

Devaluation effect varies

Move expected to bring no dramatic changes in import pattern; surcharge was clue

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Devaluation is, quite expectedly, dominating the British economic scene and outlook. Through devaluation British industry will be provided with a competitive edge both at home and abroad.

But devaluation has also focused attention on several problems which must be solved if a permanent improvement in the British balance of payments is to be achieved. Foremost among these are the need to reduce the level of home demand and shift resources from consumption into exports, and the need to restrain cost inflation.

The impact on American exports to the United Kingdom resulting from devaluation and related measures taken by the British Government is difficult to predict with precision.

In general, however, changes in British demand for American goods are not likely to be dramatic. Britain is and will remain, along with Western Germany, one of the two major European markets for American goods. American exporters need not be frightened away from Britain by the unduly pessimistic inferences they may have read in press reports.

In many respects devaluation will act as a dampener on import demand in much the same way as the temporary surcharge on imports which was in effect in 1964-66. Devaluation has generally raised the cost of imports to British buyers by an amount roughly equivalent to the 15% temporary charge on imports.

However, when the temporary surcharge was in effect, British purchases of American goods actually showed a steady and significant increase. The possibility that such purchases will continue to grow modestly despite devaluation should not be ruled out.

During 1967 American exports to Britain appear to have risen by about 12% to a new record high. Even if this pace is not maintained, it is unlikely that American sales will fall below the previous high in 1966.

As in past years, the strongest demand should be for advanced American ma-

chinery, instruments, and electronic products needed for modernization of British industry. British imports of American aircraft should continue at high levels, at least through 1969.

The sale of American consumer products may slacken, but generally speaking, these sell as luxury goods for which price is not of primary importance.

Devaluation will more specifically affect some U.S. agricultural exports. Fats and oils, mainly soybeans and lard, have been made less competitive as raw materials of edible fats by the devaluation of two of the major butter suppliers to the U.K., New Zealand and Denmark.

No major supplier of deciduous fruits has devalued but intense French competi-

Market profile—United Kingdom

Area: Comprises England, Scotland, Wales, Northern Ireland; 94,205 sq. mi.

Population: 55.1 million, 1967. Greater London, 8 million. Chief urban areas center around London, Manchester, Birmingham, Leeds, Liverpool, Newcastle upon Tyne, Glasgow.

Gross national product: GNP, 1966, climbed 4.3% to \$90.5 billion; 1967 growth estimated at 1%. Manufacturing accounts for 35% of GNP; distribution, 12%; transport and communications, 8%. Agriculture is of little importance as component of GNP; about half of food supply is imported.

Minerals: Coal; small deposits of iron ore, limestone, tin, gravel, oil shale. Large quantities of natural gas recently found in North Sea and Northeast England.

Industry: Index of industrial production, 141 in Nov. 1967 (1958 = 100). Wholesale price index, Dec. 1967, for basic materials and fuel used in manufacturing industries, 116.9 (1954 = 100). Major industries: Iron and steel, engineering, textiles, chemicals, food products, consumer goods.

Labor: Total work force, more than 25.3 million. Unemployment 2.6% in Feb. 1968. Average weekly earnings in manufacturing industries, Apr. 1967, \$59.16.

Finance: Currency, pound sterling (£1 = US\$2.40). Through raising or lowering bank rate, Bank of England can restrict or ease domestic credit; current rate, 8% (Nov. 1967, 6½%). Current terms for consumer credit, deposit of 15% to 25% and usually maximum repayment period of 24 to 30 months. National budget: Expenditure estimated at \$31 billion for 1967-68. Recurring balance of payments difficulties in post-war years.

Imports: Total, 1967, £6.4 billion; 1966, £5.9 billion. Imports from U.S.: 1967, £811.9 million; 1966, £722.9 million. Major imports from U.S.: Cereals, tobacco, textile fibers, chemicals, nonferrous metals, machinery, transport equipment, scientific instruments. U.S. share of import market, 1967, 12.6%.

Exports: Total, 1967, £5.2 billion; 1966, £5.2 billion. Exports to U.S.: 1967, £638.2 million; 1966, £651.6 million. Major exports to U.S.: Scotch whisky, textiles, iron and steel products, machinery, transport equipment.

Trade policy: Liberal. Member of GATT, OECD, EFTA.

Trade prospects: Automation equipment, specialized industrial machinery, control apparatus offer best immediate export opportunities for U.S. manufacturers.

tion has brought apple prices down since Christmas.

In the case of citrus, U.S. exports already face quota restrictions and now citrus from Spain, Israel and Cyprus has an additional advantage because of devaluation by these countries. However, U.K. tobacco imports from the U.S. should continue strong while the Rhodesia question remains unsolved.

Third country competition with U.S. exports—primarily from the EEC and EFTA countries—can be expected to stiffen in view of devaluation. Overseas suppliers are likely to reduce their prices and improve their terms in an effort to retain their position in the U.K. market.

Import substitution drive

The drive towards import savings through the substitution of British production should accelerate, essentially because domestic goods are given a competitive edge through devaluation.

However, the act of devaluation has brought home very forcibly to British industry and the British public the urgency of the country's balance-of-payments problem. This has given yet another strong boost to "Buy British" sentiment. It is increasingly cited as a reason for not buying imported products.

However, "Buy British" sentiment is not generally a controlling consideration. There is, moreover, a great deal of recognition in a trading nation such as Britain that trade is a two-way street and that an atmosphere of boycotting foreign goods would not be to Britain's long-run advantage.

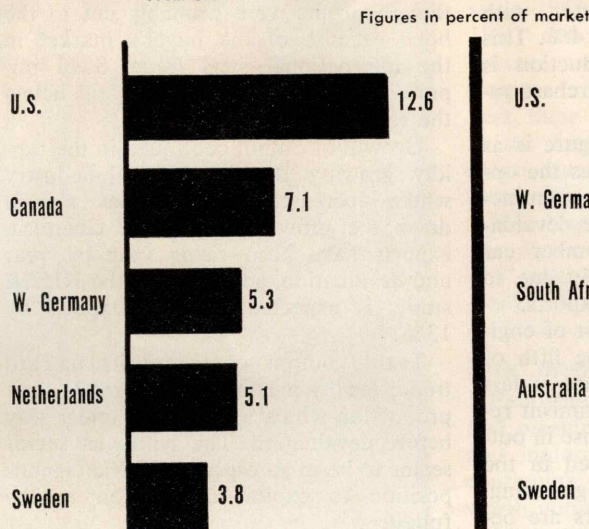
A psychological factor that could benefit American goods in the U.K. market is the possibility that British exports to the United States will surge in 1968, giving Britain for the first time in this century a clearly favorable balance of trade with the U.S.

Economic chauvinism has not been a problem in the U.K., although a certain degree of sensitivity regarding the level of U.S. investment in Britain had been noticeable. But this mood has changed markedly since the President's Jan. 1 balance of payments program. In the comments immediately following the program's announcement, there was reflected a definite appreciation for the benefits which U.S. investment had brought to Britain.

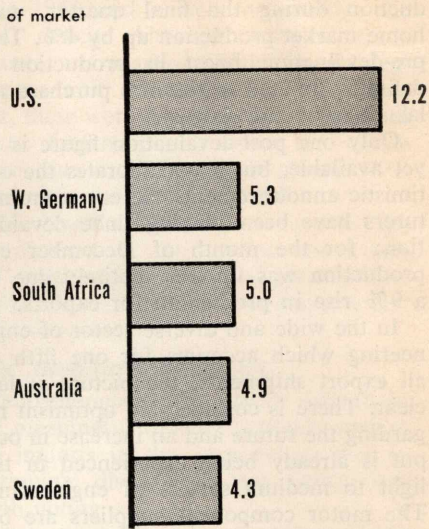
The Government acted to curb the growth of public consumption when Prime Minister Wilson on Jan. 16 announced cuts of £300 million in public spending for the financial year 1968-69 and cuts of £416 million for the following year. Sharp cuts announced in de-

U.S. is leading trade partner of U.K.

1967 Imports
Total £6,442 million
From U.S. £812 million



1967 Exports
Total £5,210 million
To U.S. £638 million



NOTE: Above figures include re-exports

fense will not show up for several years.

No announcements, however, were made to dampen a post-devaluation consumer spree. Some observers believed that the Chancellor deferred action on consumer spending because he was afraid to risk a recession by acting too early—before the post-devaluation export orders had begun to come in.

The argument against squeezing the home market too hard for the sake of exports has often been heard in Britain. Car manufacturers especially have frequently asserted that a buoyant home market is essential to a successful export drive, since a depressed home market raises unit costs and impedes export competitiveness.

Disappointment evident

Disappointment was evident in January over the lack of a tougher incomes policy as wage pressures mounted.

The size and the timing of the devaluation impact on the British economy are difficult enough to estimate. In addition, however, there is also uncertainty about the strength of the expansionist forces that were beginning to appear before devaluation. Most important of these is the effect of the reflationary measures of late August, 1966, which stimulated a revival in consumer spending. Further policy measures were expected in the new Budget.

In real terms, gross domestic product (GDP) remained virtually unchanged

during the second and third quarters of 1967. Total output figures, however, continued to show a slight improvement for the first three quarters of 1967 over the corresponding period of 1966.

The seasonally-adjusted index of industrial production for the months of September, October and November indicates that production had remained virtually static before devaluation.

So far there is little hard evidence that production is recovering, but at least a picture of sorts can be pieced together from various announcements and trends. These, taken together with recent opinion and intention surveys, should give the most nearly accurate account of the present state of industrial production in Britain.

Recent statistics released by the Electronic Engineering Association showed that exports of computers almost doubled in the first nine months of 1967 compared to the corresponding period of 1966. Exports of electronic goods generally were up 21% over the comparable period last year. Total output of electronic capital goods rose by 15%.

The motor industry, which accounts for nearly 7% of industrial manufacturing in the U.K. and for about 12% of its visible exports, is now definitely in an optimistic mood. Because of its importance, more detail than usual will be included here.

End-of-the-year figures showed that 3% fewer cars were produced in 1967

than in 1966 and there was a corresponding drop of 12% for commercial vehicle production; exports were down 10% and 18%, respectively, for the year.

What is noteworthy, however, is the very marked increase—7%—in car production during the final quarter, with home market production up by 4%. This pre-devaluation boost in production is definitely related to the hire purchase relaxations of late August.

Only one post-devaluation figure is as yet available, but it corroborates the optimistic announcements the car manufacturers have been making since devaluation: for the month of December car production was up 2%, entirely due to a 9% rise in production for exports.

In the wide and diverse sector of engineering which accounts for one fifth of all export shipments, the picture is less clear. There is considerable optimism regarding the future and an increase in output is already being experienced in the light to medium sectors of engineering. The motor component suppliers are beginning to feel the upswing in car production and appliance makers are benefiting from the consumer spending revival.

However, on the heavy mechanical engineering side orders are still below current output rates and order books continue to shrink.

Empty order books

Just recently, Britain's chemical plant industry was reported facing a crisis of overcapacity and empty order books.

In machine tools export orders are accounting for an estimated 45% of current orders, but home market orders have fallen considerably. Increasing home sales are apparently being taken over by sharply rising imports, especially from Germany and Japan.

For some years now mechanical engineering imports have been increasing faster than exports. In 1954 the total value of these imports was 18% of the total value of exports, by 1964 the import ratio had risen to 39%, and for 1967 the ratio is estimated at 45%. Apparently there are certain gaps in British demand which are not being filled by Britain's domestic industry. Nevertheless, a quickening pace of output and exports is foreseen during 1968 by the industry as revealed in a post-devaluation survey by the National Institute of Economic and Social Research (NIESR). The NIESR found that the mechanical engineering industries expect a 22% jump in exports while the electrical engineering sector expected a 19% upsurge.

Steel output recovered during the final quarter of 1967—up 7% over the comparable quarter in 1966—although total production for the year was below that of 1966.

A record level of exports was achieved last year (over five million tons) although profits were probably cut to the bone because of the buyer's market in the international steel trade. Steel imports rose markedly but were still below the record of 1964.

Growth of output continued in the rapidly growing British chemical industry where increased capacity has slowed down the growth of imports. Chemical exports have been rising year by year and devaluation, according to the NIESR study, is expected to boost exports by 13%.

Textile output continued its upward trend, led by a boom in man-made fiber production which was already under way before devaluation. The synthetics sector seems to be in an especially advantageous position to exploit devaluation to the fullest.

Woolen and knitwear industries seem definitely to be on the upswing, but the well-known structural difficulties of the Lancashire cotton textile trade have now been compounded by higher cotton prices, not only due to devaluation but also due to shortages of U.S. and Egyptian cotton.

The British paper and board industry—the largest in Europe—performed well during 1967 with increased output and exports despite months of economic squeeze and rising imports resulting from free trade with EFTA and the end of import surcharge.

Paradoxically, however, devaluation has worsened rather than improved the industry's competitive situation, since the Scandinavians raised their pulp prices which had been at an all-time low by the full amount of devaluation but held their price increases on paper down to between 6 and 12%. Competition is keen and an obvious bid is being made by the Scandinavians for a larger share of the six-million-ton British paper and board market—the third largest in the world.

The demand for housing has remained strong; housing starts were higher again in November in both the private and public sectors after a drop in October. In terms of output construction continued its rise during the third quarter of 1967. Roughly half the total output is for public housing.

Unemployment is still rising. The total number of registered unemployed stood at 2.7% in January. It had been

generally assumed last summer that the unemployment trend might hit its peak this spring and then improve rather rapidly later in the year. But the current figures are significantly lower than had been forecast for this winter. These figures are obviously being watched closely by the Government in its consideration of further measures to divert resources into exports.

Following the end of the incomes freeze and severe restraint last summer, wage rates have risen more rapidly than had been predicted: between June and November alone hourly wage rates in all industries increased 3.6%. This increase occurred during a period in which unemployment was well above normal and during which there was a "nil norm" for wage increases—no increases except for the lowest paid and those who can raise their productivity.

With the unemployment trend now expected to start falling in the near future and with the expected rise in the cost of living due to devaluation, pressures for wage increases continue to build up. Until the March 19 budget announcement, there was concern that the Government had not announced its intentions with respect to an incomes policy.

Retail prices rise

Retail prices have been steadily rising by nearly one whole point of the index per month, that is, from 118.8 in September to 121.2 in December. The rise for the year 1967, however, was still only about 2.5%.

Wholesale prices of manufactured goods held steady through November but edged up slightly in December. The first real impact of devaluation on prices became evident in the wholesale index for basic materials, which jumped five index points to 116.9 in December.

Consumer expenditure recovered last summer and was already picking up steadily by the time of devaluation. However, fed by a fear of higher prices and a tough budget ahead—as well as the usual seasonal factors—a great spending rush got under way in December and, from all appearances, spilled over into 1968.

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FRIENDLY CLIMATE FOR FOREIGN FIRMS in the U.K. was highlighted by this 100th anniversary celebration last October of the establishment of Singer Manufacturing Co. Ltd. in Clydebank, Scotland.

The index of the volume of retail sales which has been rising a point a month since September, reached a new peak of 114 in December. The increase in sales is wide-spread, but durable goods have done particularly well.

Retailers themselves reportedly doubt the staying power of the so-called "mini-boom" and the Board of Trade was keeping a week-by-week watch on consumer spending to keep it in perspective. The Government was apparently wary about restraining domestic demand too early before devaluation begins to affect the pattern of output.

Interestingly enough, there has been a relatively high level of cash sales during the spending spree. After moving upwards during the autumn, the hire purchase debt fell sharply by £13 million in December. The fall is certainly due to the new credit restrictions introduced at the time of devaluation. Nor has the spending spree been financed by an increased demand for overdrafts from private borrowers.

Even more mystifying, the National Savings figures show no unusual cash withdrawals. On the contrary, the net inflow in 1967 was better than in 1966 and a surplus of new savings was recorded in early January.

As one observer commented, there is "more cash lying around than is usually assumed."

Capital spending by British industry during the third quarter of 1967 fell even more sharply than originally estimated—6% below the second quarter. The decline was caused principally by a drop in manufacturing investment, whereas spending by the distributive and service industries remained unchanged.

There was, however, a marked fall in stockbuilding during the third quarter. This fall in stocks followed a period of little change since the end of 1966 and was spread fairly evenly among manufacturers, wholesalers and retailers.

The most recent investment intention survey conducted by the Board of Trade indicates that manufacturers expect to spend 5% more this year on capital projects than during 1967. This survey is significantly more optimistic than that of the preceding quarters, which indicated merely that investment in 1968 would be at about the 1967 level.

The survey was taken too soon after devaluation to reflect the full impact of devaluation on investment planning.

The upward trend in profits which began with companies reporting last September continued for companies reporting

in January. A 5.1% rise in profits compared with the previous year was reported for these companies. The comparable figure for dividends is a 6.4% increase.

Britain's visible trade deficit of £561 million for 1967 is the worst recorded since 1951 and is well over double the 1966 deficit. Although Britain's trade balance was marked by unfavorable influences and distortions for the whole year, these were particularly concentrated in the fourth quarter when the visible deficit rose to £337 million, almost 50% more than the whole of 1966.

The fourth quarter figures revealed the consequences of the London and Liverpool dock strikes as well as six weeks of a sharp rise in the value of imports due to devaluation.

Lack meaningful trends

Even though it will still be difficult to find meaningful trends regarding exports and imports in the near future due to continuing distortions, two points are worth noting.

First, regarding exports, disappointing as the fourth quarter figures were, they did suggest that exports to North America and the EEC had stopped falling and might even be moving upwards. More specifically, the United States and Germany are Britain's two best export markets and Britain's exports to these areas suffered during 1967—following a promising start in the first quarter.

Second, regarding imports, in spite of what appeared to be an endless series of distortions throughout the year, it is still very clear that Britain's import trend has moved up strongly. Imports during 1967 rose to an average of £533 million a month compared to £496 million in 1966. By contrast, average monthly exports fell to £419 million a month from £421 million in 1966.

Moreover, nearly half the rise in the import bill is due to imports of machinery and capital goods, sectors in which British industry is generally assumed to have a strong position.

Commenting on this particular point, the *Guardian* in an editorial recently noted that the present value per ton of engineering imports into Britain exceeds the value per ton of exports by something like 70% and that there was a wide range of sophisticated products "more expensive than a car . . . but less expensive than an airplane engine" of which Britain is now a large net importer.

British policy makers hope that devaluation will remedy this situation by making imports less competitive than home produced goods and giving further scope to import substitution.