net investment was some £70 million in 1971 and nearly £120 million in 1972. These funds are invested by the National Debt Commissioners in government and local authority debt. Assets totalled almost £400 million at market value at end-1971 and nearly £480 million at end-1972.

31 The rôle of the *special finance agencies* is to provide capital where there are difficulties in raising funds from more traditional sources. Although a number of institutions could be classified under this heading, statistics are collected from only four of them – the Agricultural Mortgage Corporation, the Commonwealth Development Finance Company, Finance for Industry Limited, and the Exporters Refinance Corporation. The first two of these agencies were set up under official auspices, but their capital (and that of Finance for Industry Limited) has been subscribed variously by the London and Scottish clearing banks, the Bank of England, and other financial, commercial and industrial institutions; some of them have since supplemented their resources by public issues of debentures. They rely on the banking sector for short-term finance. The AMC supplies finance for farmers, the CDFC for overseas private sector developments, while FFI, which was only recently (November 1973) created with the merger of the Finance Corporation for Industry and the Industrial and Commercial Finance Corporation, will be concentrating on the provision of finance for industries of all sizes. The ERC was created to supply a wide range of export finance. The individual agencies have expanded at different rates and at the end of 1971 their assets totalled about £600 million.

32 In aggregate the banks, discount houses and other financial institutions account for about half of the total outstanding government securities held by the public; the banks and, to a much lesser extent, discount houses also hold much the greater part of all the Treasury bills in the hands of domestic holders.

33 The non-bank financial institutions as a whole (and the insurance companies and pension funds in particular) are very large holders of longer-term government stocks. The building societies also hold substantial amounts of shorter-dated government stocks.

34 In terms of turnover in British government stocks on the Stock Exchange, the financial institutions are even more influential. They are responsible for nearly three quarters of the total turnover by the public in short-dated government stocks, and the discount houses alone account for half. In the market for longer-dated stocks the non-bank financial institutions are responsible for nearly half of the total. Dealings by the institutions therefore help to maintain a large and active market in government debt. The existence of such large-scale investors in the market, and their expectations of future price movements, are an important consideration in debt management.

35 Among the financial intermediaries other than the banks, only finance houses whose eligible liabilities stand at £5 million or more, are subject to reserve ratio requirements comparable with those observed by the banks. However, associations representing some of the other principal financial institutions (insurance companies, pension funds and building societies) have on occasions been informed of major changes in credit policy, so that they can bear official objectives in mind.

### II Banking system and capital market

Banks as issuing houses

36 As banker to the Government, the Bank of England are the Government's agent for the issue of new loans. The Bank also act as the issuing house for a number of bodies, particularly local authorities and Commonwealth governments. Other issues of securities both by public bodies and by industrial and commercial companies are handled by commercial banks (particularly the accepting houses), brokers, and other financial companies. About half are handled by commercial banks and half by brokers and other financial companies. All of the banks (other than the Bank of England) engaged in this type of business and many of the financial companies are members of the Issuing Houses Association. One of its purposes is to express the views of its members to the Government, the Bank of England and the Stock Exchange on matters affecting their activities. It has no power to govern the manner in which the issuing houses carry on their business. The issuing house, before carrying out an issue, will satisfy itself that the company raising the capital is creditworthy, and one with which it would allow its name to be associated. It will then advise which method of raising finance should be adopted.

Description of UK capital markets

37 For descriptive purposes it is convenient to regard the UK capital market (i.e. in negotiable securities) as consisting of four separate markets:

(a) The gilt-edged (government or government guaranteed stocks) market.

(b) The private sector fixed interest market.

(c) The private sector share (equity) market.

(d) The new issues market.

As will be seen when these markets are discussed in detail, there are distinct differences in the way business is conducted when transactions take place in these four categories of security, and they are important in determining the attitude of investors to particular forms of investment. It should be stressed, however, that these individual markets are, in fact, only parts of one capital market, centred on the Stock Exchange,[1] and that investors frequently transact business in more than one type of market at a time. For instance, an investor may decide to sell government stocks and invest the proceeds in equities, and this can be done by means of a single order to one broker. It may also be helpful before describing the markets in detail to mention two important features which they all have in common.

38 First, in the United Kingdom virtually all sterling securities, private sector as well as public sector, are in registered form, i.e. the final evidence of ownership consists of an entry in the books of a registrar rather than the possession of a bearer document, though the book entry is supported by the issue to the owner of a non-transferable certificate naming him as the holder of the stock or shares in question. Transfer of ownership is effected by the completion and delivery to the registrar of a transfer form (which, in accordance with the terms of the Stock Transfer Act 1963, needs to be signed only by the seller of the security), together with the relative stock or share certificate. In the case of certain British government stocks, the holder has the option to convert his security into bearer form, but little use has been made of this facility. (It is, however, possible to purchase, through the Stock Exchange, bearer securities denominated in currencies other than sterling.)

39 Second, as already mentioned, the activities of financial institutions are particularly important. Because these institutions keep their portfolios of securities under active review, the markets are in most cases characterised by a high turnover.

40 The separate categories of capital market are now considered in turn:

(a) The gilt-edged market

The gilt-edged market is confined to fixed interest securities issued by the central government (British government securities), by other public sector bodies (nationalised industries and local authorities),[2] by Commonwealth governments or public sector bodies, and by certain international organisations such as the International Bank for Reconstruction and Development.

Most of these issues are exempt from UK stamp duty (transactions tax) but, where this is not the case (e.g. Commonwealth issues), the borrowing body generally arranges with the Inland Revenue for the duty to be compounded (i.e. a payment, normally half-yearly, by the borrower discharges all liability). Settlement for transactions in this market is for 'cash', i.e. on the next business day after the sale has been arranged. Interest on most of the stocks is free of income tax when held by persons not resident in the United Kingdom. British government and nationalised industries' government-guaranteed securities, but not the other securities in this market, are exempt from capital gains tax, unless sold within one year of acquisition.

Switching by financial institutions is a significant feature of the market. Because of the speed with which settlement can take place, and the breadth and flexibility of the market, many types of financial institution are able to regard their holdings of gilt-edged stocks as liquid or semi-liquid assets, particularly during periods when interest rates are falling.

(b) The private sector fixed interest stock (debenture) market

In contrast with other European centres, this market is less important than the equity market. Historically, companies have preferred to finance themselves out of retained

[1] On 25th March 1973, the London stock exchange, the regional stock exchanges in the United Kingdom and the Dublin and Cork stock exchanges in the Republic of Ireland were unified and became administrative units of the Stock Exchange.

[2] Nationalised industries no longer borrow on the UK long-term capital markets, but issues remain outstanding from earlier periods. Nationalised industries' borrowing, but not local authorities', is guaranteed as to principal and interest by the central government.

profits, by further issues of share capital or by short-term borrowing from the banking system, rather than by the issue of debentures or other long-term fixed interest debt. Furthermore, in recent years the issue of ordinary debenture stock has tended to lose favour compared with stock giving an option at some future date or dates to convert into equity – in the main this reflects a wish on the part of investors to protect themselves against inflation. Debentures tend, very largely, to be taken up by insurance companies and pension funds, and are normally issued with a life of between twenty and twenty-five years to meet the requirements of these institutions. In comparison with the gilt-edged market, turnover is small, as investors tend to hold their acquisitions until maturity.

Unlike the gilt-edged market, stamp duty is payable on transactions. Settlement takes place on a settlement day eleven days after the end of the account period (usually a fortnight) during which the deal is done.

(c) The private sector share market (equity market)

This market is principally one in ordinary shares, i.e. in shares giving the entitlement to full participation in profits and to full voting rights. Preference shares (which confer a preferential right to participate in profits but only to a defined limit) and non-voting shares have not been popular with investors in recent years. Shares are generally issued fully paid. The Stock Exchange are, in fact, not normally prepared to admit to listing (i.e. accept for quotation) securities which remain partly paid subsequent to registration.

Settlement for transactions in shares is as for debentures.

(d) The new issue market

Issues in the United Kingdom are made by one of four methods:

(i) *Public issues* (direct by the borrower) or *offers for sale* (by an issuing house or broker who has bought the securities en bloc from the borrower), which may be applied for by any member of the public. Normally the securities are offered at a fixed price, but occasionally the offer is in the form of an invitation to tender, incorporating a minimum price. In such cases all successful applicants are equally allocated their stock or shares at the price of the lowest successful tender. All issues in the gilt-edged market are made by means of public issues, as are many issues by large or well-known companies.

(ii) *Placings*, by which most or all of the stock or shares will be made available to specific investors, mainly financial institutions. This method of issue is often adopted for issues of company debentures and for issues of shares for which there is unlikely to be significant public demand e.g. in specialised investment trusts.

(iii) *Rights issues*, whereby the right to subscribe for additional shares, or, less often, stock, is given to existing shareholders, who may either take up the security themselves or, because the issue price is usually set below the market price for existing shares, sell that right to other investors. This is the most common way in which companies raise new equity capital.

(iv) *Vendor consideration*, whereby shares or stock are issued in exchange for shares in another company which is being taken over or with which a merger has been arranged.

Allotment letters

41 Whichever the method of issue adopted, it is customary for the initial document of title to be a bearer instrument, or an instrument capable of becoming bearer by renunciation, known as an allotment letter. These documents are issued with a life of less than six months, and are thus exempt from the normal exchange control provisions applying to bearer documents, so that they may pass freely from hand to hand. Transactions in allotment letters are free from stamp duty and, as in all transactions in the gilt-edged market, take place for cash settlement. At the end of the life of the allotment letter, the letter must be lodged with the registrar by the then holder in exchange for a registered stock or share certificate. If the holder fails to do this, the certificate will generally be issued in the name of the original subscriber. However, some registrars (including the Bank of England) require the allotment letter to be surrendered before any name is recorded in the register or certificate is issued. Allotment letters do not contain any provision for the payment of interest or dividends, the first payment being made after the security has been converted into registered form.

Underwriting

42 A feature of the UK new issues market is that, except in the case of British government securities, nearly all public offers and placings and most rights issues are underwritten before the issue is made, i.e. if subscriptions from the public are insufficient to cover the issue, the underwriters will automatically take up the balance. (The practice in

other European centres of appointing selling syndicates to sell the stock or shares to the public is rarely seen in the United Kingdom.)

43 The practice differs, however, in the case of issues of British government stock. Subscriptions to these from the public seldom account for more than a small proportion of the total amount of stock on offer, and the balance is taken up by official portfolios for subsequent sale to the public 'on tap'. Generally, the funds used for this subscription come from the Bank of England Issue Department, representing assets backing the note issue. To subscribe for the stock, the Issue Department calls for the repayment of short-term loans to the Government so that the central government's financing requirement is not on balance affected.

Stags

44 Turnover in a new issue is often very high while it is in allotment letter form. The fact that settlement for transactions in allotment letters takes place for cash makes it possible for applicants for new issues to sell their allotments, if they so wish, with the minimum of delay. This is essential to the function of the 'stag' – a person (or company) who applies for an allotment with the hope of selling quickly at a profit to more permanent holders – for his capital resources are often strictly limited. The stag's activities are also assisted, in the case of the issue of fixed interest stocks, by the common practice of requiring only a proportion of the issue price to be paid on application, the balance being paid in the ensuing months while the issue remains in allotment letter form.

45 The activities of the stags may cause embarrassment to those managing an issue which is widely expected to move quickly to a large premium over the issue price (for instance in a period when interest rates are falling rapidly), because the issuers will have to handle a very large number of applications. Nevertheless, the market regards the stags' activities as beneficial. They help the market price to reach its equilibrium rapidly, and they also assist in channelling the issue efficiently into the hands of more permanent investors – those who have not applied initially for stock or shares and those who, having applied, have not received as large an allotment as they would have wished.

Regulation of the markets

46 Regulatory control of the markets is exercised principally by the Department of Trade and Industry, the Stock Exchange, the Bank of England, and the Panel on Take-overs and Mergers.

(a) *The Department of Trade and Industry*'s responsibilities derive from the Companies Acts of 1948 and 1967 and the Prevention of Fraud (Investments) Act 1958. The Companies Act sets out requirements regarding the information which must be provided to investors when stock or shares are offered for sale; and the Prevention of Fraud Act provides for the licensing of dealers in securities, and for control over the institutions or persons which may offer securities on behalf of others to the investing public.

(b) The rules and regulations of the *Stock Exchange* set out in detail the terms upon which a borrowing body may seek admission to the Official List (a listing) for its stock and/or shares, including the information which must be incorporated in the prospectus for the issue, and the form and nature of information which must be provided regularly thereafter (notices of meetings, dividend and profit announcements, etc.).[1]

It is a normal requirement of the Stock Exchange, before admitting a security to listing that the expected initial market value of a company's listed capital shall not be less than £500,000, and that at least 35% of the equity capital must be held by the public. Listing may normally only be sought in respect of securities which themselves have a minimum market value of £200,000. The Stock Exchange has the power to suspend the listing of individual securities, for example to prevent wild fluctuations in price caused by the absence of information about a company's position.

(c) The *Bank of England* have specific powers, delegated to them by the Treasury, in relation to the capital markets under the Borrowing (Control and Guarantees) Act 1946, and they also act as agent of the Treasury in the administration of the Exchange Control Act 1947. The Bank also regard themselves as having a general responsibility for the proper conduct of business in the markets, and to this end they maintain close links with the institutions operating in them.

The *Borrowing (Control and Guarantees) Act 1946* gives wide-ranging powers to the Treasury to control the borrowing of money or issue of shares within Great Britain (a similar act applies to Northern Ireland), but a series of general consents have been issued, leaving only three significant areas where specific consent is still required. These are:

[1] See the Stock Exchange publication *Admission of Securities to Listing*, which gives extensive notes for guidance.

(i) the issue of any sterling securities where the amount of cash to be raised is £3 million or more. The timing of these issues has to be approved by the Bank of England on behalf of the Treasury;

(ii) the issue of securities by, or guaranteed by, the central government, by UK local authorities or nationalised industries, by any Commonwealth government or local authority, or by the IBRD, the EIB and the ECSC; and

(iii) the borrowing or raising of money in Great Britain by or on behalf of persons resident outside the United Kingdom other than by the issue of non-sterling securities.

The Bank's control over the *timing* of issues is administered with the aim of maintaining an orderly flow of new issues to the market. The control is quantitative, not qualitative. Separate 'queues' are marshalled for borrowers in the gilt-edged market (other than the central government, whose issues do not normally conflict with those of other borrowers) and for private sector borrowers. The timing of an issue is usually fixed some weeks, or even months, in advance of the date of borrowing, on the understanding that the borrower will be permitted to withdraw if there should meanwhile be a substantial deterioration in market conditions. The Bank's control over the *terms* upon which certain issues, essentially those in the gilt-edged market, are made is used principally to ensure that the cost of borrowing by public sector bodies other than the central government is consistent with their status, and that the means by which they borrow does not in any way impair the ability of the central government itself to borrow in the market on the best terms.

As already mentioned the Bank of England also administer the *Exchange Control Act 1947*, as agent for the Treasury; they have in turn delegated certain authorities to authorised banks in the United Kingdom. Non-residents of the United Kingdom are permitted to invest in sterling securities. Provided that the securities were purchased with freely convertible funds (the proceeds of sale of foreign currencies, or funds held on a non-resident sterling account in the United Kingdom), the proceeds of sale or maturity may be freely remitted abroad. Restrictions are, however, placed on access to the London capital markets by non-residents and non-resident-controlled UK companies; but those UK companies undertaking new expenditure for operations in the assisted areas and those controlled by residents of other EEC countries or by residents of the overseas sterling area are normally permitted to raise finance in the United Kingdom for the purposes of their operations there without limit. Restrictions are also placed on the purchase of foreign currency securities by UK residents. Such securities, together with all bearer securities having a maximum life of more than six months, must be deposited with authorised depositaries (most banks, stockbrokers and solicitors) who are responsible for seeing that exchange control regulations are observed when the securities are dealt in.

47 The Bank of England also operate certain conventions relating to mergers and participations in banking. On 16th November 1972 the Bank announced some changes in their rules to take effect from 1st January 1973. There would no longer be objections to clearing banks taking participations of more than 25% in accepting houses, or to EEC banks (like British banks) taking participations of over 15% in accepting houses, other UK merchant banks and British overseas banks. The Bank's consent is conditional in each case on amicable agreement between the parties concerned, and on the satisfaction of tests relating to capital, management, reputation and future intentions.

(d) *The Panel on Take-overs and Mergers* supervises the operation of a voluntary code of practice for take-over procedures, and gives authoritative rulings on its interpretation. All parties to such take-over transactions, especially the City institutions which arrange them, are expected to conform with the code. The code has no legal backing, but since the Panel works in close co-operation with the Quotations Department of the Stock Exchange, it can impose sanctions by asking for the suspension of a quotation on the Stock Exchange; it can also ask the Department of Trade and Industry to withdraw the licence to deal in securities of an offending party. The Panel's members are representatives nominated by the Bank of England, by the other main City institutions and by the Confederation of British Industry; it is assisted by a small executive of permanent officials.

**Banks invest little of own funds**

48 Banks are substantial investors in British government and local authority securities, but they do not participate with their own funds to any great extent in other capital markets, and they hold only a relatively small amount of company securities. At end-June 1973 the banks and discount houses together held sterling securities (excluding money

market paper) amounting to over £4,000 million, which comprised nearly £2,400 million of British government stocks, £900 million of local authority securities, £700 million of trade investments (in the United Kingdom and overseas), £50 million of overseas government securities and £300 million of other securities. Their holdings of foreign currency securities amounted to something over £300 million.

Savings banks' security holdings

49 As was explained in the previous section, the National Savings Bank and the trustee savings banks each manage two departments whose funds are governed by different investment powers. The funds of the 'ordinary' departments of the trustee savings banks and the 'ordinary accounts' of the National Savings Bank are invested, apart from some working balances placed on deposit with the clearing banks, entirely in British government and government-guaranteed securities. The funds of the Investment Account of the National Savings Bank are placed mainly in British government but also in local authority debt. The 'special investment departments' of the trustee savings banks are allowed to manage their own investment, but this must be done by the trustees in accordance with the Trustee Savings Bank Act 1969 and instructions issued by the National Debt Commissioners. Under the current rules, these funds are invested almost entirely in British government and local authority securities. None of the departments of the savings banks are allowed, under the present regulations, to invest in equities.

Stabilisation of capital market

50 Official intervention in the UK capital market is restricted to the gilt-edged market: it is carried out by the Bank of England. Before May 1971 official policy was to intervene in the market mainly to avoid sharp fluctuations in prices (and thus in interest rates), and thereby to maximise, as it was thought, the long-run demand for government stocks. Subsequently, in placing more reliance on changes in interest rates to control credit and the money supply, the Bank of England's operations in the gilt-edged market have been more selective. The Bank remain prepared to sell stock and to undertake, at prices of their own choosing, exchanges of stock with the market by selling long-dated securities against the purchase of shorter-dated securities.[1] They are no longer prepared to provide outright support for the market in stocks having a maturity of over one year, although they reserve the right to do so at prices of their own choosing. Thus the Bank will not normally facilitate movements out of government stock by the banks or by other holders, even if such sales cause the market to weaken sharply.

51 Although the commercial banks do not hold many company securities, their activities may from time to time affect the state of the stock market – for example, their sales of large quantities of government stock contributed to the weakness of the gilt-edged market in June 1972; and their introduction of large issues to the market in their capacity as issuing houses may affect company security prices.

52 The impact of monetary measures on UK long-term capital markets is mainly indirect, working through interest rates and investors' expectations. For example, pressure on banks' reserve assets may cause them to sell gilt-edged stock and, if bank borrowing becomes difficult, may cause other holders of stock to sell to provide funds. Selling may also be generated if interest rates are expected to rise, and prices to fall. Demand for stock is likely to recover when interest rates are thought to have reached a peak. At such a time, especially if the prospect for company profits is poor, it would be possible for ordinary share prices to be falling, or to remain depressed, while the demand for government stock was recovering. But if there is a prospect of economic expansion, the expectation of increased company profits would tend to shift some of the demand for securities from fixed interest stock to equities.

53 It is also possible, of course, for developments in the long-term capital markets to affect short-term money rates. Thus an increase in demand for long-term securities, whether stock or ordinary shares, is likely to raise short-term interest rates as investors seek to finance their purchases by borrowing or selling short-term assets. If the increased demand is specifically for government stock, it will also tend to reduce the stock of money as investors make payment to the authorities for their purchases. This will put pressure on the banks' reserve ratios and so lead, other things being equal, to an increase in money market rates.

### III The public's habits with regard to investment and liquidity

54 'The public' is here defined as the non-financial private sector, and is divided, for convenience, between the personal sector (households, unincorporated businesses and

[1] For further elaboration, see Chapter II, Section III §I, II.

private non-profit-making bodies) and the company sector (industrial and commercial companies, including property companies). Illustrative figures are given in Table 15.

55 At the end of 1966 – the latest date for which complete figures of holdings are available – some 30% of the personal sector's financial assets were at short term; just over 30% in marketable securities; another 30% in life assurance and pension funds; and the remaining 10% in other long-term assets. Companies, on the other hand, held a much bigger proportion – 60% – in short-term assets; around 35% in securities; and 5% in other long-term assets (companies' direct investment abroad, although usually regarded as a financial asset, is omitted from these figures because it is primarily an alternative to fixed assets, rather than to financial assets).

56 Since 1966 the personal sector has continued, as it did in earlier years, to sell most forms of marketable securities and to invest more in short-term assets and in life assurance and pension funds. Large and persistent sales by persons of ordinary shares of individual companies, some of which have been to other companies during the course of take-overs, have to some extent been offset by purchases of investment trust shares and unit trust units; and holdings of company shares have risen in value because of increases in share prices. Persons have been indirectly investing in security markets through their contributions to life assurance and pension funds. Among short-term assets, deposits with banks and building societies have attracted most funds.

57 Companies have continued to invest most of their funds at short term in recent years, but the amounts invested have fluctuated considerably, as has the pattern of investment in the various types of short-term assets. Bank deposits are by far the most popular place for companies' liquid funds, with certificates of deposit recently growing in importance.

## IV Importance of financial transactions with foreign countries

External trade and GNP

58 External transactions are an important part of the United Kingdom's gross national product. The share of exports of goods and services in GNP fell slightly in most years between 1960 and 1967. Then, following the devaluation of sterling in November 1967, it rose sharply in 1968 and continued to rise until 1971, when the growth levelled off. These trends are illustrated in Table 16.

The official reserves

59 In the United Kingdom the official reserves of gold, foreign exchange, Special Drawing Rights and reserve position in the International Monetary Fund are held in the Exchange Equalisation Account. This account is operated by the Bank of England on behalf of the Treasury, and is treated for statistical purposes as a part of the central government sector. The funds of the account also include sterling, which is lent to the Government either against Treasury bills or in the form of ways and means advances. To pay for its purchases of foreign exchange, the EEA withdraws sterling from the Government, so increasing the Government's need to borrow from other sources. Conversely, when the EEA sells foreign exchange, it acquires sterling which it lends to the Government, so reducing the latter's need to borrow from elsewhere.

60 When the reserves have been falling, the Government has sometimes supplemented them by borrowing from overseas central banks or from the IMF. Such borrowings do not provide the Government with sterling finance when they are sold to the EEA, because the Government must itself provide the sterling with which the EEA pays for them. At other times the Government has placed foreign exchange temporarily with overseas institutions. These operations too do not affect the amount of sterling finance available to the Government.

61 Changes in the reserves and in short-term borrowing/lending of the kinds just described are together described as official financing. Together with allocations of SDRs, they finance the total currency flow, which is the outcome of all current transactions in the UK balance of payments and the balance of investment and other capital flows.

62 The effect of the EEA mechanism just described is that a deficit on the current account of the balance of payments will normally provide the Government with sterling, and so reduce its need to borrow in domestic markets; and an outflow of capital overseas (other than funds previously invested in government debt) will have a similar result. These outflows are likely to reduce the amount of short-term government debt placed with the banks and so have a contractionary effect (see paragraph 81). Conversely a balance of payments surplus or an inflow of overseas capital into the private sector is likely, other things being equal, to have an expansionary effect.

Liberalisation of capital movements

63 The Exchange Control Act 1947 distinguishes throughout between the Scheduled Territories (i.e. those listed in the first schedule to the act) and the rest of the world. In general, no restrictions are imposed by the United Kingdom on transactions between UK residents and residents of other Scheduled Territories; but restrictions are applied to transactions between UK residents and residents of countries outside the Scheduled Territories (commonly referred to as non-residents). Until recently, sterling area countries were all Scheduled Territories. But when sterling was floated on 23rd June 1972, the Scheduled Territories were reduced to the United Kingdom (including the Isle of Man and the Channel Islands) and the Republic of Ireland; and all other overseas sterling area countries were brought within the compass of formal exchange control for the first time (Gibraltar, however, became a Scheduled Territory again on 1st January 1973). For exchange control purposes, the countries comprising the rest of the world are further divided as follows,[1] with differing degrees of liberalisation applying in each case:

(a) the member states of the EEC;

(b) the overseas sterling area; and

(c) the rest of the non-Scheduled Territories.

64 The exchange control rules applied to each of the areas mentioned above are summarised in the following paragraphs:

(a) EEC

The restrictions described below are at present applied to transactions liberalised by lists A and B of the capital movements directives and will fall to be removed during a transitional period extending to the end of 1977.

(i) *Direct investment*

UK residents are allowed to finance direct investments through the official market (i.e. with foreign currency purchased at the market rate for current transactions) up to a limit of £1 million per project per annum. Any balance may be financed by foreign currency borrowing, exports free of payment, approved profit retentions, or investment currency (although the last is little used for this purpose).[2]

(ii) *Personal capital movements*

Gifts by residents to non-residents (other than gifts to residents of countries in the overseas sterling area – see below) are normally limited to £300 per donor per annum. Wedding gifts by parents may normally be made up to an amount of £3,600 per annum. Transfers of emigrants' capital through the official market are normally restricted to £5,000 per family until four years after departure. The purchase by UK residents of property for personal use outside the Scheduled Territories is limited to one property per family: foreign exchange used to acquire such a property must be purchased in the investment currency market. (Concessions in the rules relating to emigrants' assets and the purchase of property are allowed where necessary to ensure the freedom of a UK resident to take up employment in the EEC.)

(iii) *Transactions in securities*

UK residents may purchase foreign currency securities for portfolio investment only with investment currency or with borrowed foreign currency. If a UK resident sells a foreign currency security (other than an OSA security – see below) previously purchased with investment currency, only 75% of the proceeds may be sold as investment currency; the remainder has to be sold in the official market.

(b) Overseas sterling area (OSA)

Controls applied to capital transactions with the OSA also differ from those at present applied in the case of the EEC, again principally in respect of direct investment, where there is no limit to the amount of foreign currency that may be purchased in the official market. In addition, the amount which may be transferred by emigrants from the United Kingdom to the OSA on departure is £20,000 instead of £5,000; UK residents may make gifts of up to £1,000 per annum to residents of OSA countries; UK banks may finance OSA trade without limit; and the whole foreign currency proceeds of sales by UK

[1] As a consequence of the policy of economic and financial sanctions against Rhodesia, transactions with that country have since 1965 also been subject to separate and severe restrictions.

[2] Investment currency is foreign currency, originating mainly from the sale or redemption of foreign currency securities beneficially owned by residents of Scheduled Territories, which such residents may, with permission, use to purchase foreign currency securities and for certain other purposes, including direct investment and the purchase of property outside those territories. It normally changes hands at a premium, which accrues to the seller.

residents of OSA foreign currency securities (i.e. securities payable only in OSA currencies or only in OSA currencies and sterling) may normally be sold as investment currency.

(c) Rest of the non-Scheduled Territories (RNST)

Controls applied to capital transactions with this group of countries also differ from those at present applied to such transactions with other EEC members, again principally in respect of direct investment. Foreign exchange is not made available through the official market to UK residents for direct investment in RNST countries, unless the project promises a quick and commensurate benefit to the balance of payments, and continuing benefits thereafter. In such cases foreign exchange may be purchased up to £250,000 or half the cost of the investment, whichever is the greater. Any balance, or any investment which does not meet the criterion, may be financed by foreign currency borrowing etc. as indicated in (a) (i) above. Direct investment in the United Kingdom by residents of the RNST is required to be financed from external sources unless the project represents new investment in an assisted area. UK residents intending to take up employment in the RNST do not benefit from the exchange control concession available to those who wish to take advantage of the freedom of movement for workers in the EEC.

65 Restrictions on short-term international capital flows are discussed in Chapter II, Section III §II. Table 13 gives figures of the United Kingdom's main short-term external liabilities.

## Section II: Liquidity

The concept of liquidity

66 It is not possible to provide a general or precise definition of liquidity which will apply to all sectors of the economy, for the liquidity of any one sector can only be assessed in relation to its particular balance-sheet structure and financial commitments, and these vary markedly between different sectors. Furthermore in the United Kingdom a large range of assets of differing maturities and marketability is available, so that the definition of liquid assets varies for each sector.

67 A distinction may, however, be usefully drawn between the liquidity of banks and other financial intermediaries and the liquidity of the remainder of the private sector, i.e. non-financial companies and persons. The measurement of liquidity can, perhaps, be undertaken rather more easily for the various groups of financial intermediaries in relation to their balance-sheet positions; and experience, sometimes reinforced by regulation, has in several cases led to the establishment of liquidity or reserve ratios as a key statistic for analytical interpretation of the condition of certain groups. This is the case with the banking system, as is discussed below, but also holds true more widely for some other types of intermediary e.g. building societies.

68 In contrast, there is no specific definition of what constitutes liquid assets, or what might be key liquidity ratios, in the case of companies or persons. The Central Statistical Office publishes two tables showing selected liquid assets of industrial and commercial companies and of persons, together with bank advances to them,[1] but the selection is admitted to be arbitrary. Although a flow of funds analysis helps to draw attention to changes throughout the whole asset/liability portfolios of these two sectors, there is a tendency to pay particular regard to changes in their estimated money holdings as an indication of their liquidity. More generally, the rate of growth of the money stock in total is regarded as a useful indicator of the development of liquidity conditions in the economy.

**Para**

### I The liquidity of the economy

Money stock

69 There are now two main definitions of the money stock:[2] the first is a narrow definition ($M_1$) consisting of notes and coin in circulation with the public plus sterling current accounts held by the private sector only; the second is a broad definition ($M_3$) which includes all deposits, whether on deposit or current account, or certificates of deposit, and whether denominated in sterling or non-sterling currencies, held with the UK banking sector by UK residents (in the public and private sectors), together with notes and coin in circulation with the public. Annual figures of both versions are given in Table 1.

[1] *Financial Statistics* (HMSO), see Tables 82 and 88 (as numbered in the June 1973 issue).

[2] A full account of these definitions is available in recent articles in the Bank of England *Quarterly Bulletin*: 'The stock of money', September 1970, 'Changes in banking statistics', March 1972, and 'New money stock tables', December 1972.

**Analysis of money supply changes**

70 Changes in $M_3$ can be analysed in terms of the accompanying changes in the balance sheet of the banking system.[1] In these analyses the most important sources of changes in bank sterling assets are lending to the private sector and to the public sector. The latter results from the need to finance the public sector's deficit, where it is not financed from sales of debt to the non-bank private sector or by borrowing from abroad (or reductions in claims on foreigners e.g. official reserves). Increases in the sterling assets of the banking system will be matched by an equivalent increase in deposit liabilities and thus in the money stock, except to the extent that they are matched by an increase in other liabilities (e.g. bank capital and reserves) or by a net flow into the banks of non-resident sterling deposits, which are not included in $M_3$. Table 2 shows the relative importance of these influences in recent periods (the version published in the Bank of England *Quarterly Bulletin* gives quarterly figures, and monthly figures are also available).

71 It may perhaps prove to be the case that the trend in $M_1$ will be a better indicator of financial developments than $M_3$, e.g. because the trend may be less affected by structural changes in the competitiveness of time deposits with banks, as against deposits with other financial intermediaries. For the time being, however, the monthly series for $M_1$ has been available over too short a period to be of use as a major indicator. It also has the drawback that analysis by reference to the counterpart changes in the banking system's balance sheet has less meaning than for $M_3$ (which represents the greater part of the system's liabilities).

**Velocity of circulation**

72 Table 3 shows variations in the velocity of circulation for $M_1$ and $M_3$. It is however more revealing to look at demand for money functions that relate movements in the money stock to changes in real incomes, prices, and interest rates, all with various lag profiles.[2] But for various reasons attempts to find consistent UK relationships of this kind have so far met with only very limited success, and the optimum level or rate of growth of the money stock remains very much a matter for judgment, depending on the particular circumstances and taking account of the whole range of financial indicators.[3]

**Primary and secondary liquidity**

73 Preliminary figures have recently been compiled for the harmonised definitions of primary and secondary liquidity agreed by a working group of statisticians from the various EEC countries. They have not been closely studied, and it is therefore not yet possible to give any idea whether these concepts will have any relevance for the United Kingdom. Primary liquidity is not so very different from $M_1$, however, and it could therefore turn out to be useful as an indicator of financial developments. The sum of primary liquidity and secondary liquidity is a much broader concept than $M_3$: indeed it is nearer to the Central Statistical Office's selection of liquid assets mentioned in paragraph 68 above.

74 For the United Kingdom, primary liquidity comprises notes and coin, and sterling current accounts with the banking sector and at 'other credit institutions' by UK residents other than the Treasury,[4] banks, other credit institutions and local authorities,[5] i.e. by insurance companies, pension funds, industrial and commercial companies, public corporations and the personal sector. Primary liquidity differs from $M_1$ in that (i) it includes sterling current bank accounts of government departments (other than the Treasury) and public corporations, and all current accounts with ordinary departments of trustee savings banks (there are no transferable sight deposits with other UK credit institutions); and (ii) it excludes sterling current bank accounts held by 'other credit institutions'.

75 Secondary liquidity comprises a number of assets held by domestic sectors other than the Treasury, local authorities, banks and other credit institutions, and not included in the definition of primary liquidity. The specific types of assets have not yet been determined, but they will include current bank accounts in foreign currency, deposit accounts with the banking sector, time certificates of deposit, deposits other than current

[1] As shown in the Bank of England *Quarterly Bulletin*, e.g. Table 12(3) June 1973, and in *Financial Statistics*, e.g. Tables 59–62, June 1973.

[2] A recent example of such work, a study of 'The demand for money in the United Kingdom: a further investigation', by L. D. D. Price was included in the Bank of England *Quarterly Bulletin*, March 1972.

[3] See 'Does the money supply really matter?' in the *Quarterly Bulletin*, June 1973.

[4] Other credit institutions are 'other financial institutions' in the UN System of National Accounts, which excludes insurance companies and pension funds. Deposits of the National Loans Fund and the Paymaster General with the Bank of England, Banking Department are also excluded.

[5] Exceptionally, in the United Kingdom and the Netherlands, local authorities take sizable sums on deposit, and in this activity they are classed with credit institutions when measuring liquidity.

accounts with savings banks, building societies and finance houses, tax deposit accounts with the central government, Treasury bills, local authority temporary money, and national savings in the form of certificates and bonds and under the Save As You Earn scheme.

Para

## II Bank liquidity

Definition of bank liquidity

76 In the United Kingdom there is no generally accepted definition of bank liquidity. Up to 15th September 1971, the London clearing banks observed a minimum liquidity ratio which at that date was 28%, and, within that figure, a cash ratio of 8%. These ratios originated as a matter of prudence for the banks in agreement amongst themselves, but were later formalised by agreement with the Bank of England as a lever for the operation of credit control. For purposes of the ratios, cash was defined as coin and bank notes in tills, and balances with the Bank of England; and other liquid assets as money at call and short notice, UK Treasury bills, other bills, and some special refinanceable credits. The Scottish clearing banks observed a somewhat similar liquidity ratio, though for them liquid assets included balances with, and cheques in course of collection on, other banks in the United Kingdom: as these were predominantly with London clearing banks (with whom, rather than with the Bank of England, the Scottish banks maintain balances for the settlement of clearings), they represented liquidity for the Scottish clearing banks individually and collectively, but not for the banking system as a whole. These conventional ratios were abolished on 16th September 1971, from which date all banks in the United Kingdom agreed to hold day by day a minimum of 12½% of their eligible liabilities (defined broadly as their sterling resources) in certain specified reserve assets (see Chapter II, Section II). (For prudential purposes the Bank of England still expect banks to maintain certain other ratios: see Chapter II, Section II §11.)

Measurement

77 Reserve assets include balances with the Bank of England (excluding special deposits) and certain other assets which the Bank may be prepared, directly or indirectly, to turn into cash as part of their open-market operations – mainly UK Treasury bills, British government stocks with one year or less to maturity, certain categories of call money with the London money market, and commercial bills (up to a maximum limit of 2% of eligible liabilities) and local authority bills: both kinds of bills must be eligible for rediscount at the Bank of England.

78 The banks employ substantial funds in other forms of short-term investment besides reserve assets. These other assets, which form an important part of the banks' liquidity, include domestic currency in tills, call money with the London money market which is either not secured or not immediately callable, deposits with local authorities, commercial bills eligible for rediscount at the Bank of England in excess of 2% of eligible liabilities, and commercial bills ineligible for rediscount at the Bank of England. The banks also hold British government securities of more than one year to maturity; a proportion can usually be expected to qualify in a few months as a reserve asset, and the remainder seldom exceeds five years to maturity. These holdings are all readily marketable, though disposals by the banks may at times be difficult to achieve without capital loss.

79 A sizable inter-bank market in short-term funds has developed in the United Kingdom in recent years. Inter-bank loans, and holdings of certificates of deposit issued by other banks, play an important part in the liquidity of individual banks, though they clearly do not add to the liquidity of the banking system as a whole. Figures of banks' liquidity and reserve assets are provided in Table 4.

Factors affecting bank liquidity

80 In the United Kingdom, the banking sector (as defined earlier) provides such residual finance as the public sector cannot immediately borrow from other sources. This is because any excess of payments from public sector bodies over receipts, not matched by an increase in borrowing from outside the banking sector, puts cash in the hands of the banks, which either direct, or via the discount houses or the Banking Department of the Bank of England, must end up in public sector debt. These holdings of public sector debt tend to add to bank liquidity, and thus, if they are not needed to form part of the required minimum holdings of reserve assets, they will provide a base for the expansion of lending.

81 The basic influence on the liquidity of the banking sector is the residual borrowing requirement of the public sector (the central government, local authorities and public corporations). It may be reduced (increased) by an increase (decrease) in the public

sector's borrowing from abroad: this consists of changes in the sterling finance provided to the central government by changes in UK official reserve holdings (see paragraphs 59–62), changes in overseas holdings of government debt, and in any overseas borrowing by the rest of the public sector – in undertaking any of which the consequences for bank liquidity are not the primary concern. Finally, the public sector's residual borrowing requirement may be decreased (increased) by purchases (sales) of public sector debt (including, for this purpose, notes and coin) by the UK private sector other than banks.

82 The monetary authorities may influence private sector holdings of public sector debt by open-market operations. The most direct method available to the UK monetary authorities of restricting the liquidity of the banks, however, is to call for special deposits. The counterpart of special deposits is invested by the Bank of England Banking Department in public sector debt, but the special deposits themselves are not of course at the free disposal of the banks which have placed them. The monetary authorities can increase bank liquidity by releasing some or all of outstanding special deposits.

Para

## III Liquidity and public finances

### I Management of cash balances

Central government cash

83 As banker to HM Government, the Bank manage all the main accounts of the central government. Broadly, current revenue and expenditure, together with certain domestic loans and all overseas lending, pass over the Consolidated Fund account (sometimes known as the Exchequer). All government borrowing and most government domestic lending – in particular to local authorities and public corporations – is passed through the National Loans Fund account. The Paymaster General account holds the cash balances of the various government departments, and certain other funds such as the National Insurance Fund balances.

84 Unlike some other countries, the UK Government does not build up or maintain sizable cash balances. Such balances as are held with commercial banks tend to be relatively small and fairly stable, being no more than the working balances of government departments. Even the central accounts held at the Bank of England – where the daily turnover can amount to several hundreds of millions of pounds – are operated so that at the end of each day the combined balance comes to no more than about £2 million. This is normally achieved in the course of the Bank's day-to-day management of the London money market (described in more detail in Chapter II). As the Government holds all its main accounts at the Bank, any difference between government payments and receipts automatically gives rise in the first place to a change in the cash position of the commercial banks. On days when the Exchequer is faced with a prospective surplus which is not matched by a decrease in holdings of government debt or by official purchases of foreign exchange, the banks will find themselves short of cash. In these circumstances, if the Bank decide not to ease the banks' cash shortage entirely by forcing the discount market to borrow, the Issue Department will withdraw ways and means advances (i.e. overnight advances to the National Loans Fund), thus reducing the Exchequer's cash balances, and will buy Treasury bills from the market. Additionally, the Issue Department may buy Treasury bills from the Bank of England Banking Department, with the same effect on the Government's balances. Conversely, if the Exchequer faces a likely shortage of funds, the Issue Department will sell Treasury bills to the market to absorb its surplus of cash.

Other public sector cash

85 The cash balances of the local authorities and public corporations are not directly managed or controlled by the Government or the Bank of England. Balances are held mainly for working purposes, and short-term fluctuations in expenditure and revenue are most usually taken up by changes in short-term borrowing.

### II Functions of the monetary authorities, and the ways in which their activities affect the liquidity of the banks and the economy

86 The responsibilities of the Bank of England include the management of the money market and, as has been noted above, of the central government's accounts. It is the Bank's task, working with HM Treasury, to ensure that finance is available to meet each day's government spending; and to see that large surpluses do not remain unemployed, but are used each day to repurchase Treasury bills and minimise the net cost of servicing the national debt. Management of the London money market is linked to the management of the government accounts, since the net daily flow of government transactions to and from the banks is the main cause of market ease or stringency. The ways in which the

authorities can influence the liquidity of the banking sector, via the discount market, have already been mentioned.

87 The Bank also operate the Exchange Equalisation Account on behalf of HM Treasury. As explained earlier, the foreign exchange transactions of the account directly impinge on the liquidity of the banking system and can be an important factor affecting the Bank's day-to-day monetary management.

88 The Bank's success in selling government debt to the market also directly affects the liquidity of the banks and the economy – this of course being one of the main purposes of such operations.

89 The way in which the authorities seek residual finance for the Government through the money market has not been affected by the change in September 1971 from the old to the new systems of controlling the banks' ability to create credit. The banking sector provides such residual finance as the Government cannot immediately borrow from others. As explained above, the Government's residual borrowing requirement puts cash in the hands of the banks. In practice, this cash in the first instance takes the form of balances with the Banking Department of the Bank of England. It will not be retained in the form of such balances for long, because the banks naturally avoid holding larger, non-earning balances than they need. But even while it remains in this form, it is invested in government debt at one remove – since it gives rise to an increase in the Government's net indebtedness to the Banking Department. For an individual bank the choice is usually between using surplus cash to buy government debt, placing it with a discount house which in turn may invest in either public or private sector debt, or using it to lend to the private sector. But lending to the private sector – though it may reduce the surplus cash of an individual institution – will do nothing in itself to reduce the cash of the banks as a whole. The banks can only reduce this through their purchases of government debt, usually stocks or Treasury bills, or of foreign exchange from the Exchange Equalisation Account.

### III Means by which the Government raises finance

(i) Debt instruments available to the Government

British government stocks

90 Securities are issued in the form of registered stock, which may be a new stock or a further tranche of an existing issue. For issues with a life of more than five years, facilities may be made available for the subsequent exchange of registered stock into bearer form in denominations of £100, £200, £500, £1,000, £5,000, £10,000 and £50,000. Exceptionally, where an issue is a further tranche of an existing security which carries a bearer option, the option is available for the new stock, even if the remaining life is less than five years. Interest on registered stock is paid by warrant (on bearer holdings by coupon), usually half-yearly. Over the past twenty years, securities have been issued with original lives ranging from fifteen months to fifty-two years; but longer-dated stocks have been issued in the past, and certain stocks are now in existence which have no final redemption dates, the most recent of which was issued in 1947. Stocks are currently issued with a fixed redemption date, or with a band of redemption dates, the relevant option usually being exercisable by the Government. A recent departure from this practice has been the issue of a stock maturing in seven years, the holder then having an option to convert each £100 into £110 of a new stock to mature twenty years later.

91 The yield on a new security is determined by reference to a market-established pattern of yields covering the full range of government securities already in issue, from the very shortest securities (usually Treasury bills) to undated stocks. If it is desired to instigate a change in the yield pattern, this can be encouraged by issuing a new security at a more, or at a less, favourable yield than the pattern would suggest. Interest is paid in multiples of not less than ¼% per annum. The choice of coupon is a matter of judgment at the time of issue; the desired yield is then achieved through the price of issue. Issues are made for cash or, occasionally, by conversion of an existing security. In the case of cash issues, the price is usually at a small discount; prices are quoted in terms of pounds and whole pence and are payable in full at the time of issue.

92 An announcement of a new government issue is made after the market has closed for the day. A prospectus and application form are usually available on the next business day from stock exchanges and banks throughout the country; they are also advertised widely in the press. Lists of applications are opened and closed two or three business days after the advertisement, so that the normal delay between the announcement and the actual

subscriptions is three or four business days. If a conversion offer is to be made in respect of a maturing issue (which is now rarely the case), details of the offer will be sent to each registered holder of the maturing issue. Subscriptions to new issues may be made by one or more individuals or by corporate bodies; the minimum subscription accepted is for £100 nominal stock. The balance of stock which is not taken up on the day of issue by the public is subscribed for by the Issue Department of the Bank of England, which is effectively the underwriter for all government issues (see paragraph 43).

Treasury bills

93 Treasury bills maturing in ninety-one days are issued each week by tender, and bills of any maturity up to (normally) ninety-one days may be issued at any time direct to government departments and other official holders. Bills issued to the public at the tender may subsequently be bought for official portfolios, and those issued direct to official holders may subsequently be sold to the market.

Currency notes

94 Bank notes issued by the Issue Department of the Bank of England are backed mainly by government debt; and any change in the total amount of notes issued is normally matched by a similar change in the amount of government debt held. It is therefore convenient to regard holders of Bank of England notes as the real source of the lending to the Government.

Tax reserve certificates and tax deposit accounts

95 Tax reserve certificates are now no longer being issued. They provided a government security which could be bought by personal and corporate taxpayers when it was convenient to them, and held until it was surrendered to meet their tax liabilities. New tax arrangements – started in April 1973 – to collect the higher rates of income tax mostly at the time the income is received make the certificate less useful for personal taxpayers; and companies have shown a declining appetite for them in recent years. For companies, the certificates have now been replaced by tax deposit accounts with the Inland Revenue, which were introduced in April 1973. They attract interest at a rate based on the average rate of discount at the Treasury bill tender with a bonus of 2½% (not compounded) if funds are used to meet corporation tax liabilities. The minimum deposit is £5,000.

Other savings media

96 National savings, which are mainly acquired by private individuals, are offered in a variety of forms. National savings certificates can be bought in multiples of £1 with interest, payable on encashment, free of tax. British savings bonds are issued in multiples of £5: interest is assessable for income tax but, if the bonds are held to maturity, a tax-free bonus of £3 per cent is granted. Premium savings bonds are issued in units of £1 (the minimum subscription is £2); they do not earn interest, but instead are eligible for inclusion in weekly and monthly draws for tax-free cash prizes ranging from £25 to £50,000. Deposits in ordinary accounts at the National Savings Bank, or with the ordinary departments of trustee savings banks, earn interest, currently at 4% per annum, of which the first £40 is exempt from income tax. Finally, a Save As You Earn scheme provides facilities for regular contractual saving with the Department for National Savings or the trustee savings banks:[1] after making monthly payments of a maximum of £2[illegible] for five years, the saver receives a tax free bonus equal to one year's contribution, alternatively, and without making any further payments, if the savings are left invested for another two years (making seven years in all) a double bonus equal to two years' savings is received. National savings have to compete with many other outlets for personal saving, and in recent years their share in the personal sector's total investment in financial assets has diminished. But the total amount remaining invested in national savings has been remarkably stable in recent years. A number of changes in national savings facilities were recommended in the Report of the Committee to Review National Savings (the Page Report), which was published in June 1973. They are under consideration by the Government.

(ii) Borrowing from the central bank

97 In this context, the term central bank applies only to the Banking Department of the Bank of England. There are no statutory regulations governing advances by the Banking Department to the Government, and there is no ceiling on central bank lending to the Government. It is not the Bank's policy to compete with the commercial banks in lending to the private sector; the bulk of their deposit liabilities is therefore employed in government debt. In practice the Banking Department does not now make advances to the Government, although provision was made for them in the National Loans Act. The Banking Department holds government debt in a variety of forms: stocks, Treasury bills

[1] Building societies provide similar savings facilities, but the proceeds do not generally finance the Government.

and, as a cushion against short-term variations in demand from the commercial banks, a reserve of notes and coin. The aggregate is published in the weekly Bank Return, and in more detail as at end-February in the Bank's annual *Report and accounts*.

(iii) Borrowing from the banking sector

98 The categories of securities offered and the ways in which they are placed are listed in paragraph (i) above. The banks are not specifically obligated to employ funds in government paper. They must, however, hold reserve assets under the arrangements for credit control which came into effect in September 1971, and some kinds of government debt are included among these.

(iv) Borrowing from private individuals and from firms in the non-banking sector

99 Investors outside the banking sector hold all the forms of government debt listed in (i) above, notably stocks, national savings and bank notes.

(v) Borrowing from the external sector

100 Overseas holdings of government stocks and Treasury bills are large. The Government has also borrowed at long term direct from other governments (a large amount of post-war loans from the United States and Canada remains outstanding), and through the Exchange Equalisation Account at shorter term from the IMF and from overseas monetary authorities. The way in which a fall in the official reserves provides the Government with sterling finance through the EEA was described in paragraphs 59–62.

(vi) Structure of government borrowing

101 On 31st March 1973, the total national debt outstanding, payable in sterling, including nationalised industries' stocks guaranteed by the Government, both in the hands of official bodies and market (i.e. non-official) holders was £36,526 million. Of this, British government stocks totalled £27,069 million and Treasury bills £3,093 million. The remaining £6,364 million was largely made up of national savings securities. Official holdings accounted for 28% of the total and market holdings 72%. Financial institutions other than banks were estimated to hold over £8,000 million of the total debt, nearly all in government stocks, while private funds and trusts were thought to have held over £7,700 million divided fairly evenly between government stocks and national savings securities. Further details are given in Table 6.

## Chapter Two
## Instruments of monetary policy

### Development of techniques of monetary policy

102 The provision by the Bank of England of last resort lending facilities to the London money market has a very long history. However the present active use of monetary policy as one of the means by which the UK authorities have sought to bring about full employment, economic growth, relatively stable prices and external balance, can be traced back to 1951. During the second world war, and in the immediate post-war reconstruction period, the pressing need of the Government for finance, together with severe curbs on private spending, had made the banks little more than intermediaries for channelling savings into official debt. The banks emerged from the war with an abnormally large proportion of their assets in liquid form, the London clearing banks' advances in 1945 amounting to only 17% of their gross deposits. It was widely believed at this time that changes in interest rates had comparatively little effect on the real economy; and that they should be kept low to finance reconstruction and to ease the servicing of a much-expanded national debt. In pursuing a policy of cheap money, the Government relied on a combination of direct controls and austere budgetary measures; and such monetary restraints as were exercised were regarded as purely ancillary.

**Post-war reactivation of monetary policy**

103 Acute balance of payments difficulties which developed in 1949 and a sharp growth in wage and price inflation associated with the Korean War, however, led to a reappraisal of monetary action during 1951. Bank rate, which had stood almost constantly at 2% since 1932, was raised, and was to be changed over forty times in the next twenty years. The Bank of England let it be known that they would no longer automatically relieve market shortages at ruling market rates. Holders of Treasury bills were offered an exchange of up to a total of £1,000 million into short-dated funding stocks. The London clearing banks were in effect instructed to take up half, and this reduced their liquid assets ratio to 32%. It was made clear to these banks that a ratio between 32% and 28% would henceforward be regarded as normal. By 1957 these arrangements had developed into a rigid 30% minimum, which in 1963 was reduced to 28%. Despite the more frequent use of Bank rate, the main emphasis of policy at this time was directed more to the quantitative control of credit, with interest rates still playing a relatively minor part.

104 The experience of the next few years was to show that too much had been expected of this reactivation of monetary weapons. In particular, they were insufficient to counter the combined effects of an excessive pressure of demand on real resources and the heavy lending potential of the clearing banks, even though the authorities attempted to strengthen their hand by asking the banks to restrict advances to certain 'essential' purposes. These qualitative requests were being made throughout the early 1950s and, in 1955, a loose direct quantitative restriction was added. Although monetary policy had the great advantage over fiscal policy that it could be used and modified daily, its effects were seldom smooth or speedy. As its limitations became more apparent, reappraisal seemed necessary, and in 1957 a committee was appointed by the Government under the chairmanship of Lord Radcliffe to enquire into the working of the monetary system.

**The Radcliffe Committee Report**

105 The committee, which reported in 1959, thought that changes in interest rates had a potentially significant impact on lending by financial institutions. The money stock was considered to be only part of a wider concept of liquidity, and policy should act on the structure of interest rates to restrict the availability of credit. In line with this thinking, bank deposits were considered less important than bank advances. Though the authorities had introduced a special deposits scheme for the London and Scottish clearing banks which was essentially similar to a variable liquidity ratio, the main weight of regulation of bank credit in the 1960s took the form of further direct requests to restrict advances to the private sector. The Radcliffe Committee had seen such requests as being justifiable in emergency situations, and their frequent use during the 1960s reflected the pressures on the UK balance of payments at the time and the need to restrain domestic demand. Requests in the form of lending ceilings and qualitative guidelines were in force almost throughout the period from 1965 to 1971. They were extended to commercial bills and, institutionally, beyond the London and Scottish clearing banks to take in all other recognised banks in the United Kingdom (whose business had been growing in importance with the development of new money markets). The restrictions were also applied to hire-purchase finance houses. Ceiling controls had several advantages. They were

**Ceiling controls**

unequivocal – for the banks and for their customers; they worked quickly; and they could be made to cover a much wider range of credit institutions than the conventional liquidity ratio and special deposits arrangements. But they also had severe disadvantages, as a long-term means of control. They impeded competition and innovation within the banking sector, and encouraged the diversion of credit flows through other channels.

Competition and credit control

106 By 1971, the economic pressures which had obliged the Bank of England to maintain the system of ceiling controls had abated; the balance of payments was in record surplus, international interest rates were relatively low and domestic demand was slack. The opportunity was therefore taken to introduce a new scheme, which was outlined in a paper entitled *Competition and credit control* published by the Bank in May 1971. In essence, it allowed the banks more scope for competition and innovation by moving away from direct physical control to a more generalised system, under which changes in the cost of credit were to be allowed to play a greater rôle in its allocation. A uniform minimum reserve assets ratio, set at 12½% of sterling resources, was introduced across the whole banking system, and all banks became liable to calls for special deposits. A parallel scheme was negotiated for deposit-taking finance houses with eligible liabilities of £5 million or more. Their reserve ratio was set at 10%, and they were also liable to calls for special deposits. After consultation with the banks and finance houses, these arrangements were introduced in September 1971. The clearing banks' liquidity ratios and the previous special deposits scheme were superseded, and the clearing banks agreed to drop their collective agreements on rates for deposits and advances. They have subsequently responded energetically to the competitive opportunities provided under the new arrangements. From the point of view of control of credit, however, the new arrangements have required some subsequent modification in the two and a half years that they have been in force. In particular, the process of attracting funds back into an increasingly competitive banking system has been more prolonged than expected; banks have tended to take on commitments to lend without first ensuring that the necessary resources were available, and there was a growing need for an additional and more direct way of influencing the growth in the money stock. As a result, arrangements were announced in December 1973 enabling the Bank of England to call for supplementary special deposits from banks and finance houses, if the increase in their interest-bearing resources exceeds a prescribed rate.

## Section I: Refinancing policy

Para

### I General data

Bank of England rediscount facilities

107 Normal rediscount, or refinance operations by the Banking Department of the Bank of England are confined to the provision of funds to members of the London Discount Market Association. This use of the discount houses as intermediaries between the central bank and the banking system is a particular feature of the UK arrangements. It arose for historical reasons, and it is undoubtedly convenient for the Bank to deal direct with only a dozen discount houses, rather than some 300 different banks in the United Kingdom.

Legal basis

108 The Bank's powers to engage in normal refinance operations were granted by the Royal Charter of 1694, under which the Bank were incorporated, and they have been specifically reaffirmed by statute, in particular by the Bank of England Act 1833. Under these statutes the Bank's powers to engage in banking operations are unlimited, and any restrictions on their activities are self-imposed.

Bank rate

109 In particular, although the Bank's minimum lending rate (formerly Bank rate) is the rate at which the Bank will normally provide funds at last resort to a member of the London Discount Market Association by lending against approved security, the Bank are free to provide refinance at any higher rates. The minimum lending rate is normally derived automatically by taking the average rate of discount for Treasury bills established at the weekly tender, plus ½%, rounded to the nearest ¼% above. The authorities reserve the right, however, to declare a minimum lending rate which is not directly related to existing market rates; and this right was exercised in November 1973. The current arrangements for fixing the rate at which the Bank will lend at last resort were introduced in October 1972. They replaced the previous administratively fixed Bank rate, which had proved insufficiently flexible to respond appropriately to fluctuations in rates after the introduction of the new arrangements for control of credit in September 1971. This change is discussed further in §111 of this section.

Access confined to discount houses

110 Refinance is normally made available only to the twelve discount houses which comprise the London Discount Market Association, and only these institutions can be said to have a right to refinance from the central bank. Granting refinance other than at last resort to a member of the Discount Market Association, and granting any refinance to any other institution, are entirely at the discretion of the Bank.

Para

## II Refinancing

### I Rediscounting

Bills eligible for rediscount

111 Bills which are eligible for rediscount at the Bank of England comprise:

(a) Treasury bills;

(b) bills of the Government of Northern Ireland;

(c) bills of local authorities which, having statutory powers to borrow on bills, have agreed to observe the Bank's conditions of issue; and

(d) commercial bills, provided that they have not more than 180 days to run, are payable in the United Kingdom, and bear two names each affording adequate British security (one of which must be that of the acceptor). The list of eligible acceptors includes the members of the Accepting Houses Committee, the London and Scottish clearing banks, the larger British overseas banks and those Commonwealth banks which have had branches in London for many years, together with certain other banks.

The Bank impose conditions about the average life of a parcel of bills offered for rediscount, and about the minimum life of individual bills.

### II Advances against securities

112 The Bank provide refinance, as distinct from engaging in open-market operations, by granting advances against security rather than rediscounting eligible paper. When granting advances, the Bank require as security either those instruments which are eligible for rediscount (described in the previous section) and/or UK government or UK government-guaranteed stocks which have a maximum of five years to run to final maturity. Such security deposited with the Bank must not be less than 105% of the value of each advance. For the calculation of this margin, Treasury bills, Northern Ireland and local authority bills are valued at their nominal value, and eligible government securities at their middle market value at the close of business on the previous day. A proportion, which may vary from time to time, of all security must also normally be in the form of Treasury bills.

Last resort facility

113 Subject to these conditions, the Bank of England have granted to the discount houses (Section III §I, Ia) individual banking facilities whereby they can, at discretion, borrow from the Bank for the purpose of balancing their individual books. Such borrowing is not intended to be a permanent source of finance for the discount houses. It is normally made for a minimum period of seven days. Neither the use by individı houses of this facility nor the interest rate is published, but the rate is related to curren market rates and the yields which the discount houses can obtain on their assets. The size of each discount house's facility is directly related to its resources, i.e. its capital and reserves. The Bank of England may also compel the discount houses to borrow as an act of monetary policy to raise short-term interest rates. In this case the Bank must first have created a shortage in the money market (see also Section III §I), and the lending is normally for a period of seven days at the Bank's minimum lending rate.

Overnight and seven-day lending

114 Apart from these facilities, which the discount houses use at their discretion, the Bank sometimes lend to them overnight to smooth out temporary shortages of funds in the market. This overnight lending is done only on the initiative of the Bank, and all conditions attached to the lending are at the Bank's discretion.

Emergency export credit refinance

115 Apart from the foregoing normal refinancing operations undertaken by the Banking Department of the Bank of England, the Issue Department of the Bank also extend emergency facilities for refinancing certain medium-term export credit and bank lending for shipbuilding. These special facilities are distinct from the normal refinancing arrangements for export and shipbuilding credit provided to eligible banks by the Government under arrangements agreed with the Export Credits Guarantee Department and with the Department of Trade and Industry. Transactions eligible for emergency refinancing are those where the bank concerned has agreed to provide finance for export and shipbuilding, at a fixed rate of interest determined by the Government. With export contracts, the terms must provide for deferred payments by the buyer over a period of two

years or more from the contract date. The contracts must also carry a guarantee from the Export Credits Guarantee Department, issued direct to the bank concerned. Shipbuilding contracts must carry a guarantee from the Department of Trade and Industry issued to the bank concerned under the Shipbuilding Industry Acts 1967 and 1971.

116 The emergency facility has not so far been used, but the Bank of England are willing to refinance eligible transactions on demand, when a participating bank represents to the satisfaction of the Bank that it needs to make use of the facility in the last resort to meet a large and unexpected withdrawal of deposits, or to meet some other situation which is of an emergency character and justifies central bank intervention. The amount of such refinance would be determined in the light of the particular circumstances, and the interest rate and other conditions would be identical with those on the original transaction. The rates currently applicable under the official fixed interest rate schemes are a range of 6%–8½% per annum for medium and long-term export credit, and 7% per annum for shipbuilding credit.

Para

## III Effectiveness of refinancing policy and action through interest rates

Bank rate and market rates

117 Until the London and Scottish clearing banks abandoned their cartel arrangements in September 1971, as part of the change in the system of credit control made at that time, the rates which they had offered on deposits and charged on advances had been directly related to Bank rate. A change in Bank rate, therefore, automatically led to commensurate changes over a wide range of banking rates. Since then, the banks have set their base rates independently, and there has been rather more room for these to reflect the pressure of demand for funds in the market. Nevertheless the ability of the Bank of England to determine shorter-term market rates has not been significantly reduced, and they can counter a move which they do not regard as appropriate by undertaking open-market operations at prices of their choosing. Any sizable change in short-term market rates, which the Bank bring about, is now usually reflected automatically by a change in the Bank's minimum lending rate (see Section I, §1). Before the introduction of more flexible arrangements for the minimum lending rate in October 1972, such changes in market rates were normally validated, although perhaps after some lapse in time, by a change in Bank rate, which had also come to be regarded as a signal of the authorities' intentions. (Changes in Bank rate usually led market rates upwards, and followed them downwards.) The authorities have retained the option to continue to give such signals by raising or lowering the minimum lending rate independently of these arrangements, if they wish by this means to take an initiative on interest rates. Such action was taken to raise the rate in November 1973, as part of a general tightening of monetary policy.

118 Comparisons of movements in Bank rate and movements in yields on short-dated (up to five years to maturity) and long-dated (twenty-five years to maturity) British government stocks suggest that a change in Bank rate has tended to be reflected in a change in the same direction in yields throughout the term structure. As might be expected, however, the relationship becomes weaker the longer the maturity.

119 In the United Kingdom, the evidence available both from econometric research and from direct enquiry about the effects of changes in interest rates on the desire to borrow or to spend is inconclusive. In general, it would appear that borrowing and spending are fairly interest inelastic, though there are some activities on which monetary influences have a more perceptible impact, such as spending on private houses. The building societies are largely dependent for their resources on savings deposits repayable on demand. As a result, if short-term market rates rise, the societies can be inhibited from increasing their deposit rates comparably by the effects of such increases on the rates they must charge to borrowers on mortgages. When the new arrangements for credit control were first introduced, therefore, it was recognised that circumstances might arise in which competition for individuals' savings might require to be restrained in the interests of the finance of housing. This happened in September 1973 after short-term market rates had risen sharply, and the flow of funds into the societies had dwindled. To reduce the competition with the societies, the Bank asked the banks to observe a maximum limit of 9½% on the rate of interest which they pay on deposits in amounts of under £10,000, of whatever term to maturity.

Limitation of interest on deposits to protect building societies

Effect on flow of funds . . .

120 Changes in market rates, nevertheless, seem to have had more effect in diverting flows of funds through different channels than in changing final domestic expenditures. As yields on some assets have risen relative to others, particularly where changes in rates are infrequent e.g. on national savings in relation to building societies' deposits, funds

have tended to flow towards the higher yielding assets. Similarly, as rates in the United Kingdom have risen in comparison with overseas rates, they have attracted an inflow of funds. The identification of the effect of changes in UK interest rates on international capital flows has been severely complicated by the difficulty of taking adequate account of such considerations as confidence in the currency and changes in exchange controls, quite apart from the common problem that changes in rates on marketable assets affect expectations of future changes in rates.

. . . particularly from overseas

121 Nevertheless relatively tight and expensive money in the United Kingdom does seem to have induced inward capital flows. To the extent that international capital flows are more strongly affected by domestic monetary conditions than are domestic expenditures, it is harder to use monetary policy for domestic objectives. By the same token, however, it may be easier to use monetary policy to adjust temporary external disequilibria. There are a number of different approaches to the problems posed by large-scale international movements of liquid funds, such as recycling, exchange controls, or operations in the forward market. The UK authorities have been prepared to use any, or all, of these approaches as seemed appropriate. No doubt largely as a result of this pragmatic attitude, variations in interest rates or monetary conditions, which the authorities felt to be necessary for domestic reasons, cannot in general be said to have been prevented by external considerations. Nevertheless it would also be broadly true to say that the majority of 'signalling' changes in Bank rate have been regarded as appropriate in the light of external considerations.

## Section II: Regulation of bank liquidity

122 A general description of developments in methods of credit control and of the considerations which have led to changes in these methods, may be found at the beginning of this chapter.

Para

### I Minimum reserves policy

#### I Organisation of the system

UK credit control requirements are voluntary

123 There has never been any legal requirement in the United Kingdom for the observance by banks of cash or liquidity ratios, or calls for special deposits. Where such arrangements have been in force, they have been based on voluntary agreements made either among the banks themselves or between them and the Bank of England, with the powers under the Bank of England Act 1946 remaining untested in the background (see Chapter I).

Requirements in force up to 1971

124 Before the changes introduced in September 1971, the London clearing banks (originally by agreement among themselves, but later at the request of the Bank England) had since 1946 held a minimum of 8% of their total deposit liabilities in cash (coin, bank notes and balances with the Bank of England). At the request of the Bank of England, they also held from 1951 a minimum proportion of their total deposit liabilities in liquid assets (cash, money at call and short notice, UK Treasury bills and other bills and refinanceable credits), set at 28% from 1963 to 1971. Until 1971 there was a similar, but less formal, agreement between the Bank of England and the Scottish clearing banks concerning a minimum liquidity ratio. Between 1960 and 1971, the clearing banks' liquidity ratios were the fulcrum on which from time to time they were required to place special deposits, expressed as a percentage of total deposit liabilities, with the Bank of England. Other banks had no arrangements with the Bank of England up to September 1971 for observing any minimum cash or liquidity ratios; but in 1968 all banks other than the London and Scottish clearing banks and the Northern Ireland banks agreed, when called upon to do so, to place cash deposits, expressed as a percentage of certain of their deposit liabilities, with the Bank of England. This scheme, however, was never used. It is discussed more fully in the next Sub-section II.

Current reserve requirements

125 Under the arrangements for credit control introduced in September 1971, all banks agreed to observe daily a uniform minimum reserve ratio of 12½% of eligible liabilities (in effect, a measure of the banks' sterling resources) and to place with the Bank such special deposits as might be required from time to time. Similar arrangements (except that the minimum reserve ratio was 10%) were agreed for deposit-taking finance houses with eligible liabilities of £5 million or more. At the same time the discount houses, and a few other members of the London money market, agreed to maintain at least 50% of their

eligible borrowed funds in defined categories of public sector debt. These arrangements and subsequent modifications to the arrangements for the discount houses are described in more detail below.[1]

**1 Reserve and public sector lending ratios**

(a) Banks

126 All institutions in the United Kingdom recognised as banks by the Bank of England, including the UK offices of overseas banks, observe a uniform minimum reserve ratio, irrespective of their size, and each bank has agreed to maintain daily at least 12½% of its total eligible liabilities, as defined below, in certain specified reserve assets. Apart from a limitation on holdings of commercial bills, there are no restrictions on the distribution of funds between the particular categories of reserve assets.

127 *Eligible liabilities*, for this purpose, are defined as follows:

- (i) all sterling deposits, of an original maturity of two years or under, from UK residents (other than banks) and from overseas residents [other than overseas offices – see (iv) below] including any funds due to customers or third parties temporarily held on suspense accounts;
- (ii) all sterling deposits – of whatever term – from banks in the United Kingdom, less any sterling claims on such banks;
- (iii) all sterling certificates of deposit issued – of whatever term – less any holdings of such certificates;
- (iv) the bank's net deposit liability, if any, in sterling to its own overseas offices;
- (v) the bank's net liability, if any, in currencies other than sterling; less
- (vi) 60% of the net value of transit items included in the bank's balance sheet (i.e. the value of cheques in course of collection etc. included among the bank's assets less the value of credits in course of transmission included among liabilities).

128 *Reserve assets* comprise:

- (i) balances with the Bank of England (other than special deposits);
- (ii) British government and Northern Ireland government Treasury bills;
- (iii) company tax reserve certificates;
- (iv) secured money at call with the discount houses, and with certain other firms doing a similar type of business, or certain firms directly connected with the overnight finance of the gilt-edged market;
- (v) British government stocks and nationalised industries' stocks guaranteed by the Government with one year or less to final maturity;
- (vi) local authority bills eligible for rediscount at the Bank of England; and
- (vii) commercial bills eligible for rediscount at the Bank of England, up to a maximum of 2% of total eligible liabilities.

The following modifications of reserve asset definitions were agreed with the Northern Ireland Bankers' Association in recognition of the special problems arising from the fact that the branch banking system in Northern Ireland is operated by banks which, in varying degrees, also operate the branch banking system in the Republic of Ireland:

1 In calculating its eligible liabilities, a member of the association may include its net liability (if any) to its offices in the Republic of Ireland.

2 As an additional transitional arrangement for two years from the end of June 1972, a member bank may include in reserve assets certain liabilities of the central bank or Government of the Republic of Ireland which have traditionally been regarded as liquid assets by the Northern Ireland banks. Any holdings so included must be in excess of those required by the Dublin authorities for their own purposes, and should form only a modest proportion of the 12½% UK ratio.

3 Consideration will be given if necessary to the inclusion in reserve assets of special lending under government guarantee arising from the emergency in Northern Ireland or from the needs of reconstruction.

[1] Details of the appropriate descriptive and explanatory articles on competition and credit control in the Bank of England *Quarterly Bulletin* may be found in the bibliography.

(b) Finance houses

129 The parallel scheme for finance houses applies in principle to all deposit-taking instalment credit finance houses which are not recognised as banks, though the minimum reserve ratio in their case is 10% instead of 12½%. In practice, finance houses with eligible liabilities of less than £5 million are exempt. As the finance houses perform a much less varied type of business than the banks, the definition of their *eligible liabilities* is confined to all sterling deposits with an original maturity of two years or less received from UK residents, other than banks, or from overseas. Borrowing from a parent company which is not a bank – unless it has a fixed maturity of over two years – is treated as an eligible liability, but all permanent capital and long-term borrowing is excluded. The definition of *reserve assets* is exactly the same for finance houses as for banks.

(c) Money market

130 The discount houses and firms doing a similar type of business have agreed to limit aggregate holdings of certain assets by each house to a maximum of twenty times its capital and reserves.[1] This arrangement was introduced in July 1973, before which the discount houses had been obliged to hold at least 50% of borrowed funds in defined categories of public sector debt.

131 Defined assets are:

(i) balances at the Bank of England;

(ii) UK and Northern Ireland Treasury bills;

(iii) local authority and other public boards' bills eligible for rediscount at the Bank o England;

(iv) Bank bills drawn by nationalised industries under specific government guarantee;

(v) local authority negotiable bonds;

(vi) British government stocks and stocks of nationalised industries guaranteed by the Government with not more than five years to final maturity; and

(vii) local authority stocks with not more than five years to final maturity.

The Bank continue to require, however, that the size of each house's total business should bear an appropriate relationship to its capital and reserves.

Surveillance of reserve requirements

132 All institutions observing the ratios set out in (a), (b) and (c) above report their eligible liabilities, reserve assets and reserve ratios (or equivalent, for the money market) to the Bank of England on special forms sixteen times a year (as at the middle of each month – usually the third Wednesday – and as at the end of each calendar quarter), but they are expected to fulfil daily their agreement to maintain a minimum ratio. The arrangements agreed with the banks, discount houses and finance houses make no provision for penalties for failure to observe minimum ratios.

133 Figures for eligible liabilities, reserve assets and reserve ratios of the different groups of banks (other than the Northern Ireland banks) and of the finance houses together with the constitution of reserve assets held by banks, are shown in Table 4. Current figures are released to the press monthly, and are regularly available in Table 9 of the Bank of England *Quarterly Bulletin*. Recent figures showing the undefined assets multiple of the money market houses are published quarterly in Table 7 of the *Bulletin*.

**2 Special deposits with the Bank of England**

(a) General calls

134 Calls for special deposits are normally expressed as a uniform percentage across the banking system of each institution's total eligible liabilities. In principle, there is no discrimination between institutions in the application of the calls; exceptionally, because of special economic and political considerations, banks in Northern Ireland have so far been exempted from such calls for special deposits as have been made. Calls and repayments are normally announced on a Thursday. Amounts called are rounded to the nearest £5,000 and are adjusted monthly to take account of changes in reported eligible liabilities. Special deposits bear interest at a rate closely related to the Treasury bill rate.[2]

135 Calls for special deposits from the finance houses are normally at the same rate as calls on the banks, but the Bank have the right in certain (unpublished) circumstances to

[1] Based on a three-year moving average of end-December figures relating to the net worth of each house.

[2] For the duration of Stage Three of the Government's counter-inflationary policy announced in October 1973, however, interest is being withheld on the proportion of special deposits which each bank in Great Britain's sterling current account business bears to its total eligible liabilities.

call special deposits from the finance houses at a higher rate. It is unlikely, however, that the total of reserve assets and special deposits will ever represent a higher proportion of eligible liabilities for the finance houses than for the banks.

(b) Differential calls

136 For the purposes of domestic monetary policy (and in conformity with the EEC Directive of 21st March 1972), arrangements have been made (but not yet used) to distinguish between domestic and overseas deposits with the banking system in making calls for special deposits. Additionally to, or separately from, a uniform rate of call applied to the total of each institution's eligible liabilities, the Bank of England may announce a uniform rate of call applied to the increase, if any, in each institution's liabilities to overseas residents (other than in respect of certificates of deposit) from a specified starting date. Alternatively they may exempt each institution's outstanding liabilities to overseas residents (other than in respect of certificates of deposit) from a uniform rate of call applied to the total of each institution's eligible liabilities, or they may apply a lower rate of call to overseas liabilities. Liabilities to overseas residents are defined for this purpose as sterling deposits of overseas residents with an original maturity of two years or less; the net liability, if any, to overseas offices in sterling; and the net liability, if any, in currencies other than sterling. Because of difficulties of identification, all transit items are allocated to domestic deposits. The base date for calls differentiating against overseas deposits will normally be the mid-monthly make-up day following the announcement of the call, though the Bank reserve the right to specify the previous make-up day. In certain circumstances an individual institution may elect to average its overseas deposits over the eight Wednesdays up to the base date and each succeeding make-up day. Discount houses and other firms observing the assets multiples are not subject to general calls for special deposits, but they are liable to differential calls against overseas deposits. Such calls would be at the same rate as for banks, and would be levied on any increase since the base date in overseas sterling funds borrowed, together with any increase in net currency liabilities.

(c) Supplementary calls

137 To reinforce the Bank's influence over the money stock and bank lending, banks and deposit-taking finance houses were asked in December 1973 to be prepared to make non-interest-bearing special deposits related to the growth in their interest-bearing resources:

(i) interest-bearing resources are defined as the interest-bearing element of each institution's eligible liabilities;

(ii) the growth in each institution's interest-bearing resources is measured from the average of the amounts outstanding on the three mid-monthly reporting days preceding each activation of this scheme;

(iii) up to 50% of the growth in each institution's interest-bearing resources, on a three months' moving average basis, over and above a specified rate, is placed on non-interest-bearing deposit with the Bank, subject to;

(iv) no deposit is required to be made within the first six months of the initial activation of this scheme;

(v) non-interest-bearing special deposits made are repayable in full if the growth in an institution's interest-bearing resources falls back to the rate specified, or in part if the amount of the excess declines; and

(vi) the requirement to make non-interest-bearing special deposits may be varied or suspended at the Bank's discretion.

The initial activation of the scheme took effect immediately on 17th December and applied to all banks (except the Northern Ireland banks) and to deposit-taking finance houses. The base is therefore the average of interest-bearing resources on the reporting days in mid-October, November and December 1973. The rate of growth specified is 8% for the first six months. It is intended that the rate to be specified thereafter will be notified to the banks and finance houses concerned not later than the end of April 1974. The rate of deposit required will be progressive with the excess rate of growth of each institution's interest-bearing resources: in respect of an excess of 1% or less, the rate will be 5%; in respect of an excess of over 1% but not more than 3%, the rate will be 25%; thereafter the rate will be 50%.

The effect of these arrangements is that, if the average of an institution's interest-bearing resources on the reporting days for April, May and June 1974 were to exceed the

average amount outstanding on the reporting days in October, November and December 1973 by more than 8%, a non-interest-bearing special deposit on the scale specified above would be required to be lodged during July 1974. Thereafter the requirement to lodge non-interest-bearing special deposits will be assessed monthly in relation to the rate of growth in interest-bearing resources to be specified.

Banks and deposit-taking finance houses were not expected to respond to the introduction of these arrangements with a general rise in their lending rates.

**II How the system works**

138 The minimum reserve ratio provides the UK monetary authorities with a fulcrum for their operations concerned with tightening or easing the liquidity position of the banking system. The present reserve ratio of 12½% does not, however, in most cases force banks to hold more of certain classes of liquid assets than they would voluntarily wish to hold on prudential grounds. All banks are subject to the same reserve ratio, and this provides a starting point for competition between them.

*Reserve ratios varied by special deposits*

139 The ratio obliges the banking system to obtain the reserve assets needed to support additional lending, and thus to some extent provides an automatic check on the expansion of bank lending to the private sector. Nevertheless its main importance for policy lies less in its rôle as a fulcrum or as an automatic check, but rather in the authorities' ability to vary it. In the United Kingdom this is done by means of calls for special deposits, and not by an administrative change in the ratio itself. Although the effect is the same, the use of special deposits is intended to emphasise the temporary nature of the measure, and thus reduce the danger of calls for additional reserves being built into the banks' normal reserve base and distorting the structure of their portfolios.

*Pre-1971 use of special deposits*

140 Before the changes in the arrangements for the control of credit introduced in September 1971, the authorities' direct methods of influencing credit creation varied from one group of banks to another, because of the complications of adapting existing arrangements (e.g. the clearing banks' liquidity ratios, and special deposits) to new circumstances and new banking institutions. Reliance came to be placed increasingly on lending ceilings, referred to at the beginning of this chapter, because they could be applied with some uniformity and be easily extended to embrace new institutions. So far as the less comprehensive forms of control were concerned, the London and Scottish clearing banks alone observed formal liquid asset ratios, and (over and above these ratios) the authorities sought to influence these banks by the imposition of special deposits, which were related broadly to their sterling liabilities (i.e. they were called as – say – 1% or 2% of gross deposits). They were not, in general, thought of as penal: they earned interest effectively at the current Treasury bill rate, and were intended to immobilise excess liquid assets. During one period in 1969, however, the rate paid on the special deposits of the London clearing banks was halved, as a sign of the authorities' displeasure with their failure to reduce advances in accordance with specific quantitative requests. In the period after 1960, when the first call for special deposits was made, this instrument was used fairly frequently.

*1967 cash deposits scheme*

141 The other banks did not observe any common liquid assets ratio before September 1971. The composition of their balance sheets differed widely, depending on the nature of their UK business. Under these circumstances, a general call for special deposits from all banks as a means of immobilising funds would have been inequitable. The rapid growth in their business during the 1960s, however, emphasised the need for these banks to be subject to some form of control, if only in equity to the clearing banks. A separate scheme was, therefore, introduced in 1967, under which the authorities could call for cash deposits from the other banks. The deposits were normally to earn interest at a rate equivalent to the yield on Treasury bills, but the Bank of England could in certain circumstances pay a lower rate to all banks or to individual banks. It was not expected that they would have been used in a penal way, however, so they would have been a similar instrument to the special deposits applicable to the clearing banks. The scheme was designed for use in times when lending ceilings were no longer applied. Such a time did not arrive before the new system of credit control was introduced in September 1971, and no cash deposits were ever called.

*Post-1971 special deposits used to immobilise funds*

142 One of the reasons for the introduction of the new arrangements for the control of credit in 1971 was a wish to place more reliance on the market mechanism for the allocation of credit, and to withdraw from direct intervention, lending ceilings being completely withdrawn. It therefore seemed inappropriate to attach a direct penalty to

special deposits which, under the new system, are called in equal proportions from all banks, and earn interest at the Treasury bill rate. They are intended to immobilise liquid funds, and not directly to penalise profitability.[1] Calls are usually announced several days ahead of the required date of payment, to give the banks reasonable time in which to organise their books to meet the call. Thus a 1% general call was announced on 15th November 1972 for payment of half by 30th November and the remainder by 14th December.

They do not directly affect lending to private sector

143 The immobilisation of funds through calls for special deposits does not itself ensure any reduction in the willingness of banks to make advances to the private sector. The banks individually are likely to try to finance a call initially either by reducing surplus holdings of short-term assets, by selling British government stocks or by bidding for additional funds in the market. They will only be disposed to reduce their lending if the price at which they can sell government stocks falls, and the rate at which they can obtain extra funds from the market rises to a point which the banks find relatively unattractive. Even then, if increases in interest rates do not discourage the demand for advances, the banks may be prepared to bid strongly for funds at rising rates in the market to satisfy both the call for special deposits and demand from borrowers. In these circumstances a call for special deposits may be seen as a complement rather than an alternative to changes in interest rates.

144 On some occasions, however, the authorities may consider it appropriate to allow interest rates to rise without calling special deposits and, on others, to call special deposits without an accompanying rise in rates. These last occasions should be seen more as a signal of the authorities' intentions than as likely to have much direct effect on the lending ability of the banks, who should not, in the circumstances, have much difficulty in obtaining the necessary funds. The use of special deposits in this way as a signalling device was not uncommon in the period before 1971, especially as the main controls on advances were direct, rather than through the market mechanism.

145 If the effect of a call for special deposits is to encourage the banks to bid more aggressively for funds and UK rates rise, this may in turn lead to an inflow of capital from abroad. In these circumstances the authorities may well wish to prevent the inflow from restoring the banks' liquidity. With this in mind, the UK authorities negotiated and agreed a scheme for differential calls for special deposits (already described in Section II, I), which would make it possible to moderate the effect on the domestic money stock of inflows from abroad; these incremental calls could be at different and possibly much higher percentage rates than general calls. Similarly, the differential scheme could be used if necessary to exclude non-resident deposits from a general call for special deposits, in circumstances where the authorities wished to maintain domestic monetary restraint but not to discourage inflows of foreign funds.

Para

## II Other banking ratios

146 No other formally agreed minimum reserve requirements are in use in the United Kingdom for credit control purposes. In the course of maintaining an informal supervision over the stability of the banking sector, however, the Bank of England have regard to four principal prudential balance sheet ratios, the first and most important of which is the relationship between a bank's liabilities to the public and its free resources. Liabilities to the public comprise total current and contingent liabilities, including liabilities on acceptances; liabilities to all companies within the same group as the bank under scrutiny are also included. Free resources are defined as shareholders' funds (including paid-up share capital, reserves and profit and loss account), and any long-term, subordinated and unsecured loan capital, less fixed and other capital assets (including intangible, fixed and leased assets and unquoted securities), plus any surplus (or less any shortfall) between the market and book value of quoted securities. The Bank regard the norm for the relationship between free resources and liabilities to the public as 1:10.

The second ratio is between quick assets and deposits. Quick assets comprise all immediately realisable assets; deposits consist of all banking deposits, including deposits from companies within the same group. The Bank expect to see quick assets amounting to more than one third of deposits. The other two requirements are that quick assets should normally be at least one fifth of a bank's liabilities on acceptances, and that acceptances should not exceed four times a bank's free resources.

[1] Although, as already mentioned in footnote [2] on page 28, for the duration of Stage Three of the Government's counter-inflation policy introduced in October 1973, interest is not being paid on the proportion of special deposits which each bank's current account business bears to its total eligible liabilities.

## Section III: Control of the money market and of relations with foreign money markets

Para

### 1 Open-market policy

**I The money market**

London has several money markets

147 There are several interrelated money markets in London. In some, the lending of money is secured against collateral which varies from one market to another; in others lending is unsecured. The main sterling markets consist of the conventional money market or discount market, and the wholesale or parallel markets in local authorities' temporary money, in inter-bank funds and in sterling certificates of deposit. All these markets are connected through the banks and brokers which operate in them with the London euro-currency markets. There are also markets in London which deal in US dollar certificates of deposit and US dollar commercial paper.

(a) The discount market

148 The principal and longeststanding market is the discount market. It is not only large (total assets outstanding were some £2,500 million in mid-1973) but it is distinguished from the other money markets because it is the main one in which the Bank of England operate, and because money lent at call to officially approved operators in it is an eligible reserve asset for the banks.

149 The discount market is made up from the twelve discount houses which are members of the London Discount Market Association, two discount brokers and the money trading departments of six banks which have traditionally carried on an essentially similar kind of business to the houses. These firms operate by borrowing short, largely day to day from the banks, and lending longer, generally up to three months to the private sector and up to five years to the public sector. They borrow mainly against the provision of security, and invest their funds in Treasury bills; local authority bills; government, government-guaranteed and local authority stocks and bonds with not more than five years to final maturity; sterling bills of exchange; and sterling certificates of deposit. For the purposes of monetary policy the discount houses, discount brokers and money trading banks have agreed to observe limits on their assets as a multiple of their resources. They make their profits by borrowing more cheaply than they lend, and (to some extent) from dealing profits on their assets.

150 There are no distinctive legal requirements to be met before becoming an operator in the discount market. This depends entirely on the willingness of the other operators in the market to deal with a new entrant at rates which will yield a profit to him. The Bank of England provide cash to the members of the association and certain brokers against acceptable collateral as lender of last resort to the banking system (see Section I, §II), and before granting such a facility the Bank require to be satisfied that the firm concerned has a sound reputation and adequate financial resources to fulfil this important intermediary rôle.

Bill markets

151 As a rule, the discount houses invest up to about 40% of their funds in sterling bills of exchange and Treasury bills, but this proportion can vary markedly, depending on the supply of suitable bills. The houses acquire their Treasury bills by bidding for them at the weekly tender, and by purchasing them from the Bank of England or other holders in the course of day-to-day market operations. They sell them partly to the banks who wish to hold them as reserve assets, and partly to non-bank holders. They may also sell them to the Bank of England on occasions when the Bank relieve shortages of cash by buying Treasury bills direct from the market (discussed further in the following Sub-section II).

Treasury bill tender

152 In bidding for Treasury bills at the weekly tender, the members of the London Discount Market Association fulfil a unique function. By their agreement to tender each week for at least the full amount of bills on offer, they ensure that the banking system acts as a residual form of government financing and that the Government always obtains the amount it requires. They also enable the Bank of England, if they so wish, to create a shortage of funds in the money market through varying the amount of bills offered at the tender. The shortages created enable the Bank to influence the money markets in such form and at such rates as may accord with current monetary policy.

153 Each member of the association tenders each week for at least its agreed share of the total amount of Treasury bills on offer. The members can do this in the knowledge that the Bank of England will, if necessary, always provide (at a price) the cash needed to take up the bills, either through open-market operations or as lender of last resort. The

minimum share of an individual house in the total bid at the tender is broadly related to its capital and reserves. Houses may tender for more bills than their share but never for less. Up to September 1971 the members of the association tendered each week only for their quota, and at a price agreed between themselves. With the introduction of the new arrangements for the control of credit, a syndicated bid price was no longer consistent with the competition which the arrangements were intended to promote, and the houses now therefore submit bids of a size (at or above their agreed minimum), and at prices, of their own choosing. As a result, the total amount of the tender remains fully covered by the houses, but no longer at a common price. The deposit banks, although not precluded, do not usually tender for Treasury bills for their own account, though they do submit tenders on behalf of their customers. As already explained, they normally obtain the Treasury bills they require for their own account from the discount market, who hold the bills obtained at successive tenders as a stock-in-trade to meet the banks' requirements.

154 The discount market buy commercial bills (mainly bank bills) from banks and others. The characteristics of commercial bills eligible for rediscount at the Bank of England have already been described (see Section I, §II of this chapter); these bills are readily marketable and acceptable as collateral for call money from the banking system. The discount houses also provide a market in other bank bills, and bills and short-dated (usually up to a maturity of one year) bonds issued by UK local authorities.

(b) The local authority market

155 The other short-term money markets are frequently referred to as the parallel markets because they have grown up alongside the discount market, either to meet particular needs or as a consequence of restrictions. They have no formal organisation or institutional arrangements. The local authority temporary money market developed in response to a decision by the Government in 1955 that the local authorities should obtain a larger proportion of their funds from private sources, and it was fuelled by foreign funds after sterling became convertible for current transactions in 1958. In this market, transactions take place between lenders (mainly banks, and industrial and commercial companies) and the local authorities through brokers. The instrument of borrowing is a simple deposit receipt which can, however, be converted into a legal mortgage secured on the revenues of the local authority at the request of the lender. Amounts of £50,000 and upwards are normal, but amounts down to £5,000 are not uncommon. Most of the loans are repayable at two or seven days' notice but loans with an initial period of up to three months are common with some of longer duration, one to three years, and occasional loans of ten to fifteen years' duration; in practice, whatever the period of notice, funds are often left with the local authorities for a considerable period of time.

(c) The inter-bank market

156 The inter-bank market is a market in sterling funds between banks operating in London. It developed because it provided a convenient and easily operated way for the banks to employ balances, particularly during periods of quantitative controls on lending to the private sector, at rates of interest generally higher than those obtainable on call money lent to the discount market (which were subject to conventional limits related to the yields obtainable on the assets in which they could be employed). It is closely linked with the foreign exchange and euro-currency markets, and to the other sterling money markets. Money is borrowed and lent overnight and for periods of up to five years, though most transactions are for short periods. Lending is normally unsecured, and liquidity and security are achieved by careful matching of liabilities and assets by term, and by lenders placing limits on the amounts lent to individual banks. When calculating its eligible liabilities for credit control purposes, a bank must include sterling deposits taken from banks, but can offset any sterling claims on other banks.

(d) The market in sterling certificates of deposit

157 After the successful development in the United Kingdom of a market in dollar certificates of deposit, which were introduced into the United States in 1961 and into the United Kingdom in 1966, a number of banks suggested that a market in sterling certificates might be a useful addition to the range of services provided by the UK banking system. The first certificates were issued in October 1968, after amending legislation had brought them within the definition of securities for exchange control purposes. They are documents issued by a UK office of a British or foreign bank, certifying that a sterling deposit has been made with that bank. They are repayable to bearer on surrender at maturity, and are issued in multiples of £10,000 with a minimum of £50,000 and a normal maximum of £500,000, and a term to maturity of not less than three months but

not longer than five years. Rates of interest, which are fixed for the full term of the deposit, are usually closely related to corresponding rates in the inter-bank market.

158 Sterling certificates are not eligible as security for advances by the Bank of England to the discount market, and the Bank will not discount them. Other banks may take them as security for call money, but the Bank have indicated that banks should not normally buy or take as collateral certificates issued by themselves or their own subsidiaries. Holdings of certificates by banks do not qualify as reserve assets, as mentioned earlier, but they may be subtracted from a bank's total deposit liabilities (including liabilities on certificates outstanding) in the calculation of eligible liabilities.

159 In the primary market for sterling certificates of deposit, banks either issue certificates to the ultimate holders (other UK banks, financial institutions and industrial and commercial companies) or place them in the secondary market made by members of the London Discount Market Association and a few banks. These institutions buy certificates from issuing banks or other holders, and either sell them or hold them to maturity. Brokers may be employed for any of these transactions. Sterling certificates have proved attractive both to issuers and holders, and the amounts issued have increased very rapidly in recent years.

**II Open-market operations**

160 Open-market operations are used by the Bank of England as a means of influencing interest rates and, associated with this, the liquidity of the domestic banking system. Th Bank are also conscious of the need to ensure that the financing requirements of the central government are met, and that conditions are created which are conducive to an orderly market in government securities. Open-market operations are one of the key instruments of monetary policy which, working on a fulcrum of the banks' reserve ratios and reinforced as necessary by action on special deposits, seeks to influence movements in both the cost and the stock of money.

Operations on long-term rates

161 The authorities' open-market operations take place in the markets in long-term and short-term assets. Their influence on long-term interest rates is achieved through their dealings in the market for British government and government-guaranteed stocks, known as the gilt-edged market. For this purpose the Bank of England have at their disposal the portfolio of stock held in the Issue Department, which provides the backing for the note issue. This portfolio is made up chiefly of government stocks and Treasury bills, the composition of which varies according to market management operations and objectives. At any one time the portfolio may contain some twenty to thirty different government stocks with a final maturity varying between a few months and forty years or more, or without a final maturity date.

Aims of official operations in the gilt-edged market

162 The Bank originally began to deal in the gilt-edged market to meet the financing and refinancing needs of the central government. As a result of vast accumulations debt during two world wars and subsequent years of deficit financing, the scale of the refinancing requirement alone from year to year is very large. There are at present some fifty government stocks outstanding, amounting to a nominal value of over £25,000 million, and it is not uncommon for £1,500 – £2,000 million of stock to mature in a year. So the Bank start with the need to refinance sums of this order, quite apart from any current commitments. In coping with this problem the Bank have three general aims:

1 To buy in as much as possible of stocks nearing maturity, to avoid the disruption which would occur in the short-term markets if the Government paid out substantial amounts in redeeming a stock on one day.

2 To maximise sales of long-dated stocks especially to the general public, since the alternative to this is to finance the Government through the sale of short-dated debt, which would be likely to lead to the expansion of the banks' reserve assets.

3 To lengthen the average life of stocks held by the market through switching, i.e. through sales by the Bank of longer-dated stocks to the market against purchases of shorter-dated stocks.

In practice, as each stock matures it is sometimes necessary (but now rare) to offer a conversion stock to replace it, but more often there is no direct coincidence of maturities and new issues. New issues are made in substantial amounts (hundreds of millions of pounds) and very little is taken up by the public at the time of issue. They are bought in

Tap stocks

the main by the Issue Department and made available for sale 'on tap' through open-market operations at a price determined by the Bank. It is for this reason that they are

known colloquially as tap stocks. The Bank normally aim to have in the Issue Department large holdings of stock in the short, medium and long-dated sectors, which thus provide a means of influencing markets in the whole range of gilt-edged maturities.

Method of intervention in gilt-edged market

163 Before the publication in May 1971 of new proposals for the control of credit, the Bank's interventions in the gilt-edged market had gradually extended over the years, from facilitating government financing and refinancing to smoothing out, at the same time, fluctuations in interest rates. The Bank were prepared to deal at prices of their own choosing in the whole range of government securities. Some time before the reappraisal of monetary policy which led to the proposals of May 1971, however, the UK authorities had concluded that operations in the gilt-edged market should pay regard to quantitative effects on the monetary aggregates as well as to interest rates. In response, the Bank's tactics became more flexible, especially in the prices at which they were prepared to deal. But this flexibility was still not enough to influence critically the ability of the banks to supplement their liquidity by selling large quantities of stock at times of their own choosing, and at prices close to those current in the market. The Bank therefore announced in May 1971 that they would no longer normally be prepared to respond to requests to buy stock outright, except for those with one year or less to maturity. The purpose of this was to make it less easy for the banks to sell their holdings of gilt-edged stocks without loss, to finance increases in their lending, and thereby to frustrate the new arrangements for control of credit.

164 This change was, of course, designed primarily to assist the effectiveness of a restrictive monetary policy. To provide for the implementation of an easy monetary policy under which expansionary open-market operations might be appropriate, the Bank reserve the right to make outright purchases of stock with over a year to maturity, at their discretion and initiative. Conversely, this provision has occasionally been used modestly in periods of severe tightness of liquidity (such as during the second quarter of 1972, as described in the next two paragraphs) to relieve the serious technical strain on the jobbers' (i.e. dealers') books.

Experience of current method of operation

165 In the first nine months after these changes were introduced, they were not fully tested. Demand for government stocks was strong for a number of reasons: the UK balance of payments was in surplus, confidence in the US dollar was low and the inflow of funds from overseas was heavy, part being ultimately invested in the gilt-edged market. At home, output was low and unemployment rising, so that monetary policy was relaxed and interest rates were falling. In these circumstances, the authorities were able to sell very large amounts of stock. A month or so after the Washington Agreement on the realignment of exchange rates in December 1971, however, the situation began to change. The overseas inflow dwindled and, during the spring when it became apparent that official attempts to reduce the rate of growth in domestic wages and prices were not succeeding, concern about the sterling exchange rate developed. Although interest rates had started to turn upwards, the withdrawal of funds from London after the flotation of sterling in the second half of June was rapid and heavy. To restore their reserve assets, the banks would have been obliged to sell in the market a large amount of government stocks, but the authorities made available to them exceptionally a temporary purchase and resale facility in short-dated gilt-edged stocks at a special rate of interest. These arrangements were designed to avoid excessive reaction in both the money and gilt-edged markets, and unduly sharp fluctuations in interest rates. The banks temporarily sold some £360 million stocks to the authorities and thereby gained a breathing space in which to correct the balance of their portfolios.

Temporary purchase and resale facility

166 The gilt-edged market had been generally weak in the months preceding these exceptional measures. Market demand for stock was low, the authorities – while redeeming stocks as they matured and continuing to buy in next-maturing stocks – had been able to sell little stock, and prices tended to fluctuate more sharply than before the Bank withdrew from the market in May 1971. There was unease in the market about its capacity to operate efficiently, and this was increased by the news that three firms of gilt-edged dealers for varying reasons would be withdrawing from the market. The Bank had in fact been aware of the threat to marketability of stock during this first experience of tightening conditions, and subsequently let it be known that they had made some limited purchases of stocks with maturities over one year, as well as providing the temporary repurchase facilities to the banks. The doubts in the market do not seem to have persisted for very long after these events, however, and it has subsequently continued to function satisfactorily.

Operations on short-term interest rates

167 So far as operations in the short-term money market are concerned, the Bank's intervention is designed to smooth out shortages or surpluses which may occur on particular days. These arise daily from the flows of central government revenue and expenditure, but may also be caused by settlements of official transactions in the gilt-edged market (as described above), foreign exchange settlements on behalf of the Exchange Equalisation Account, the maturity and take-up of Treasury bills, the issue or surrender of notes, and from the transactions of the Bank's other customers, particularly overseas central banks. If a shortage exists on a particular day, the banks are likely to be drawing on the most liquid reserves amongst their assets, their money lent at call to the discount houses. The discount houses therefore find themselves short of funds and, unless the Bank take steps to alleviate the shortage by other means, they will be forced to borrow from the Bank as lender of last resort. Alleviation takes place through purchases by the Bank of Treasury bills, or local authority bills, from the discount houses or from the banks themselves. On occasions, when Treasury bills and local authority bills are in short supply, the Bank may also buy limited quantities of fine bank bills, (and on exceptional occasions, the Bank have also bought local authority bonds and have placed short-term deposits with local authorities). The transactions may be either for account of the Banking Department or the Issue Department. They are normally effected at rates in line with the Treasury bill rate established at the preceding tender, which has a neutral impact on the level of rates generally; but, on occasions, they may be done at rates out of line with the tender rate, if the Bank wish to influence existing short-term rates.

Control depends on shortage of funds in the market

168 Clearly the Bank have control over the money market only if a condition o shortage exists. If the market has a surplus, this can be absorbed by offering Treasury bills to the discount houses and banks, but there is no way of forcing the market to buy more bills than it is willing to hold. However, the Bank can normally ensure that there is a shortage over a week as a whole by fixing the weekly Treasury bill tender (already discussed in Section III §I, Sub-section I), at a size which ensures this. As has been mentioned earlier, the discount houses have agreed to tender between them for at least the full amount of the bills on offer, so that, other things being equal, a condition of shortage is thus created.

Official dealing rates

169 The main changes in the money market introduced with the new arrangements for control of credit in September 1971 which affect the authorities' open-market operations have already been described (e.g. Section I §I, and earlier in Section III). The changes at the tender have made it possible for the Bank to determine the prices at which they will deal in Treasury bills. Before September 1971 the discount market had agreed prices among themselves for dealing in long bills (i.e. bills with two to three months to maturity) in the week following each tender, and the Bank had dealt in line with these prices, relying on forcing the market to borrow at last resort to influence the rate. Since September 1971, however, the Bank have also used their freedom over dealing rates in bills to encourage rates to move in the desired direction. On several occasions when th authorities have wished to move away from very relaxed monetary conditions, the Bank have set their dealing rates for bills above what they would have been, given the normal relationship with the average tender rate, and have held these rates until the tender rate moved into line. In September 1972, the average tender rate went above Bank rate when the amount of bills on offer was greater than the market wished to absorb. With Bank rate below market rates, the Bank had lost their normal means of influencing the market by lending, and there was a clear need for a more flexible last resort rate. Accordingly the Bank's new minimum lending rate was introduced on 13th October (described in Section I).

Para

## II Operations affecting short-term international capital flows

Sterling convertibility

170 Convertibility of sterling for non-residents dates *de facto* from the spring of 1954, but not until the end of 1958 was this formalised, when it was announced that, for the first time since 1939, sterling earned by non-residents, or held by them in bank deposits or Treasury bills, was to be freely convertible in London into gold, US dollars, or any other currency. Domestic convertibility (freedom for residents of the United Kingdom to convert sterling) continues to be subject to restrictions: UK residents need exchange control permission (freely given in the case of current transactions – controls on capital movements were described in Chapter I, Section I) to buy foreign exchange or to make payments to non-residents, and must in general sell their foreign currency receipts in the official market to authorised banks (those banks in the United Kingdom which have been authorised by HM Treasury to deal in foreign currencies). The foreign currency positions of the UK banks are strictly limited.

**Foreign currency positions of banks**

171 Authorised banks are subject to two quantitative restrictions on their foreign currency positions. The first restriction limits the size of a bank's permitted 'open' position, which is defined as the difference between total assets (spot and forward) and total liabilities in foreign currencies; the aim is to limit the extent to which a bank may run an uncovered position, whether a net asset or a net liability. The second restriction limits the extent to which a bank may hold net spot assets in cover of net forward liabilities.

172 UK banks' offshore foreign currency deposit business, as measured by their external liabilities and claims in overseas currencies, has increased dramatically since 1963. This reflects both the expansion in business of the banks already doing foreign currency deposit business in London in 1963, which numbered 132, and also business gained by some 100 newcomers to the London market since 1963, including many which have their head office in the United States. Deposits received from overseas countries totalled £1,300 million at the end of 1963: by June 1973 they amounted to over £28,000 million. A high proportion of the money has been on-lent abroad; the amount lent to UK residents was no more than about £1,800 million in June 1973.

**Foreign currency borrowing for domestic use**

173 Much foreign currency lending to UK residents has been used, with UK exchange control approval, to finance investment overseas. During 1970, however, the general demand from UK companies for such funds to convert into sterling for domestic use was felt to be incompatible with a restrictive domestic credit policy. Accordingly, from January 1971, foreign currency borrowing by residents for home use has normally been authorised only where it is for a minimum term of five years; in October 1973, this was reduced to two years. Inward uncovered switching by banks is, as already stated, strictly limited; covered switching is in theory unlimited, because it would be meaningless to limit it as long as non-residents are freely permitted to acquire sterling deposits. Foreign currency deposits switched into sterling are, however, regarded by the UK authorities as eligible liabilities for purposes of credit control and subject to the 12½% reserve assets ratio. In August 1971 the prospect of increasingly large speculative inflows into sterling led to the introduction of a series of exchange control measures with the object of preventing further non-resident acquisitions of certain sterling assets and, at the same time, restricting switching of foreign currencies into sterling by UK banks. These measures were withdrawn after the general realignment of currencies agreed in Washington in December 1971. While it is not possible to isolate the effect of any single economic factor with any precision, international flows of funds have not at any time seriously undermined the control of UK domestic liquidity. The UK authorities have generally relied on exchange rate policy and direct exchange control measures to regulate these flows. The new arrangements for control of credit include provision for special deposits applied differentially between the bank deposits of UK and overseas residents (described in Section II of this chapter); these deposits are not intended primarily to affect international flows, however, but rather to prevent such flows from having an undesirable effect on the domestic monetary situation.

**Forward intervention**

174 The Bank of England have from time to time intervened in the forward foreign exchange market. Such intervention was on a considerable scale between November 1964 and November 1967 in support of the exchange rate.

**The UK and EEC intervention arrangements**

175 On 1st May 1972 the United Kingdom undertook to abide by the EEC intervention arrangements under which the exchange rates of participating countries were to be kept within the narrower range of 2¼% from cross-parity, rather than the 4½% which would result from maintaining the limits of fluctuation permitted by the Washington Agreement of December 1971. A sudden wave of speculation against sterling in June 1972 severely tested these arrangements and, when the outflow of funds became large, it was announced on 23rd June that sterling would be allowed to find its own level against all other currencies. It was the UK Government's intention, however, to return to a fixed rate of exchange as soon as practicable. With about £1,000 million flowing out of the United Kingdom in little over one week in June 1972, this experience illustrates the volatility of short-term capital movements.

## Section IV Direct action on lending

176 Under the new arrangements, control of credit is now exercised mainly through the Bank of England's ability to influence the cost of credit and the resources available to the banks. But the Bank have retained the right, if necessary, to give qualitative guidance to

the banks, described in §II below; and under the arrangements for supplementary special deposits already described, they can influence more closely the rate of growth in the banks' interest-bearing resources.

177 The current system of credit control is based, as already mentioned, on voluntary agreement between the Bank of England and the banks and other relevant deposit-taking institutions. The Bank published a document for discussion called *Competition and credit control* in May 1971;[1] consultations followed with the banks, discount market and finance houses and, when agreement had been reached, the new arrangements were introduced in September. The details were set out in another document published by the Bank called *Reserve ratios and Special Deposits*.[2] Legal backing for the new arrangements was not necessary but the Bank do have in reserve powers of direction over the banks under the 1946 Bank of England Act.

Para

## I Quantitative credit control

UK reliance on quantitative control in 1960s

178 A broad outline of the quantitative controls on lending which were in use in the United Kingdom with varying degrees of stringency for much of the twenty-five years before September 1971 was given at the beginning of this chapter. Quantitative guidance was approved by the Radcliffe Commitee as a method of control suitable for use in emergency and, in the United Kingdom, it proved to be a fairly effective way of regulating the growth of bank credit. Instead of being kept in reserve as an emergency weapon however, quantitative regulation became a central and continuing feature of UK credit control during the 1960s, partly because pressure on the balance of payments and the exchange rate made it difficult for the authorities to allow any relaxation of domestic credit, and partly because of the increasing importance of banks other than the clearing banks, and the difficulty of extending equitable liquidity ratio controls and special deposit arrangements to them.

Requests to banks

179 The quantitative controls in general took two main forms. During the 1940s and 1950s, the authorities addressed requests only to the London and Scottish clearing banks asking them in broad terms to restrict the increase in their lending, or as in 1955 to make a 'positive and significant reduction in their advances over the next few months'. In the 1960s, the controls were extended to the other banks in the United Kingdom, which were growing in number and importance, and to the finance houses; banks' acceptances and purchases of commercial bills were controlled as well as advances; and the requests were expressed numerically in terms of a percentage change compared with the amount of each bank's lending at a specified base date. Thus in May 1965 the Governor of the Bank of England wrote to the banks asking that their advances to the private sector, acceptances and holdings of commercial bills should not rise by more than 5% in the twelve months to March 1966. Monthly surveillance of individual banks' compliance with these requests was based on statistics submitted by them to the Bank of England.

Numerical ceilings

Abandoned in 1971

180 As the use of quantitative restrictions became prolonged (and they were in force continuously between 1965 and 1971, apart from a short break in 1967) their disadvantages became increasingly apparent. As mentioned at the beginning of this chapter, they restricted the freedom of competition between banks, and cushioned inefficiency. The choice of base dates for ceiling controls was inevitably arbitrary, and affected banks unevenly and inequitably, while the problem of fixing an appropriate ceiling for bank lending became increasingly difficult as the life of the restrictions was prolonged from year to year. Moreover, the controls distorted the flow of credit and encouraged the growth of credit-giving institutions which were not restricted by them. The changes outlined in *Competition and credit control* were therefore widely welcomed in principle by the banking community.

Para

## II Selective credit control

Selective guidance before 1971

181 The quantitative controls on lending in force up to 1971 were usually accompanied by qualitative guidance. Priorities varied from time to time, but lending for activities likely to improve the balance of payments was generally favoured. In the early 1950s the banks were asked to restrict advances to 'essential' purposes, to withhold credit for speculative purchases of securities, real property or commodities, and to limit finance for

[1] Bank of England *Quarterly Bulletin*, June 1971, page 189.

[2] Issued as a supplement to the Bank of England *Quarterly Bulletin*, September 1971.

hire purchase. Later, under the arrangements announced after devaluation in November 1967, ceilings were to apply to all lending outside the public sector, except for identifiable export credit. Within the ceiling, priority was to be given to finance for production and investment necessary to sustain or increase exports and invisible earnings, and to save imports. The growth in lending to persons was to be halted without delay (though bridging finance for house purchase would still be made available), and other non-priority lending was to be severely restricted, especially finance of imports of manufactured goods for consumption or stockbuilding. Precise supervision of such qualitative guidance was impracticable, but the Bank held periodic discussions with the banks on the direction of their lending, and movements in advances to the main groups of borrowers indicated that the guidance did have some effect. In the twelve months after November 1967, for example, lending to persons other than for house purchase rose by only £9 million after seasonal adjustment, compared with £104 million in the preceding nine months.

Hire-purchase terms control

182 Apart from selective control of lending through central bank guidance, another important measure available to the UK authorities is the control of hire-purchase terms for consumers' durable goods. The control is exercised by the Department of Trade and Industry (formerly the Board of Trade), at first under the Supplies and Services (Transitional Power) Act 1945 and subsequently under the Emergency Laws (Re-enactments and Repeals) Act 1964. Restrictions were first imposed on minimum down-payments and maximum repayment periods in February 1952, and they were varied frequently in the succeeding nineteen years, until all terms controls on hire purchase, credit sale and rental agreements were removed by the Chancellor of the Exchequer in July 1971. They were reintroduced in December 1973, but many different forms of consumer credit have developed in recent years alongside instalment credit, and it was necessary to back up the controls with requests to banks and finance houses providing other forms of consumer credit not to do so on terms more favourable than for hire purchase. Comprehensive legislation affecting all kinds of consumer credit was introduced into Parliament in December 1973 and, when it becomes law, the use of terms control bearing on one particular form of consumer lending, instalment credit, will no longer be practicable.[1] Manipulation of terms control, however, has been a very effective and rapid means of influencing domestic demand, though it bears very heavily on a limited number of consumer goods industries. In the six months after the tightening of terms control in July 1966, net hire-purchase credit outstanding fell by £135 million compared with a fall of only £22 million in the preceding six months; and when terms controls and lending ceilings were removed in the third quarter of 1971 net credit extended rose by £232 million in the next six months against £38 million in the six months preceding. Sales of cars in particular are substantially financed by instalment credit, and were heavily affected by the changes in terms.

Use of selective guidance under competition and credit control

183 Although quantitative ceiling controls on lending were abandoned in September 1971, the Bank of England indicated to the banks that they would continue to give them such qualitative guidance as may be appropriate. In practice, no action was taken under this proviso until August 1972, when the Governor of the Bank wrote to the banks, asking them to make credit less readily available to property companies and for financial transactions not associated with the maintenance and expansion of industry. This request was strengthened a year later in September 1973, when the banks were reminded of the need to provide finance for exports, industrial investment and other essential purposes. In order to ensure the availability of credit for these purposes, they were asked to exercise significant restraint in the provision of credit to persons, and further restraint on lending for property development and financial transactions. In December 1973, the banks and finance houses were again asked to reinforce strongly their restraint on lending to persons generally, to property companies and for purely financial transactions.

[1] The proposed consumer credit legislation failed to reach the statute books before Parliament was dissolved on 8th February 1974.

# Bibliography


**Bank of England** *An introduction to flow of funds accounting: 1952–70* 1972

**Bank of England** *Statistical Abstract* 1970

**Bank of England** *Quarterly Bulletin*:

Commentaries, analyses of financial statistics, and regular monetary and banking statistics

Articles:

'Competition and credit control' June 1971 pages 189–93. Text of a consultative document issued in May 1971

'Key issues in monetary and credit policy' June 1971 pages 195–8. Text of an address by the Governor

'Competition and credit control: the discount market' September 1971 pages 314–15

'Reserve ratios and Special Deposits' September 1971 Supplement

'Competition and credit control' December 1971 pages 477–81. Extract from a lecture by the Chief Cashier

'Reserve ratios: further definitions' December 1971 pages 482–9

'Competition and credit control: further developments' March 1973 pages 51–5

'Competition and credit control: modified arrangements for the discount market' September 1973 pages 306–7

'The management of money day by day' March 1963 pages 15–21

'The Exchange Equalisation Account: its origins and development' December 1968 pages 377–90

'The importance of money' June 1970 pages 159–98

'The financial institutions' December 1970, March and June 1971 pages 419–31; 48–71; and 199–210

'Timing relationships between movements of monetary and national income variables' December 1970 pages 459–72

'The demand for money in the United Kingdom: a further investigation' March 1972 pages 43–55

'Banking mergers and participations' December 1972 page 452. Press notice of November 1972

'Sterling certificates of deposit' December 1972 pages 487–95

'Substitution among capital-certain assets in the personal sector of the UK economy' December 1972 pages 509–11. Summary of a research paper

'Does the money supply really matter?' June 1973 pages 193–202. Text of an address by the Deputy Governor

**Bain, A. D.** *The control of the money supply* London: Penguin, 1970

**Central Office of Information** *British financial institutions* London: HM Stationery Office, 1971

**Central Statistical Office** *Financial Statistics* London: HM Stationery Office, monthly

**Croome, D. R. and Johnson, H. G. eds.** *Money in Britain 1959–1969* Oxford: University Press, 1970

**Johnson, H. G. ed.** *Readings in British monetary economics* Oxford: University Press, 1972

**Pringle, Robin** *A guide to banking in Britain* London: Charles Knight, 1973

**Radcliffe Report** *Report of the Committee on the Working of the Monetary System* Cmnd 827 London: HM Stationery Office, 1959

**Radcliffe Report** *Committee on the Working of the Monetary System: Minutes of Evidence* 4 vols London: HM Stationery Office, 1960

*Report from the Select Committee on Nationalised Industries: the Bank of England* London: HM Stationery Office, 1970

**Revell, Jack** *The British Financial System* London: Macmillan, 1973

## Statistical tables

Table 1 Composition of the money stock ($M_1$ and $M_3$)
Table 2 Influences on the money stock ($M_3$)
Table 3 Velocity of circulation
Table 4 Bank liquidity
Table 5 Banks' reserve and other sterling assets
Table 6 Public debt
Table 7 Financial institutions' holdings of long-term securities
Table 8 Bank of England intervention in the money market
Table 9 Bank rate
Table 10 Rates and amounts of minimum reserves
Table 11 Amounts of sterling money market funds outstanding
Table 12 Range of money market rates
Table 13 Short-term liabilities to and claims on foreign countries
Table 14 Deposits with the various institutions in the banking sector
Table 15 Persons' and companies' financial investment
Table 16 Gross national product and exports of goods and services

**Notes, definitions and symbols**

1 Holdings relate to 31st December except in the case of local authority pension funds where they relate to 31st March.

2 Only rough estimates of the holdings of some groups of institutions have been possible.

3 Holdings are at market value except in the following cases where book and/or nominal values have been used:

| | |
|---|---|
| Banks | |
| Insurance companies | 1961–72 |
| Public sector pension funds | 1960–63 |
| Private sector pension funds | 1960–62 |
| Local authority pension funds | 1960–64 |
| Building societies | 1960–72 |
| Trustee savings banks, special investment department | 1959–60 (nominal value) |

not available.

— nil or less than half the final digit shown.

**Table 1**

**Composition of the money stock ($M_1$ and $M_3$)**

£ millions

| | 1963 | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 |
|---|---|---|---|---|---|---|---|---|---|---|
| UK private sector sterling current accounts with banks [a] | 5,071 | 5,106 | 5,212 | 5,149 | 5,627 | 5,925 | 5,806 | 6,315 | 7,499 | 8,578 |
| Notes and coin in circulation with the public | 2,251 | 2,451 | 2,636 | 2,695 | 2,815 | 2,859 | 3,006 | 3,320 | 3,589 | 4,079 |
| **Money stock, $M_1$** | **7,322** | **7,557** | **7,848** | **7,844** | **8,442** | **8,784** | **8,812** | **9,635** | **11,088** | **12,657** |
| UK private sector: | | | | | | | | | | |
| Sterling deposit accounts with banks | 3,632 | 4,026 | 4,648 | 5,059 | 5,780 | 6,481 | 6,770 | 7,349 | 8,174 | 11,856 |
| Other currency accounts with banks | 105 | 105 | 116 | 149 | 255 | 335 | 464 | 509 | 430 | 802 |
| Deposits with discount houses | 112 | 112 | 77 | 96 | 103 | 102 | 93 | 181 | 305 | 305 |
| Public sector deposits with banks | 345 | 355 | 394 | 407 | 423 | 390 | 457 | 501 | 544 | 625 |
| Total of items included in $M_3$ but not in $M_1$ | 4,194 | 4,598 | 5,235 | 5,711 | 6,561 | 7,308 | 7,784 | 8,540 | 9,453 | 13,588 |
| **Money stock, $M_3$** | **11,516** | **12,155** | **13,083** | **13,555** | **15,003** | **16,092** | **16,596** | **18,175** | **20,541** | **26,245** |
| Annual change in $M_1$ [b] | | + 249 | + 301 | + 3 | + 674 | + 349 | + 27 | + 830 | +1,055 | +1,517 |
| *Per cent* | | *+ 3·4* | *+ 4·0* | — | *+ 8·6* | *+ 4·1* | *+ 0·3* | *+ 9·4* | *+ 10·9* | *+ 13·7* |
| Annual change in $M_3$ [b] | + 765 | + 653 | + 938 | + 479 | +1,345 | +1,152 | + 503 | +1,586 | +2,366 | +5,299 |
| *Per cent* | *+ 7·1* | *+ 5·7* | *+ 7·7* | *+ 3·7* | *+ 9·9* | *+ 7·7* | *+ 3·1* | *+ 9·6* | *+ 13·0* | *+ 25·8* |

[a] 60% of the net value of transit items within the banking sector is deducted.

[b] The changes shown in $M_1$ and $M_3$ may differ from those which can be calculated by reference to the outstanding amounts, mainly because of breaks in the series attributable to changes in the composition of the banking sector.

**Table 2**

**Influences on the money stock ($M_3$)**

£ millions

| | 1963 | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 |
|---|---|---|---|---|---|---|---|---|---|---|
| Public sector borrowing requirement (surplus −): | | | | | | | | | | |
| Central government | + 153 | + 434 | + 610 | + 530 | +1,155 | + 759 | −1,112 | − 678 | + 562 | +1,426 |
| Other public sector | + 679 | + 561 | + 578 | + 429 | + 679 | + 558 | + 638 | + 682 | + 817 | + 634 |
| Purchases (−) of public sector debt by private sector other than banks: | | | | | | | | | | |
| Central government | + 3 | − 121 | + 3 | + 117 | − 306 | + 315 | − 90 | − 52 | −2,306 | − 753 |
| Other public sector | − 587 | − 389 | − 472 | − 377 | − 331 | − 340 | − 257 | − 68 | + 199 | − 237 |
| Bank lending to private sector | + 736 | + 999 | + 508 | + 52 | + 634 | + 725 | + 597 | +1,315 | +1,856 | +6,434 |
| External finance (increase −): | | | | | | | | | | |
| Public sector | − 103 | − 656 | − 96 | − 413 | − 502 | −1,111 | + 594 | +1,350 | +2,667 | −1,601 |
| Banking sector | − 27 | − 88 | − 66 | + 257 | + 41 | + 236 | + 141 | − 753 | −1,061 | + 9 |
| Banks' net non-deposit liabilities (increase −) | − 89 | − 87 | − 127 | − 116 | − 25 | + 10 | − 8 | − 210 | − 368 | − 613 |
| **Change in money stock, $M_3$** | **+ 765** | **+ 653** | **+ 938** | **+ 479** | **+1,345** | **+1,152** | **+ 503** | **+1,586** | **+2,366** | **+5,299** |

**Table 3**

**Velocity of circulation** [a]

| | 1963 | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 |
|---|---|---|---|---|---|---|---|---|---|---|
| GNP/$M_1$ | | 4·503 | 4·671 | 4·881 | 4·940 | 5·051 | 5·297 | 5·516 | 5·569 | 5·229 |
| GNP/$M_3$ | 2·760 | 2·830 | 2·851 | 2·876 | 2·841 | 2·798 | 2·851 | 2·926 | 2·923 | 2·654 |

[a] The figures given in this table are ratios of gross national product at current market prices to centred annual averages of the narrow ($M_1$) and broad ($M_3$) versions of the money stock.

**Tables 1, 2 and 3**

**Table 4**

**Bank liquidity [a]**

## 1 London clearing banks

£ millions

| | Gross deposits | Liquid assets | | | | | | Liquidity ratio (%) [b] |
|---|---|---|---|---|---|---|---|---|
| | | Notes and coin | Balances with Bank of England | Money at call and short notice | British government Treasury bills | UK commercial and other bills | Total | |
| 31 Dec. 1958 | 7,199 | 373 | 213 | 587 | 1,185 | 135 | 2,493 | *34·6* |
| 16 Dec. 1959 | 7,439 | 385 | 215 | 560 | 1,218 | 164 | 2,543 | *34·2* |
| 14 Dec. 1960 | 7,523 | 398 | 217 | 623 | 1,006 | 155 | 2,399 | *31·9* |
| 13 Dec. 1961 | 7,555 | 406 | 220 | 706 | 1,081 | 252 | 2,666 | *35·3* |
| 12 Dec. 1962 | 7,903 | 420 | 224 | 786 | 986 | 268 | 2,684 | *34·0* |
| 11 Dec. 1963 | 8,337 | 464 | 226 | 787 | 940 | 305 | 2,723 | *32·7* |
| 16 Dec. 1964 | 8,996 | 516 | 251 | 882 | 679 | 426 | 2,754 | *30·6* |
| 15 Dec. 1965 | 9,454 | 548 | 244 | 1,020 | 770 | 456 | 3,039 | *32·1* |
| 14 Dec. 1966 | 9,501 | 562 | 238 | 1,171 | 681 | 474 | 3,126 | *32·9* |
| 13 Dec. 1967 | 10,262 | 570 | 252 | 1,366 | 450 | 489 | 3,127 | *30·5* |
| 11 Dec. 1968 | 10,736 | 599 | 266 | 1,487 | 510 | 525 | 3,385 | *31·5* |
| 10 Dec. 1969 | 10,724 | 678 | 216 | 1,549 | 394 | 608 | 3,446 | *32·1* |
| 9 Dec. 1970 | 10,606 | 668 | 162 | 1,590 | 406 | 764 | 3,590 | *33·8* |

## 2 Scottish clearing banks

£ millions

| | Gross deposits and notes outstanding | Liquid assets | | | | | | Liquidity ratio (%) |
|---|---|---|---|---|---|---|---|---|
| | | Notes and coin | Balances with Bank of England and other banks | Money at call and short notice | British government Treasury bills | UK commercial and other bills | Total | |
| Dec. 1958 | 911 | 133 | 106[c] | 78 | 26 | 6 | 349[c] | *38·3* |
| Dec. 1959 | 954 | 136 | 105[c] | 90 | 23 | 6 | 361[c] | *37·8* |
| 21 Dec. 1960 | 934 | 145 | 46 | 82 | 20 | 6 | 299 | *32·0* |
| 13 Dec. 1961 | 946 | 148 | 58 | 66 | 41 | 9 | 323 | *34·2* |
| 12 Dec. 1962 | 966 | 145 | 44 | 91 | 24 | 9 | 312 | *32·4* |
| 11 Dec. 1963 | 1,005 | 150 | 49 | 95 | 30 | 10 | 334 | *33·2* |
| 16 Dec. 1964 | 1,052 | 153 | 59 | 78 | 21 | 13 | 324 | *30·8* |
| 15 Dec. 1965 | 1,093 | 157 | 58 | 104 | 34 | 13 | 366 | *33·4* |
| 14 Dec. 1966 | 1,114 | 160 | 57 | 112 | 23 | 15 | 365 | *32·8* |
| 13 Dec. 1967 | 1,208 | 167 | 65 | 119 | 28 | 14 | 393 | *32·5* |
| 11 Dec. 1968 | 1,281 | 174 | 76 | 115 | 31 | 17 | 414 | *32·3* |
| 10 Dec. 1969 | 1,283 | 180 | 82 | 127 | 9 | 23 | 421 | *32·8* |
| 9 Dec. 1970 | 1,276 | 185 | 96 | 152 | 5 | 33 | 472 | *37·0* |

[a] For a definition of liquidity as illustrated in these tables, see Chapter II, Section II §1.I. The operational significance of these liquidity requirements was superseded by the new credit control arrangements introduced during 1971.

[b] Agreed minimum: 30% until September 1963; 28% until September 1971.

[c] Including items in transit.

**Table 5**

**Banks' reserve and other sterling assets**

## 1 Reserve assets

£ millions

| | Eligible liabilities | Reserve assets | | | | | | | | Reserve ratio (%) [b] |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Balances with Bank of England | UK and N. Ireland Treasury bills | Company tax reserve certificates | Money at call | British government stocks up to 1 year [a] | Local authority bills | Commercial bills | Total | |
| 8 Dec. 1971 | 17,900 | 178 | 299 | 54 | 2,076 | 291 | 40 | 169 | 3,107 | *17·4* |
| 13 Dec. 1972 | 22,761 | 222 | 341 | 53 | 2,040 | 481 | 76 | 358 | 3,571 | *15·7* |

## 2 Other sterling assets

£ millions

| | Notes and coin | Other call money | Other commercial and local authority bills | Deposits with local authorities [c] | British government stocks with a maturity of: | | | Inter-bank | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | 12–18 months | 18 months – 5 years | Over 5 years and undated | Balances with UK banks | Holdings of certificates of deposit |
| 8 Dec. 1971 | 852 | 447 | 1,137 | 478 | 239 | 1,346 | 921 | 2,103 | 1,160 |
| 13 Dec. 1972 | 939 | 194 | 466 | 475 | — | 1,041 | 422 | 4,441 | 2,945 |

[a] With one year or less to final maturity.

[b] Agreed minimum: 12½%.

[c] Deposits with a maturity up to one year. Figures are as at end-December, and the figure for 1971 is net of deposits from local authorities.

## Table 6

## Public debt

£ millions

Nominal values

| End-March | 1958 | 1959 | 1960 | 1961 | 1962 | 1963 | 1964 | 1965 | 1966 | 1967 |
|---|---|---|---|---|---|---|---|---|---|---|
| **A** National debt: total [a] | 28,363 | 28,482 | 28,979 | 29,559 | 30,035 | 29,807 | 30,222 | 30,461 | 31,318 | 31,921 |
| By holder:[b] | | | | | | | | | | |
| UK official holdings [c] | 7,032 | 7,208 | 7,412 | 7,897 | 8,260 | 8,193 | 8,592 | 8,926 | 9,324 | 9,273 |
| Market holdings | 21,331 | 21,274 | 21,567 | 21,662 | 21,775 | 21,614 | 21,630 | 21,535 | 21,994 | 22,648 |
| Public bodies [d] | 179 | 192 | 197 | 198 | 232 | 150 | 196 | 195 | 189 | 193 |
| Banking sector | 4,706 | 4,390 | 4,036 | 3,481 | 3,458 | 3,422 | 3,539 | 2,980 | 3,359 | 3,539 |
| Other financial institutions [e] | 1,840 | 1,934 | 2,020 | 2,440 | 2,534 | 3,664 | 3,723 | 4,001 | 4,213 | 4,580 |
| Overseas holders [f] | 3,094 | 2,920 | 3,141 | 3,093 | 3,168 | 3,597 | 3,628 | 4,190 | 4,527 | 4,482 |
| Other holders | 11,512 | 11,838 | 12,173 | 12,450 | 12,383 | 10,781 | 10,544 | 10,169 | 9,706 | 9,854 |
| By type of debt: | | | | | | | | | | |
| Stocks | 18,578 | 18,163 | 18,134 | 19,176 | 18,546 | 19,740 | 19,992 | 19,619 | 19,692 | 21,610 |
| *of which:* | | | | | | | | | | |
| *0·5 years* | *3,773* | *3,200* | *3,028* | *4,841* | *3,799* | *5,029* | *5,402* | *5,109* | *5,352* | *6,261* |
| *5–15 years* | *5,498* | *5,794* | *6,046* | *5,806* | *6,158* | *5,609* | *5,138* | *5,248* | *5,689* | *5,777* |
| *Over 15 years and undated* | *9,307* | *9,169* | *9,060* | *8,529* | *8,589* | *9,102* | *9,452* | *9,262* | *8,651* | *9,572* |
| Treasury bills | 4,571 | 4,898 | 5,202 | 4,648 | 5,331 | 4,237 | 4,418 | 4,672 | 5,122 | 3,885 |
| Ways and means advances | 277 | 341 | 246 | 307 | 261 | 239 | 315 | 343 | 303 | 273 |
| National savings securities | 2,735 | 3,044 | 3,293 | 3,510 | 3,577 | 3,678 | 3,720 | 3,823 | 3,664 | 3,630 |
| Tax reserve certificates | 346 | 390 | 355 | 377 | 397 | 352 | 292 | 251 | 192 | 289 |
| Interest-free notes due to IMF | 579 | 502 | 651 | 510 | 800 | 510 | 515 | 868 | 1,537 | 1,508 |
| Other [g] | 1,277 | 1,144 | 1,100 | 1,031 | 1,123 | 1,051 | 970 | 885 | 808 | 72[illegible] |
| **B** Local authorities' gross loan debt [h] | 5,742 | 6,132 | 6,555 | 6,972 | 7,509 | 8,083 | 8,800 | 9,731 | 10,752 | 11,822 |
| *of which:* | | | | | | | | | | |
| *Temporary borrowing* [j] | — | — | — | *901* | *1,211* | *1,241* | *1,483* | *1,809* | *1,674* | *1,644* |
| *From central government* | *3,274* | *3,241* | *3,205* | *3,167* | *3,145* | *3,114* | *3,107* | *3,351* | *3,904* | *4,478* |

[a] As defined in the *Finance Accounts of the United Kingdom* for years up to 1968 and the *Consolidated Fund and National Loans Fund Accounts (Supplementary Statements)* for subsequent years, but excluding debt payable in external currencies and including nationalised industries' stocks guaranteed by the Government.

[b] Partly estimated, as in annual articles in the Bank of England *Quarterly Bulletin* (June 1962, March 1963 to March 1973, December 1973). The figures for different years may not be strictly comparable: the major breaks in the series are noted below.

[c] The holdings of the Issue and Banking Departments of the Bank of England, the Exchange Equalisation Account, government departments, the National Debt Commissioners and, from 1966, the Northern Ireland Government.

[d] Public corporations (chiefly nationalised industries) and local authorities.

[e] The figures for 1958–1960 exclude all superannuation funds other than local authorities' superannuation funds, and those for 1961 and 1962 exclude private sector superannuation funds.

[f] For 1962 and previous years overseas holders comprise only official holders.

[g] Comprising terminable annuities due to the National Debt Commissioners, holdings of interest-free notes by international organisations other than the International Monetary Fund, sterling loans from overseas governments and some other minor items.

[h] As defined in the *Annual Abstract of Statistics*.

[j] As defined in *Financial Statistics*. Comprises (with minor exceptions) all loans repayable within a year of their inception: longer-term debt within one year of maturity or running on at short notice after maturity is not included.

## Table 7

## Financial institutions' holdings of long-term securities

£ millions

| | 1958 | 1959 | 1960 | 1961 | 1962 | 1963 | 1964 | 1965 | 1966 | 1967 |
|---|---|---|---|---|---|---|---|---|---|---|
| Banks | 1,327 | 1,349 | 1,118 | 973 | 1,202 | 1,281 | 1,174 | 1,324 | 1,319 | 1,260 |
| Insurance companies | .. | .. | .. | 4,954 | 5,347 | 5,842 | 6,344 | 6,775 | 7,177 | 8,020 |
| Pension funds: | | | | | | | | | | |
| Public sector | .. | .. | 479 | 530 | 582 | 634 | 755 | 802 | 802 | 1,030 |
| Private sector | .. | .. | .. | .. | 2,287 | 2,706 | 2,734 | 3,020 | 3,077 | 3,416 |
| Local authorities | .. | .. | 554 | 602 | 658 | 717 | 779 | 731 | 809 | 873 |
| Building societies | .. | .. | 368 | 395 | 471 | 548 | 540 | 657 | 761 | 1,006 |
| Hire-purchase finance houses | .. | .. | .. | .. | 44 | 51 | 61 | 74 | 87 | 84 |
| Investment trust companies | .. | .. | 1,962 | 2,245 | 2,302 | 2,796 | 2,827 | 3,035 | 2,917 | 3,915 |
| Unit trusts | .. | .. | 189 | 219 | 254 | 343 | 394 | 489 | 537 | 770 |
| Trustee savings banks, special investment departments | .. | 125 | 158 | 168 | 231 | 289 | 341 | 391 | 440 | 504 |
| National savings bank, special investment account | | | | | | | | | 31 | 80 |
| **Total** | .. | .. | .. | .. | **13,378** | **15,207** | **15,949** | **16,903** | **17,957** | **20,958** |

| 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | End-March |
|---|---|---|---|---|---|---|
| 33,647 | 33,485 | 32,366 | 32,805 | 35,400 | 36,526 | A National debt: total [a] |
| | | | | | | By holder: [b] |
| 9,212 | 9,433 | 8,984 | 9,166 | 8,762 | 10,183 | UK official holdings [c] |
| 24,435 | 24,052 | 23,382 | 23,639 | 26,638 | 26,343 | Market holdings |
| 190 | 216 | 217 | 174 | 222 | 171 | Public bodies [d] |
| 3,403 | 2,826 | 2,465 | 2,691 | 3,631 | 2,619 | Banking sector |
| 5,263 | 5,234 | 5,825 | 6,610 | 7,830 | 8,072 | Other financial institutions [e] |
| 5,891 | 6,468 | 5,253 | 4,646 | 4,773 | 4,857 | Overseas holders [f] |
| 9,688 | 9,308 | 9,622 | 9,518 | 10,182 | 10,624 | Other holders |
| | | | | | | By type of debt: |
| 21,844 | 20,982 | 21,240 | 23,067 | 25,342 | 27,069 | Stocks |
| | | | | | | *of which:* |
| *7,041* | *6,700* | *5,636* | *6,275* | *7,387* | *6,923* | *0–5 years* |
| *4,685* | *4,698* | *5,258* | *4,784* | *4,382* | *6,590* | *5–15 years* |
| *10,118* | *9,584* | *10,346* | *12,008* | *13,573* | *13,556* | *Over 15 years and undated* |
| 5,455 | 5,741 | 4,561 | 3,291 | 3,586 | 3,093 | Treasury bills |
| 278 | 338 | 428 | 556 | 502 | 634 | Ways and means advances |
| 3,683 | 3,676 | 3,559 | 3,574 | 3,967 | 4,178 | National savings securities |
| 308 | 344 | 292 | 326 | 372 | 218 | Tax reserve certificates |
| 1,433 | 1,828 | 1,836 | 1,630 | 1,352 | 1,120 | Interest-free notes due to IMF |
| 646 | 576 | 450 | 361 | 279 | 214 | Other [g] |
| 12,975 | 14,167 | 15,184 | 16,902 | 17,581 | 19,048 | B Local authorities' gross loan debt [h] |
| | | | | | | *of which:* |
| *2,007* | *1,959* | *1,936* | *1,919* | *2,010* | *2,607* | *Temporary borrowing* [j] |
| *4,872* | *5,369* | *5,937* | *6,649* | *7,511* | *8,482* | *From central government* |

| 1968 | 1969 | 1970 | 1971 | 1972 | |
|---|---|---|---|---|---|
| 1,383 | 1,380 | 1,625 | 2,223 | 1,950 | Banks |
| 9,019 | 9,562 | 10,190 | 11,413 | 12,857 | Insurance companies |
| | | | | | Pension funds: |
| 1,307 | 1,217 | 1,313 | 1,967 | 2,427 | Public sector |
| 3,925 | 3,990 | 4,047 | 5,526 | 6,279 | Private sector |
| 1,044 | 1,175 | 1,200 | 1,249 | 1,755 | Local authorities |
| 939 | 1,035 | 1,351 | 1,797 | 1,774 | Building societies |
| 64 | 78 | 68 | 101 | 68 | Hire-purchase finance houses |
| 5,458 | 4,670 | 4,244 | 5,659 | 7,329 | Investment trust companies |
| 1,304 | 1,296 | 1,245 | 1,880 | 2,326 | Unit trusts |
| 520 | 518 | 604 | 853 | 958 | Trustee savings banks, special investment departments |
| 120 | 166 | 227 | 329 | 386 | National savings bank, special investment account |
| **25,083** | **25,087** | **26,114** | **32,997** | **38,109** | **Total** |

**Table 8**

**Bank of England intervention in the money market**

| | Frequency of intervention [a] | | | | Amount of intervention | | | |
|---|---|---|---|---|---|---|---|---|
| | No intervention | Assistance given | | Surplus absorbed by sales of Treasury bills | Assistance given | | | Surplus absorbed by sales of Treasury bills |
| | | | | | At penal rates [b] | At market rates | | |
| Year ending | | At penal rates | At market rates | | | Purchases of Treasury bills | Other [b] | |
| | | | | | | *£ millions* | | |
| 31 Dec. 1958 | 106 | 92 | 172 | 11 | 413 | 2,321 | — | 159 |
| 10 Dec. 1959 | 108 | 48 | 156 | 18 | 177 | 1,696 | — | 196 |
| 14 Dec. 1960 | 93 | 53 | 179 | 24 | 248 | 2,428 | — | 310 |
| 13 Dec. 1961 | 83 | 66 | 169 | 40 | 485 | 3,204 | — | 490 |
| 12 Dec. 1962 | 74 | 63 | 182 | 36 | 446 | 3,721 | — | 451 |
| 11 Dec. 1963 | 61 | 50 | 188 | 42 | 399 | 3,899 | — | 470 |
| 16 Dec. 1964 | 65 | 7 | 220 | 24 | 58 | 5,030 | — | 301 |
| 15 Dec. 1965 | 72 | 49 | 180 | 41 | 561 | 4,592 | — | 768 |
| 14 Dec. 1966 | 43 | 45 | 201 | 49 | 575 | 4,468 | 692 | 894 |
| 13 Dec. 1967 | 24 | 56 | 256 | 18 | 1,298 | 6,377 | 5,709 | 506 |
| 11 Dec. 1968 | 26 | — | 249 | 28 | — | 5,168 | 6,477 | 458 |
| 10 Dec. 1969 | 53 | — | 149 | 81 | — | 3,303 | 463 | 1,475 |
| 9 Dec. 1970 | 37 | 21 | 147 | 60 | 760 | 3,615 | 341 | 1,465 |
| 8 Dec. 1971 | 42 | 22 | 149 | 54 | 931 | 4,775 | 404 | 1,981 |
| 13 Dec. 1972 | 52 | 23 | 140 | 54 | 938 | 5,163 | 620 | 1,708 |

[a] The number of working days on which the Bank did or did not intervene in the market.
[b] Advances are shown gross, before taking account of repayments.

**Table 8**

## Table 9

### Bank rate [a]

Per cent per annum

| Year | Date | Rate |
|---|---|---|
| 1958 | 20th March | 6 |
| | 22nd May | 5½ |
| | 19th June | 5 |
| | 14th August | 4½ |
| | 20th November | 4 |
| 1959 | No change | |
| 1960 | 21st January | 5 |
| | 23rd June | 6 |
| | 27th October | 5½ |
| | 8th December | 5 |
| 1961 | 25th July | 7 |
| | 5th October | 6½ |
| | 2nd November | 6 |
| 1962 | 8th March | 5½ |
| | 22nd March | 5 |
| | 26th April | 4½ |
| 1963 | 3rd January | 4 |
| 1964 | 27th February | 5 |
| | 23rd November | 7 |
| 1965 | 3rd June | 6 |
| 1966 | 14th July | 7 |
| 1967 | 26th January | 6½ |
| | 16th March | 6 |
| | 4th May | 5½ |
| 1967 | 19th October | 6 |
| | 9th November | 6½ |
| | 18th November | 8 |
| 1968 | 21st March | 7½ |
| | 19th September | 7 |
| 1969 | 27th February | 8 |
| 1970 | 5th March | 7½ |
| | 15th April | 7 |
| 1971 | 1st April | 6 |
| | 2nd September | 5 |
| 1972 | 22nd June | 6 |
| | 13th October | 7¼ |
| | 27th October | 7½ |
| | 1st December | 7¾ |
| | 8th December | 8 |
| | 22nd December | 9 |
| 1973 | 19th January | 8¾ |
| | 23rd March | 8½ |
| | 13th April | 8 |
| | 19th April | 8¼ |
| | 11th May | 8 |
| | 18th May | 7¾ |
| | 22nd June | 7½ |

[a] The minimum lending rate from 13th October 1972, see Chapter II, Section 1 §1.

**Table 10**

**Rates and amounts of minimum reserves**

**1 Rates of minimum reserves**

Per cent of gross deposits

| Date effective | London clearing banks: Cash ratio | London clearing banks: Liquidity ratio | London clearing banks: Special deposits | Scottish clearing banks: Liquidity ratio (informal) [a] | Scottish clearing banks: Special deposits |
|---|---|---|---|---|---|
| 1946 | 8·0 | — | — | — | — |
| 1957 | ,, | 30·0 | — | 30·0 | — |
| 15 June 1960 | ,, | ,, | 1·0 | ,, | 0·50 |
| 20 July 1960 | ,, | ,, | 1·5 | ,, | 0·75 |
| 17 Aug. 1960 | ,, | ,, | 2·0 | ,, | 1·00 |
| 16 Aug. 1961 | ,, | ,, | 2·5 | ,, | 1·25 |
| 20 Sept. 1961 | ,, | ,, | 3·0 | ,, | 1·50 |
| 12 May 1962 | ,, | ,, | 2·5 | ,, | 1·25 |
| 18 June 1962 | ,, | ,, | 2·0 | ,, | 1·00 |
| 8 Oct. 1962 | ,, | ,, | 1·5 | ,, | 0·75 |
| 15 Oct. 1962 | ,, | ,, | 1·0 | ,, | 0·50 |
| 10 Dec. 1962 | ,, | ,, | 0·5 | ,, | 0·25 |
| 17 Dec. 1962 | ,, | ,, | — | ,, | — |
| Sept. 1963 | ,, | 28·0 | — | 28·0 | — |
| 19 May 1965 | ,, | ,, | 0·5 | ,, | 0·25 |
| 16 June 1965 | ,, | ,, | 1·0 | ,, | 0·50 |
| 20 July 1966 | ,, | ,, | 1·5 | ,, | 0·75 |
| 17 Aug. 1966 | ,, | ,, | 2·0 | ,, | 1·00 |
| 6 May 1970 | ,, | ,, | 2·5 | ,, | 1·25 |
| 11 Nov. 1970 | ,, | ,, | 3·5 | ,, | 1·75 |
| 15 Sept. 1971 | ,, | ,, | — | ,, | — |

Per cent of eligible liabilities

| | Banks: Reserve ratio | Banks: Special deposits [b] | Finance houses: Reserve ratio | Finance houses: Special deposits | Discount market: Public sector lending ratio [c] |
|---|---|---|---|---|---|
| 16 Sept. 1971 | 12·5 | — | — | — | 50·0 |
| 8 Dec. 1971 | ,, | — | 2·5 | — | ,, |
| 15 Mar. 1972 | ,, | — | 5·0 | — | ,, |
| 21 June 1972 | ,, | — | 7·5 | — | ,, |
| 20 Sept. 1972 | ,, | — | 10·0 | — | ,, |
| 30 Nov. 1972 | ,, | 0·5 | ,, | 0·5 | ,, |
| 14 Dec. 1972 | ,, | 1·0 | ,, | 1·0 | ,, |

[a] Percentage of gross deposits and notes outstanding.
[b] These calls were not applied to banks in Northern Ireland.
[c] Percentage of eligible borrowed funds.

## 2 Amounts of minimum reserves

£ millions

| | London clearing banks | | | | | | | Scottish clearing banks | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Gross deposits | Cash | % | Liquid assets | % | Special deposits [a] | % | Gross deposits and notes outstanding | (Gross deposits) | Liquid assets | % | Special deposits [a] | % [b] |
| 31 Dec. 1958 | 7,199 | 586 | *8·1* | 2,493 | *34·6* | — | — | 911 | (791) | 349[d] | *38·3* | — | — |
| 16 Dec. 1959 | 7,439 | 600 | *8·*[illegible] | 2,543 | *34·2* | — | — | 954 | (831) | 361[d] | *37·8* | — | — |
| 14 Dec. 1960[c] | 7,523 | 615 | *8·2* | 2,399 | *31·9* | 148 | *2·0* | 934 | (809) | 299 | *32·0* | 8·0 | *1·00* |
| 13 Dec. 1961 | 7,555 | 626 | *8·3* | 2,666 | *35·3* | 224 | *3·0* | 946 | (818) | 323 | *34·2* | 12·3 | *1·50* |
| 12 Dec. 1962 | 7,903 | 644 | *8·1* | 2,684 | *34·0* | — | — | 966 | (843) | 312 | *32·4* | — | — |
| 11 Dec. 1963 | 8,337 | 690 | *8·3* | 2,723 | *32·7* | — | — | 1,005 | (879) | 334 | *33·2* | — | — |
| 16 Dec. 1964 | 8,996 | 767 | *8·5* | 2,754 | *30·6* | — | — | 1,052 | (925) | 324 | *30·8* | — | — |
| 15 Dec. 1965 | 9,454 | 792 | *8·4* | 3,039 | *32·1* | 93 | *1·0* | 1,093 | (962) | 366 | *33·4* | 4·9 | *0·50* |
| 14 Dec. 1966 | 9,501 | 800 | *8·4* | 3,126 | *32·9* | 190 | *2·0* | 1,114 | (982) | 365 | *32·8* | 9·9 | *1·00* |
| 13 Dec. 1967 | 10,262 | 822 | *8·0* | 3,127 | *30·5* | 205 | *2·0* | 1,208 | (1,070) | 393 | *32·5* | 10·7 | *1·00* |
| 11 Dec. 1968 | 10,736 | 865 | *8·1* | 3,385 | *31·5* | 215 | *2·0* | 1,281 | (1,138) | 414 | *32·3* | 11·4 | *1·00* |
| 10 Dec. 1969 | 10,724 | 894 | *8·3* | 3,446 | *32·1* | 215 | *2·0* | 1,283 | (1,134) | 421 | *32·8* | 11·3 | *1·00* |
| 9 Dec. 1970 | 10,606 | 830 | *7·8* | 3,590 | *33·8* | 371 | *3·5* | 1,276 | (1,119) | 472 | *37·0* | 19·6 | *1·75* |

| | Banks | | | | | Finance houses | | | | | Discount market | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Eligible liabilities | Reserve assets | % | Special deposits | % [e] | Eligible liabilities | Reserve assets | % | Special deposits | % [e] | Eligible borrowed funds | Public sector assets | % |
| 20 Oct. 1971 | 17,147 | 2,721 | *15·9* | — | — | 756 | 12·6 | *1·7* | — | — | 2,129 | 1,276 | *59·9* |
| 17 Nov. 1971 | 17,224 | 2,696 | *15·7* | — | — | 751 | 14·9 | *2·0* | — | — | 2,226 | 1,370 | *61·5* |
| 8 Dec. 1971 | 17,900 | 3,107 | *17·4* | — | — | 762 | 22·4 | *2·9* | — | — | 2,646 | 1,741 | *65·8* |
| 19 Jan. 1972 | 18,035 | 3,449 | *19·1* | — | — | 737 | 34·4 | *4·7* | — | — | 2,928 | 1,893 | *64·7* |
| 16 Feb. 1972 | 17,633 | 2,852 | *16·1* | — | — | 727 | 36·8 | *5·1* | — | — | 2,575 | 1,547 | *60·1* |
| 15 Mar. 1972 | 18,951[f] | 2,916[f] | *15·4*[f] | — | — | 259[g] | 10·9[g] | *4·2*[g] | — | — | 2,670 | 1,493 | *55·9* |
| 19 Apr. 1972 | 19,752 | 3,110 | *15·7* | — | — | 238 | 15·6 | *6·6* | — | — | 2,595 | 1,563 | *60·2* |
| 17 May 1972 | 20,123 | 2,990 | *14·9* | — | — | 236 | 15·5 | *6·6* | — | — | 2,369 | 1,404 | *59·3* |
| 21 June 1972 | 20,744 | 3,007 | *14·5* | — | — | 247 | 19·0 | *7·7* | — | — | 2,356 | 1,398 | *59·3* |
| 19 July 1972 | 21,445 | 3,122 | *14·6* | — | — | 236 | 19·8 | *8·4* | — | — | 2,595 | 1,373 | *52·9* |
| 16 Aug. 1972 | 21,413 | 3,163 | *14·8* | — | — | 243 | 19·8 | *8·1* | — | — | 2,530 | 1,366 | *54·0* |
| 20 Sept. 1972 | 21,745 | 3,241 | *14·9* | — | — | 249 | 25·2 | *10·1* | — | — | 2,509 | 1,502 | *59·9* |
| 18 Oct. 1972 | 22,093 | 3,223 | *14·6* | — | — | 261 | 27·1 | *10·4* | — | — | 2,299 | 1,281 | *55·7* |
| 15 Nov. 1972 | 22,288 | 3,190 | *14·3* | — | — | 272 | 27·7 | *10·2* | — | — | 2,249 | 1,324 | *58·9* |
| 13 Dec. 1972 | 22,761 | 3,571 | *15·7* | 117 | *0·5* | 284 | 31·0 | *10·9* | 1·4 | *0·5* | 2,398 | 1,371 | *57·2* |

[a] At following mid-month.
[b] Of gross deposits only.
[c] Scottish clearing banks as at 21st December.
[d] Including items in transit.
[e] Of previous month's eligible liabilities.
[f] Includes, for the first time, figures for five finance houses recognised or confirmed as banks in January 1972.
[g] Affected by some of the banking recognitions mentioned in footnote [f].

**Table 11**

## Amounts of sterling money market funds outstanding

£ millions

| End-year | Discount houses: funds borrowed [a] | | | Local authorities temporary money [b] | | | Inter-bank deposits | Certificates of deposit: holdings | | | | Finance houses: deposits | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | UK banks | Other | Total | UK banks [c] | Other | Total | UK banks | UK banks | Discount houses | Other | Total | UK banks | Other | Total |
| 1958 | 876 | 131 | 1,007 | .. | .. | .. | .. | — | — | — | — | .. | .. | .. |
| 1959 | 915 | 162 | 1,077 | .. | .. | .. | .. | — | — | — | — | .. | .. | .. |
| 1960 | 999 | 140 | 1,139 | .. | .. | .. | .. | — | — | — | — | .. | .. | .. |
| 1961 | 1,023 | 130 | 1,153 | 295 | 784 | 1,079 | .. | — | — | — | — | .. | .. | 337 |
| 1962 | 1,046 | 140 | 1,186 | 330 | 812 | 1,142 | 260 | — | — | — | — | 49 | 288 | 337 |
| 1963 | 1,070 | 162 | 1,232 | 370 | 979 | 1,349 | 350 | — | — | — | — | 71 | 319 | 390 |
| 1964 | 1,073 | 132 | 1,205 | 473 | 1,239 | 1,712 | 462 | — | — | — | — | 84 | 410 | 494 |
| 1965 | 1,270 | 111 | 1,381 | 425 | 1,315 | 1,740 | 588 | — | — | — | — | 123 | 531 | 654 |
| 1966 | 1,365 | 119 | 1,484 | 406 | 1,322 | 1,728 | 712 | — | — | — | — | 94 | 554 | 648 |
| 1967 | 1,532 | 130 | 1,662 | 502 | 1,352 | 1,854 | 924 | — | — | — | — | 97 | 494 | 591 |
| 1968 | 1,452 | 121 | 1,573 | 545 | 1,325 | 1,870 | 1,333 | 26 | 56 | 83 | 165 | 118 | 494 | 612 |
| 1969 | 1,616 | 109 | 1,725 | 506 | 1,390 | 1,896 | 1,728 | 169 | 97 | 176 | 442 | 119 | 517 | 636 |
| 1970 | 2,055 | 204 | 2,259 | 479 | 1,400 | 1,879 | 1,978 | 592 | 269 | 228 | 1,089 | 97 | 591 | 688 |
| 1971 | 2,563 | 398 | 2,961 | 659 | 1,315 | 1,974 | 2,200 | 1,214 | 457 | 701 | 2,372 | 212 | 611 | 823 |
| 1972 | 2,144 | 386 | 2,530 | 659 | 1,749 | 2,408 | 4,760 | 2,919 | 458 | 1,553 | 4,930 | 116 | 321 | 437[d] |

[a] A small amount of borrowed funds is in foreign currencies (125 at end-1971 and 172 at end-1972).
[b] Deposits and revenue bills of up to one year.
[c] From end-1965 to end-1971 inclusive, deposits with local authorities are net of deposits from them.
[d] Excluding figures of those institutions, recognised or confirmed as banks in January 1972, which were previously classified as finance houses.

**Table 11**

**Table 12**

**Range of money market rates**

Per cent per annum

| Last Friday in quarter: | | Treasury bills average allotment rate | Local authorities temporary loans: 3 months | Sterling certificates of deposit: 3 months [a] | Inter-bank rate: 3 months [b] | Euro-dollar deposits in London: 3 months |
|---|---|---|---|---|---|---|
| 1958 | Mar. | 5·52 | 6·38 | | | 2·50 |
| | June | 4·29 | 5·31 | | | 2·38 |
| | Sept. | 3·63 | 4·16 | | | 2·63 |
| | Dec. | 3·15 | 4·06 | | | 3·25 |
| 1959 | Mar. | 3·28 | 4·13 | | | 3·34 |
| | June | 3·45 | 4·00 | | | 3·63 |
| | Sept. | 3·47 | 4·00 | | | 4·50 |
| | Dec. | 3·68 | 4·06 | | | 5·13 |
| 1960 | Mar. | 4·62 | 4·88 | | | 4·34 |
| | June | 5·68 | 5·88 | | | 4·13 |
| | Sept. | 5·56 | 5·81 | | | 3·81 |
| | Dec. | 4·35 | 5·19 | | | 4·31 |
| 1961 | Mar. | 4·48 | 5·50 | | | 3·69 |
| | June | 4·53 | 6·13 | | | 3·34 |
| | Sept. | 6·55 | 7·56 | | | 3·38 |
| | Dec. | 5·40 | 6·69 | | | 4·13 |
| 1962 | Mar. | 4·40 | 5·75 | | | 3·66 |
| | June | 3·92 | 4·56 | | | 3·75 |
| | Sept. | 3·63 | 4·50 | | | 3·94 |
| | Dec. | 3·72 | 4·81 | | | 3·94 |
| 1963 | Mar. | 3·75 | 4·50 | | | 3·63 |
| | June | 3·70 | 4·25 | | | 3·88 |
| | Sept. | 3·67 | 4·19 | | | 4·19 |
| | Dec. | 3·72 | 4·56 | | | 4·25 |
| 1964 | Mar. | 4·30 | 5·19 | | | 4·25 |
| | June | 4·46 | 5·00 | | | 4·31 |
| | Sept. | 4·70 | 5·13 | | | 4·44 |
| | Dec. | 6·63 | 7·75 | | 7·56 | 4·56 |
| 1965 | Mar. | 6·55 | 7·75 | | 7·75 | 4·88 |
| | June | 5·54 | 6·44 | | 6·53 | 4·94 |
| | Sept. | 5·49 | 6·25 | | 6·50 | 4·94 |
| | Dec. | 5·52 | 6·38 | | 6·56 | 5·31 |
| 1966 | Mar. | 5·60 | 6·38 | | 6·69 | 5·81 |
| | June | 5·73 | 6·38 | | 6·53 | 6·09 |
| | Sept. | 6·75 | 7·50 | | 7·50 | 7·06 |
| | Dec. | 6·53 | 7·28 | | 7·34 | 6·56 |
| 1967 | Mar. | 5·49 | 6·25 | | 6·19 | 5·38 |
| | June | 5·28 | 5·50 | | 5·63 | 5·38 |
| | Sept. | 5·48 | 5·66 | | 5·81 | 5·78 |
| | Dec. | 7·48 | 7·81 | | 8·25 | 6·31 |
| 1968 | Mar. | 7·11 | 8·06 | | 7·88 | 6·38 |
| | June | 7·24 | 8·13 | | 8·19 | 6·88 |
| | Sept. | 6·58 | 7·41 | | 7·38 | 6·25 |
| | Dec. | 6·78 | 7·75 | 7·78 | 7·91 | 7·13 |
| 1969 | Mar. | 7·78 | 8·13 | 8·88 | 9·00 | 8·55 |
| | June | 7·88 | 9·38 | 9·19 | 9·41 | 10·56 |
| | Sept. | 7·81 | 9·88 | 9·81 | 9·88 | 11·25 |
| | Dec. | 7·65 | 9·03 | 9·19 | 9·25 | 10·06 |
| 1970 | Mar. | 7·18 | 8·88 | 8·88 | 9·00 | 8·63 |
| | June | 6·86 | 7·88 | 7·88 | 7·84 | 9·06 |
| | Sept. | 6·81 | 7·28 | 7·25 | 7·50 | 8·50 |
| | Dec. | 6·82 | 7·25 | 7·25 | 7·19 | 6·56 |
| 1971 | Mar. | 6·62 | 7·31 | 7·44 | 7·34 | 5·38 |
| | June | 5·59 | 6·31 | 6·31 | 6·25 | 6·50 |
| | Sept. | 4·75 | 5·31 | 5·19 | 5·19 | 7·63 |
| | Dec. | 4·41 | 4·56 | 4·69 | 4·69 | 5·75 |
| 1972 | Mar. | 4·31 | 4·94 | 4·88 | 4·88 | 5·53 |
| | June | 5·64 | 7·56 | 7·75 | 7·72 | 5·31 |
| | Sept. | 6·63 | 7·50 | 7·56 | 7·53 | 5·94 |
| | Dec. | 8·31 | 8·75 | 9·00 | 9·06 | 5·91 |
| 1973 | Mar. | 7·94 | 10·13 | 9·81 | 9·91 | 8·69 |
| | June | 6·96 | 8·13 | 8·13 | 8·06 | 9·06 |

[a] Sterling certificate of deposit market started October 1968.
[b] Inter-bank market started in early 1960s; figures not available before December 1964.

**Table 13**

**Short-term liabilities to and claims on foreign countries**

£ millions

| | UK liabilities | | | | | | UK claims | |
|---|---|---|---|---|---|---|---|---|
| | Sterling | | | | | Non-sterling currencies | Sterling | Non-sterling currencies |
| | Deposits with: | | | Treasury bills | Total | | | |
| End-year | Banks | Local authorities | Finance houses | | | | | |
| 1958 | .. | .. | .. | .. | 3,612 | 125 | 389 | 135 |
| 1959 | .. | .. | .. | .. | 3,798 | 264 | 425 | 296 |
| 1960 | .. | .. | .. | .. | 4,262 | 633 | 487 | 604 |
| 1961 | .. | .. | .. | .. | 3,932 | 749 | 548 | 733 |
| 1962 | .. | .. | .. | .. | 3,930 | 1,038 | 595 | 1,010 |
| 1962 | 1,526 | 93 | 98 | 1,016 | 2,733 | 1,158 | 318 | 1,058 |
| 1963 | 1,720 | 84 | 76 | 1,103 | 2,983 | 1,408 | 348 | 1,330 |
| 1964 | 1,744 | 132 | 87 | 986 | 2,949 | 1,927 | 422 | 1,693 |
| 1965 | 1,888 | 170 | 126 | 719 | 2,903 | 2,244 | 372 | 2,021 |
| 1966 | 1,924 | 135 | 137 | 646 | 2,842 | 3,079 | 370 | 3,061 |
| 1967 | 1,843 | 135 | 102 | 536 | 2,616 | 4,488 | 367 | 4,420 |
| 1968 | 1,739 | 71 | 51 | 453 | 2,314 | 7,223 | 371 | 7,187 |
| 1969 | 1,821 | 96 | 57 | 375 | 2,349 | 12,083 | 415 | 12,083 |
| 1970 | 2,193 | 56 | 119 | 376 | 2,743 | 15,283 | 423 | 14,816 |
| 1971 | 3,122 | 117 | 136 | 730 | 4,105 | 17,685/17,605 | 415 | 16,786/16,680 |
| 1972 | 3,034 | 262 | 23 | 879 | 4,198 | 25,460 | 609 | 24,019 |

**Notes**

**UK liabilities in sterling** (excluding liabilities to international organisations)

1958–62 Taken from overseas sterling holdings series (Bank of England *Statistical Abstract*, Table 21). No breakdown by instrument is available; figures include indistinguishably, for example, commercial bills, British government stocks, and liabilities in overseas sterling area currencies.

1962–72 See *Statistical Abstract*, Table 24 (with amendments for later years) and Bank of England *Quarterly Bulletin*, September 1973, Table 25; figures exclude overseas sterling area currencies.

**UK claims in sterling**

1958–62 Figures include claims in overseas sterling area currencies; also acceptances and commercial bills. (See *Statistical Abstract*, Table 21).

1962–72 See *Statistical Abstract*, Table 25 (with amendments for later years) and September 1973 *Quarterly Bulletin*, Table 26; figures exclude claims in overseas sterling area currencies; they represent only advances and overdrafts as currently published in the *Quarterly Bulletin*.

**UK liabilities and claims in currencies other than sterling**

No breakdown by instrument is available. Notes to Table 20 of the *Statistical Abstract* explain the component instruments. At the end of 1971 commercial bills lodged with UK banks were removed from the series. Latest figures from September 1973 *Quarterly Bulletin*, Table 23.

1958–62 Figures exclude overseas sterling area currencies.

1962–72 Figures include overseas sterling area currencies.

**Table 14**
**Deposits with various institutions in the banking sector**
£ millions

| End-December | 1963 | | | 1968 | | | 1972 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Sterling | Foreign currencies | Total | Sterling | Foreign currencies | Total | Sterling | Foreign currencies | Total |
| London clearing banks | 7,862 | 82 | 7,944 | 10,165 | 237 | 10,402 | 16,105 | 1,345 | 17,450 |
| Scottish clearing banks | 802 | 4 | 806 | 1,038 | 7 | 1,045 | 1,541 | 96 | 1,637 |
| Northern Ireland banks | 161 | — | 161 | 240 | — | 240 | 426 | 42 | 468 |
| Other deposit banks | 298 | — | 298 | 303 | — | 303 | 574 | 2 | 576 |
| Accepting houses, overseas banks and other banks | 2,091 | 1,643 | 3,734 | 4,247 | 9,342 | 13,589 | 13,619 | 34,588 | 48,207 |
| Discount houses | 1,232 | — | 1,232 | 1,568 | 5 | 1,573 | 2,485 | 56 | 2,541 |
| National Giro | — | — | — | 10 | — | 10 | 100 | — | 100 |
| Bank of England, Banking Department | 307 | — | 307 | 662 | — | 662 | 880 | — | 880 |
| **Total** | **12,753** | **1,729** | **14,482** | **18,233** | **9,591** | **27,824** | **35,730** | **36,129** | **71,859** |
| Total, excluding intra-sector liabilities | 11,085 | 1,331 | 12,416 | 14,789 | 7,422 | 22,211 | 24,829 | 26,146 | 50,975 |

## Table 15

### Persons' and companies' financial investment

£ millions

| | Holdings end-1966 | Cash transactions 1967 | 1968 | 1969 | 1970 | 1971 | 1972 |
|---|---|---|---|---|---|---|---|
| **Personal sector** | | | | | | | |
| Notes and coin [a] | 2,021 | + 61 | + 72 | + 73 | + 115 | + 197 | + 246 |
| Bank deposits | 7,466 | + 740 | + 682 | + 308 | + 822 | + 953 | +1,767 |
| Savings deposits: | | | | | | | |
| Public sector | 2,781 | − 58 | − 81 | − 99 | − 7 | + 121 | + 198 |
| Private sector | 1,164 | + 168 | + 168 | + 111 | + 165 | + 241 | + 354 |
| Building societies' shares and deposits | 5,825 | +1,090 | + 762 | + 890 | +1,484 | +1,961 | +2,139 |
| Deposits with finance houses | 114 | − 10 | − 1 | − 2 | + 9 | + 5 | − 29 |
| Other short-term assets: | | | | | | | |
| Tax reserve certificates | 129 | + 9 | + 54 | − 11 | + 1 | + 24 | − 8 |
| Local authorities' debt | 330 | − 21 | + 5 | + 13 | − 17 | − 51 | + 35 |
| Marketable securities: | | | | | | | |
| Government [b] | 3,036 [c] | − 216 | − 241 | + 79 | − 222 | + 470 | − 32 |
| Companies and overseas [d] | 18,504 [c] | − 503 | − 444 | − 333 | − 753 | −1,253 | − 796 |
| Other long-term loans: | | | | | | | |
| National savings securities | 4,208 | + 15 | − 12 | − 125 | − 44 | + 250 | + 274 |
| Local authorities' debt | 2,062 [c] | + 150 | + 186 | + 213 | − 62 | − 181 | − 117 |
| Life assurance and pension funds | 20,584 | +1,372 | +1,508 | +1,505 | +1,763 | +1,981 | +2,374 |
| **Total** | **68,224** | **+2,797** | **+2,658** | **+2,622** | **+3,254** | **+4,718** | **+6,405** |
| **Company sector** | | | | | | | |
| Notes and coin [a] | 674 | + 64 | − 20 | + 73 | + 206 | + 76 | + 249 |
| Bank deposits | 2,802 [e] | + 321 | + 318 | − 214 | + 121 | + 919 | +2,037 |
| Other deposits | 313 | + 2 | + 26 | + 55 | − 9 | + 47 | + 45 |
| Other short-term assets: | | | | | | | |
| Treasury bills and tax reserve certificates | 282 | + 29 | − 58 | − 40 | + 4 | + 68 | − 96 |
| Import deposits | — | — | + 75 | + 403 | − 225 | − 253 | — |
| Local authorities' debt | 393 | + 29 | − 59 | − 78 | − 65 | + 37 | + 102 |
| Hire-purchase credit | 505 | − 15 | + 10 | − 1 | + 27 | + 59 | + 86 |
| Trade credit to overseas | 569 [c] | + 44 | + 155 | + 181 | + 93 | + 96 | + 103 |
| Marketable securities: | | | | | | | |
| Government [b] | 758 [c] | . . | . . | . . | . . | . . | . . |
| Companies and overseas [f] | 2,993 [c] | + 385 | + 407 | + 363 | + 432 | + 576 | + 700 |
| Other long-term loans (local authorities' debt) | 485 [c] | + 12 | + 27 | − 6 | − 54 | − 12 | + 23 |
| **Total** | **9,774** | **+ 871** | **+ 881** | **+ 736** | **+ 530** | **+1,613** | **+3,249** |

[a] Mainly liabilities of the public sector. It is assumed that all non-bank holdings are by persons and companies; the split between these sectors is very approximate.
[b] Transactions cannot be divided between persons and companies; it is assumed that those of companies are insignificant.
[c] Market values; estimated by the Department of Applied Economics, Cambridge.
[d] Including unit trust units.
[e] Gross deposits. Figures for items in transit, etc. are not available by sector, but changes in these are attributed to companies.
[f] Excluding direct investment abroad.

| | Percentage of total holdings end-1966 | Percentage of total new funds invested 1967 | 1968 | 1969 | 1970 | 1971 | 1972 |
|---|---|---|---|---|---|---|---|
| **Personal sector** | | | | | | | |
| Notes and coin [a] | *3* | *2* | *3* | *3* | *4* | *4* | *4* |
| Bank deposits | *11* | *27* | *26* | *12* | *25* | *20* | *28* |
| Savings deposits: | | | | | | | |
| Public sector | *4* | *– 2* | *– 3* | *– 4* | — | *3* | *3* |
| Private sector | *2* | *6* | *6* | *4* | *5* | *5* | *6* |
| Building societies' shares and deposits | *9* | *39* | *29* | *34* | *46* | *42* | *33* |
| Deposits with finance houses | — | — | — | — | — | — | *– 1* |
| Other short-term assets: | | | | | | | |
| Tax reserve certificates | — | — | *2* | — | — | *1* | — |
| Local authorities' debt | — | *– 1* | — | *1* | *– 1* | *– 1* | — |
| Marketable securities: | | | | | | | |
| Government [b] | *5* | *– 8* | *– 9* | *3* | *– 7* | *10* | — |
| Companies and overseas [d] | *27* | *– 18* | *– 17* | *– 14* | *– 23* | *– 27* | *– 12* |
| Other long-term loans: | | | | | | | |
| National savings securities | *6* | *1* | *– 1* | *– 5* | *– 1* | *5* | *4* |
| Local authorities' debt | *3* | *5* | *7* | *8* | *– 2* | *– 4* | *– 2* |
| Life assurance and pension funds | *30* | *49* | *57* | *58* | *54* | *42* | *37* |
| **Total** | *100* | *100* | *100* | *100* | *100* | *100* | *100* |
| **Company sector** | | | | | | | |
| Notes and coin [a] | *7* | *8* | *– 2* | *10* | *39* | *5* | *8* |
| Bank deposits | *29* | *37* | *36* | *– 29* | *23* | *57* | *63* |
| Other deposits | *3* | — | *3* | *7* | *– 2* | *3* | *1* |
| Other short-term assets: | | | | | | | |
| Treasury bills and tax reserve certificates | *3* | *3* | *– 7* | *– 5* | *1* | *4* | *– 3* |
| Import deposits | — | — | *9* | *55* | *– 43* | *– 16* | — |
| Local authorities' debt | *4* | *3* | *– 7* | *– 11* | *– 13* | *2* | *3* |
| Hire-purchase credit | *5* | *– 2* | *1* | — | *5* | *4* | *2* |
| Trade credit to overseas | *6* | *5* | *18* | *25* | *18* | *6* | *3* |
| Marketable securities: | | | | | | | |
| Government [b] | *8* | .. | .. | .. | .. | .. | .. |
| Companies and overseas [f] | *30* | *44* | *46* | *49* | *82* | *36* | *22* |
| Other long-term loans (local authorities' debt) | *5* | *2* | *3* | *– 1* | *– 10* | *– 1* | *1* |
| **Total** | *100* | *100* | *100* | *100* | *100* | *100* | *100* |

**Table 16**

**Gross national product and exports of goods and services**

£ millions

| | GNP at factor cost (current market prices) | Export of goods (f.o.b.) [a] | Export of services | Total exports of goods and services | Exports of goods and services as % of GNP |
|---|---|---|---|---|---|
| 1960 | 22,866 | 3,732 | 1,415 | 5,147 | *22·5* |
| 1966 | 33,444 | 5,184 | 1,859 | 7,043 | *21·1* |
| 1967 | 35,214 | 5,124 | 2,121 | 7,245 | *20·6* |
| 1968 | 37,598 | 6,274 | 2,528 | 8,802 | *23·4* |
| 1969 | 39,667 | 7,063 | 2,787 | 9,850 | *24·8* |
| 1970 | 43,303 | 7,893 | 3,362 | 11,255 | *26·0* |
| 1971 | 48,675 | 8,796 | 3,836 | 12,632 | *26·0* |
| 1972 | 53,940 | 9,134 | 4,197 | 13,331 | *24·7* |

[a] General trade (i.e. including trade in bonded warehouses) according to official export statistics.