Financial review

Summary

The review describes developments in various markets, mainly in the period November 1977 to January 1978.

The change in exchange market intervention policy at the end of October meant that financial developments during these three months were very different from those of the previous three.

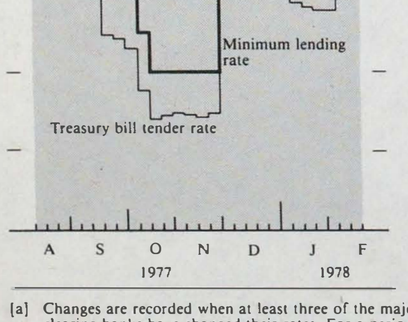
In the *money market*, with the lessening of external pressures and with monetary expansion running slightly above the target range, interest rates rose in November after falling steeply earlier in the year; they fell back a little in January. In the *gilt-edged market*, prices and turnover fell during the period; nevertheless, in the December quarter as a whole the authorities sold over £2,000 million net of stock. *Equity* prices and turnover also fell in November to January. In the *foreign exchange market*, sterling's effective exchange rate index rose from 64.6 to 66.5 during the period; the US dollar was weak.

The underlying growth of the *London euro-currency market* was probably rather slower in the fourth quarter than in the previous three months. The *oil-exporting countries*' revenues and cash surplus were both virtually unchanged in the quarter. The *commodity markets* were generally quiet in November to January.

The final section of the review describes movements in the *investment currency premium* in 1977 as a whole. The effective premium fell from 44% at the beginning of 1977 to 32% at the end of the year.

Short-term interest rates in London

Interest rates rose at the end of November but fell back a little in January.



[a] Changes are recorded when at least three of the major London clearing banks have changed their rates. For a period of six weeks beginning around the end of November, when the banks had widely varying rates, the mean of the highest and lowest rates is shown.

The money market

With monetary expansion running a little above the target range and with the lessening of pressures from external inflows, market opinion came increasingly to the view that interest rates had earlier fallen further than was likely to prove appropriate in the new circumstances. As a consequence, the Bank's minimum lending rate rose by two percentage points, from 5% to 7%, after the Treasury bill tender on 25th November, falling back a little to 6$\frac{1}{2}$% on 6th January.

Conditions in the money market were mixed in November, but generally much tighter in December and January, partly because of heavy sales of gilt-edged stocks by the authorities. The effect of these sales was heightened first by the usual pre-Christmas rise in the note issue and then in January by unexpectedly large tax payments. The Bank sold Treasury bills from time to time, when the market was in surplus (mainly in November); and shortages were met primarily by the purchase of Treasury bills or local authority bills, or by overnight loans at minimum lending rate. On occasion, however, the Bank found it necessary to make known their views about short-term interest rates by lending at minimum lending rate for seven days. In the middle of January, some short-term swaps were carried out by the Exchange Equalisation Account in the foreign exchange market to even out flows in the domestic money market (see pages 19 and 25).

In the second half of November, money-market rates became firmer in reaction to the announcement of the rise in sterling M_3 in the six months to mid-October, which was above the target range for 1977/78. The market recognised, furthermore, that the change in exchange market intervention policy meant that foreign inflows were no longer exerting downward pressure on short-term money rates. By lending for seven days at minimum lending rate on 24th November, the Bank indicated that they would not stand in the way of a move to higher rates; and minimum lending rate went up by 2% to 7% as a result of the Treasury bill tender on the next day, the first rise for over a year.

Early in the following week, money-market rates continued to rise, but on 30th November the Bank, in a public statement, expressed the view that the distortion of the interest-rate structure caused by the earlier inflows had already been adequately corrected; this calmed the market, and minimum lending rate remained unchanged at 7% at the tender at the end of the week. During the course of December, there was a tendency for rates to ease, as inflation continued to slow down and the outlook for the public sector borrowing requirement and the money supply appeared more reassuring; and several times during the month the Bank found it necessary to signal by seven-day lending at minimum lending rate that they looked for stability in the rate at least until the end of the year. Early in January, however, pressures for a fall in rates grew, and minimum lending rate fell by ½% to 6½%, after the Bank had indicated by lending to the market for seven days that there should not be too sharp a reduction. Pressures for a further fall in rates continued, but any further reduction in minimum lending rate was discouraged by the Bank on a number of occasions, and minimum lending rate finished the month unchaged at 6½%.

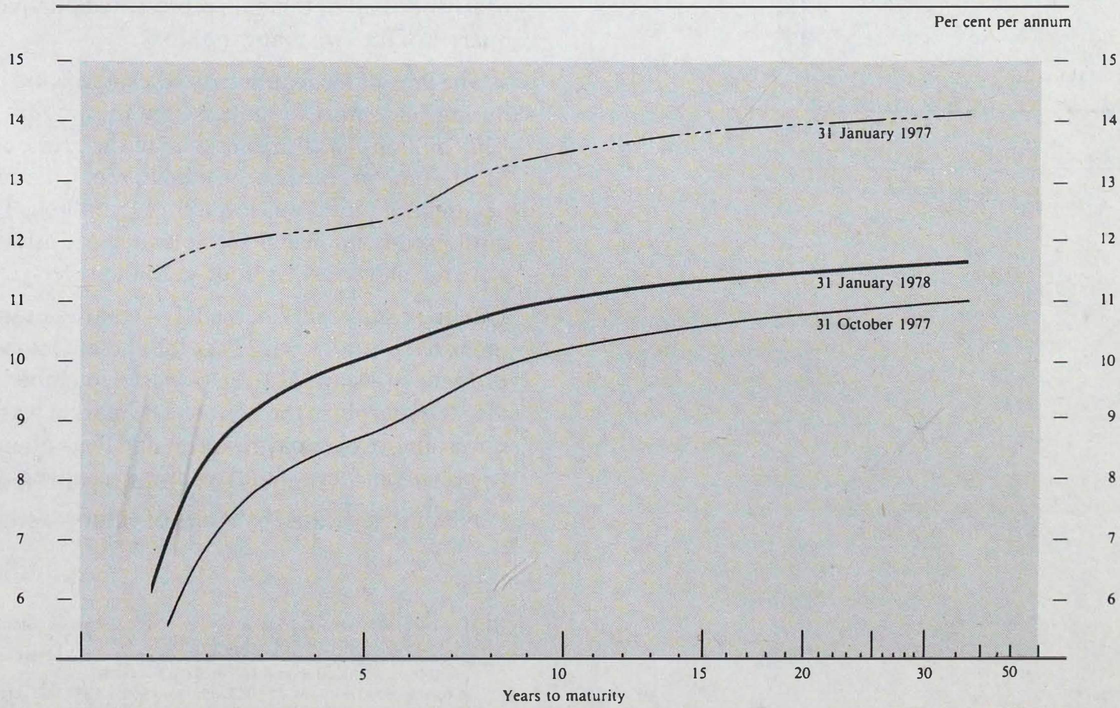
During the uncertainty in the week after the rise in minimum lending rate to 7%, the London and Scottish clearing banks raised their base and deposit rates by varying amounts, leaving an unusually wide spread in both—from 6¾% to 7½% in base rates and from 3½% to 4½% in deposit rates. After the fall in minimum lending rate early in January, however, base rates were all reduced to 6½% and deposit rates to 3%.

Capital markets

Conditions in the gilt-edged market varied during the period, with

Time/yield curves of British government stocks [a]

Yields rose on balance during November to January, particularly on short-dated stocks.



[a] The lines measure the nominal rate of interest which a stock at each maturity should bear if issued at par. The curve runs from the shortest-dated stock with a life of more than one year to the longest-dated stock. A revision to the construction of these curves was described in the June 1976 *Bulletin* (page 212). The relevant computer program is available from the Economic Intelligence Department of the Bank at the address given on the reverse of the contents page.

yields fluctuating in the light of the market's varying assessment of the implications of the prospects for inflation—particularly the course of pay settlements—and of the development of the money supply. Overall, yields rose on balance, and turnover was considerably less buoyant than in the previous three months.

A long-dated tap stock, 10½% Exchequer Stock 1997, had been exhausted on 27th October. Immediately after the change in exchange market intervention policy at the end of October, long-dated gilt-edged stocks became firmer. But following the surprise rejection by the miners of a productivity scheme shortly afterwards, uncertainty developed and with it a demand for variable rate stocks. By the middle of November, however, the market had become somewhat firmer again, and a new long-dated, fixed-coupon issue, £600 million 10% Treasury Stock 1992 at £95.50%, was made on the 17th,[1] but for the remainder of the month yields rose and sales were negligible.

Early in December, however, in the context of more favourable financial news, both the short-dated tap stock, 8¼% Treasury Stock 1982, and the 1992 stock came into demand: the short-dated stock was exhausted on the 7th and the long-dated on the 9th. A new short-dated stock, £800 million 8¼% Exchequer Stock 1981, at £96.75%, was issued on 15th December and exhausted on 4th January; [1], [2] a new long-dated issue, £800 million 10½% Treasury Stock 1999 at £95.00%, was made on 22nd December, [1] and was over-subscribed. A further long-dated issue, £800 million 10¼% Exchequer Stock 1995 at £95.00%, was made on 12th January.[1]

During the December quarter, the authorities sold £2,075 million net of stock,[3] bringing the total for the first nine months of the current financial year to £5,635 million (compared with £4,630 million in the corresponding period of 1976/77). Net sales of long-dated stocks during the quarter amounted to £1,365 million, of medium-dated to £1,260 million and of stocks within one to five years of maturity to £840 million. Two stocks matured during the quarter—3% Treasury Stock 1977 on 15th November and British Transport 4% Stock 1972/77 on 20th December, with £250 million and £85 million[4] respectively in market hands. The authorities also bought £1,065 million net of stocks within one year of maturity: nearly one half of this sum represented purchases earlier in the quarter of the two maturing stocks.

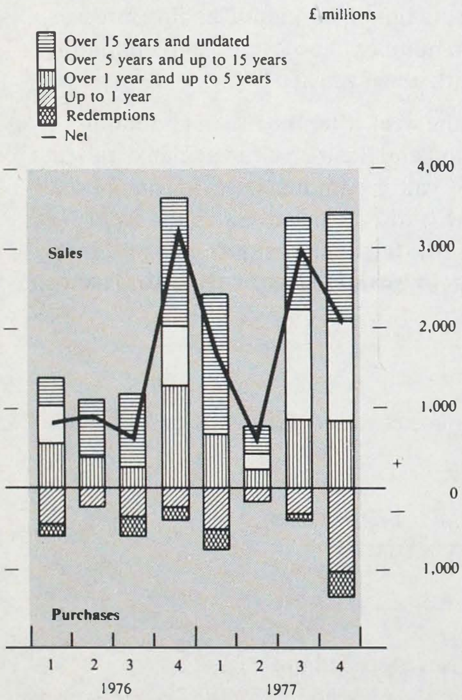
The flow of local authority stock and bond issues continued during November to January, but the amount raised—just over £300 million—was smaller than in the previous three months.[3] Most of the proceeds were used to repay maturing stocks and the net amount raised was less than £15 million. The stock issues included both fixed-coupon and variable rate securities: and among the bonds were the first five-year, four-year and three-year variable rate bonds.

In the equity market, the FT-Actuaries industrial (500) share price index fell overall from 239 at the end of October to 220 at the end of January—some 11% below last September's peak. Turnover also fell sharply in the period. The market was affected by continuing uncertainties over pay restraint and fears about company profits (especially in view of the stronger exchange rate).

New money raised by issues of equity capital rose to about £215

Official transactions in gilt-edged stocks by maturity [a]

During the December quarter, the authorities sold over £2,000 million net of stock, spread fairly evenly throughout the maturity range.



[a] Components are on occasion too small to be shown separately.

[1] For both 10% Treasury Stock 1992 and 8¼% Exchequer Stock 1981, the issue price was payable in full on application. For 10½% Treasury Stock 1999, £15 was payable on application, £40 on 9th January and £40 on 6th February; for 10¼% Exchequer Stock 1995, £30 was payable on application and £65 on 27th February.

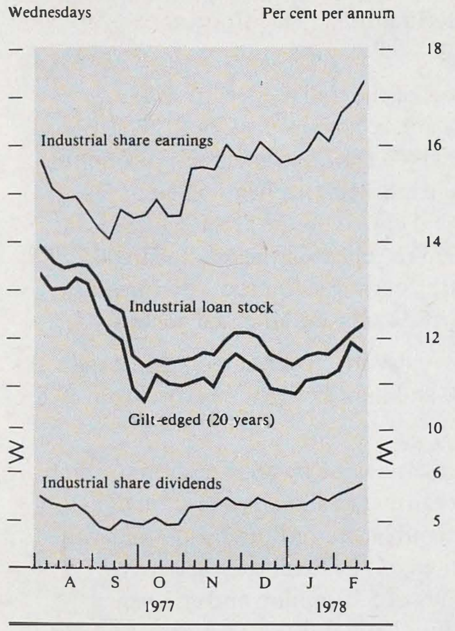
[2] A further £100 million of 8¼% Exchequer Stock 1981 was reserved for the Commissioners for the Reduction of the National Debt, for public funds under their management.

[3] The figures are cash values, and for partly-paid stocks therefore incorporate only instalments actually paid.

[4] Of this £85 million, some £10 million had still not been presented for redemption by the end of December and is therefore not included in the quarter's figures for redemptions.

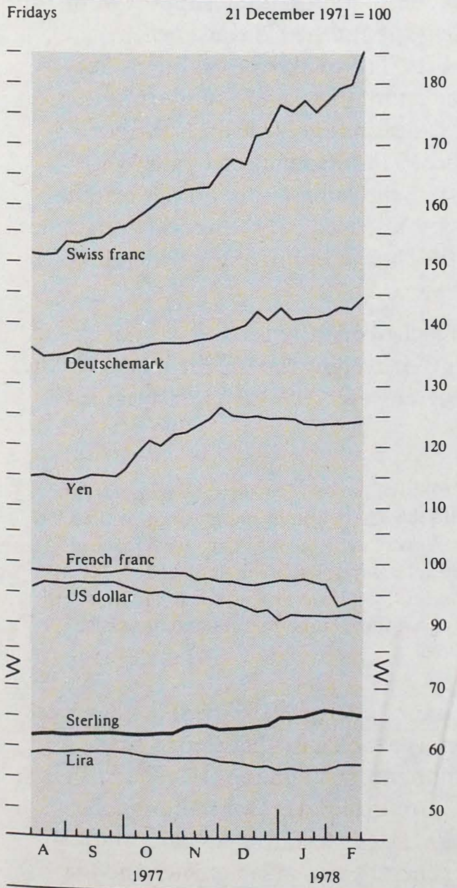
Security yields

Yields on debentures and long-dated gilt-edged were steadier than during the previous three months.



Indices of effective exchange rates

Sterling appreciated during the period; the US dollar was persistently weak.



million in the period (mainly in November and December),[1] compared with around £150 million in August to October. In addition, early in December, a second call of just over £290 million fell due on the British Petroleum shares sold by the Government.[2]

Net sales of unit trust units were £53 million, or £25 million more than in the previous period.

Turnover in the debenture market fell sharply in November to January, and yields rose on balance. Over the period as a whole, redemptions by companies once again exceeded new money raised by way of loan capital and preference shares.

With sterling's future looking more settled, and sterling interest rates having declined markedly over the past year, issues of sterling-related euro-bonds were resumed in November—the one previous issue had been in 1972. For exchange control purposes these bonds are foreign currency securities, so that most investors are likely to be non-residents; foreign borrowers may use the proceeds only for direct investment in the United Kingdom, and British borrowers may use them domestically or for approved outward direct investment. The first two issues appeared to be well received at first by the market but, with some uncertainty about the course of UK interest rates and the completion of four further issues within a very short period, the prices of all six soon fell sharply. However, there was subsequently some improvement in market sentiment, and six further issues were announced in the latter part of January and in February.

Foreign exchange and gold markets

Over the three months from November to January, the attention of the foreign exchange markets was again focused on the fortunes of the dollar: its persistent tendency to weakness, particularly in December, led the US authorities to intervene more actively in the market early in the New Year in order to check speculation and restore order. The pound tended to rise against the dollar during the period, and the effective exchange rate index too rose from 64.6 just after sterling had been allowed to float more freely at the end of October to 66.5 at the end of January. Official intervention in the spot market was confined to smoothing operations designed to maintain the orderliness of the market without exerting any long-run influence on the exchange rate. This involved both purchases and sales of dollars by the Exchange Equalisation Account; at times during December and January the market's offerings of dollars were very heavy, and over those two months the purchases exceeded the sales. There was also some intervention in the short-dated swap markets designed to even out flows in the sterling money market, and in longer-dated swap markets to provide funds for forthcoming foreign currency payments by the Government.

Sterling

On 31st October, the authorities ended their policy of intervening in the market to prevent a rise in sterling's effective exchange rate index: the sterling/dollar rate rose from $1.7772 at the close on 28th October to $1.8630 on the morning of 1st November, the effective exchange rate index rising from 62.5 to 65.1. Sterling then weakened on profit-taking and on the unexpected news of the opposition of the National Union of Mineworkers to productivity agreements: a low point of $1.7905 was reached on the afternoon of 3rd November. For most of the rest of the month, sterling traded quietly in the range $1.80–1.83¼, the effective index remaining between 63.2 and 64.0.

[1] This figure does not include the offer for sale by Imperial Chemical Industries Limited of shares in Imperial Metal Industries Limited. This is not new money for the purposes of these statistics, since the money accrues not to the borrowing company, Imperial Metal Industries Limited, but to an existing shareholder.

[2] See September 1977 *Bulletin*, page 303.

Sterling moved broadly in sympathy with other currencies against a weak dollar over December as a whole, although it lost ground early in the month. The lost ground was made up later, especially after the publication on the 28th of an OECD report which was optimistic about the prospects for the UK economy. At the end of the month, the sterling/dollar rate stood at $1.9185 and the effective index was 65.2.

With the continuing weakness of the dollar, sterling made rapid progress early in January and reached a peak of $1.9933 on the 4th. However, the US Treasury's announcement of more active intervention in foreign exchange markets (see below) had an immediate impact, and the pound closed on the 5th at $1.8845; the effective index, which was 66.2 at the close on the 4th, fell to 64.7. In the second week of the month, sterling stabilised with the index around 65.8, but later the rate rose as the dollar eased generally.

During November to January, sterling appreciated against the dollar from $1.8396 to $1.9520 and its effective index rose from 64.6 to 66.5.

Over the three months, the reserves rose by $657 million to reach a gross total of $20.9 billion at the end of January—five times as high as at the end of 1976. New public sector borrowings under the exchange cover scheme amounted to $257 million; there were repayments of earlier borrowings of $71 million and end-year payments of $208 million of capital and interest on North American loans.

The US dollar

After a fairly quiet November which saw its exchange rate against the deutschemark fall from DM2.2537 to DM2.2269, the dollar weakened sharply in December, despite substantial support from central banks, on continuing fears about the US trade deficit, especially the scale of fuel imports. The weakness was intensified when market expectations of an announcement of support for the dollar after the central bankers' meetings in Basle on 12th and 13th December were not fulfilled. The introduction by the West German authorities on the 15th of measures to discourage external purchases of deutschemark assets afforded only temporary assistance, and uncertainty about the future chairmanship of the Federal Reserve Board was another adverse factor.

The dollar's low point was reached on 4th January, when it closed in London at DM2.0690: later that evening the US Treasury and the Board of Governors of the Federal Reserve System jointly issued the following announcement:

> The Exchange Stabilisation Fund of the US Treasury will henceforth be utilised actively, together with the $20 billion swap network operated by the Federal Reserve System. A swap agreement has just been reached by the Treasury with the Deutsche Bundesbank and is already in force. Joint intervention by the Treasury, the Federal Reserve and foreign central banks is designed to check speculation and re-establish order in the foreign exchange markets.

There was an immediate rise in the dollar, which closed in New York at DM2.1413. The Federal Reserve took a further step to show support for the dollar by an announcement on the 6th of a rise in the discount rate of ½% to 6½% for external reasons, though the subsequent rise in US short-term rates was rather less. For the rest of January, trading in dollars generally was much quieter and the dollar ended the month at DM2.1062.

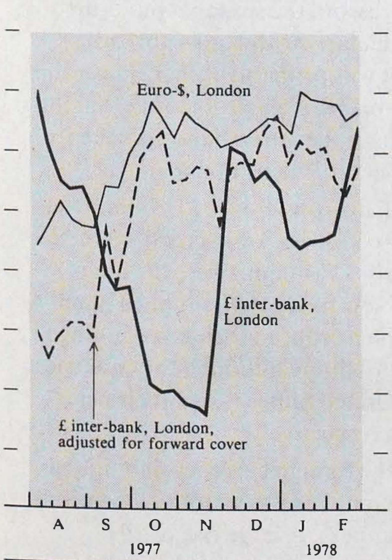
Other currencies

There was considerable pressure on the margins between the 'snake' currencies for most of November and December, with the deutschemark at the top for most of the period. All the other currencies spent some time at or near the bottom of the range; intervention in 'snake' currencies was on a much larger scale than previously in 1977, but in some cases the central banks concerned sold dollars to support their currencies although they were appreciating against the dollar. The West German measures announced on 15th December to control external purchases of deutschemark assets had only a transitory effect in easing the strain, and indeed, the pressure was not relieved until the US Treasury's announcement on 4th January. Since then the span of the 'snake' has remained comfortably within its limit. The mid-point of the 'snake' rose from a premium of $15\frac{5}{8}$% against dollar parities at the end of October to $23\frac{1}{16}$% at the end of January.

The Japanese yen appreciated by $3\frac{3}{4}$% against the dollar during November and the first half of December, but afterwards remained fairly stable, despite the fluctuations of the dollar elsewhere. On 17th November, the Japanese authorities announced controls on inflows; as in the West German case these appear to have had little effect in checking the appreciation. The Swiss franc has been more volatile than most other currencies: after appreciating by $15\frac{1}{2}$%, from Sw.fr.2.2350 to Sw.fr.1.9325, against the dollar between the end of October and 4th January, it fell back to Sw.fr.1.9760 at end-January.

UK and US three-month interest rates

The sharp rise in sterling interest rates in late November temporarily closed the uncovered differential which had emerged in favour of the dollar.



Interest rates and differentials

The three-month sterling inter-bank rate, which had been stable at around $4\frac{7}{8}$% for most of November, rose sharply with the rise in minimum lending rate on the 25th to $7\frac{1}{8}$% on the 30th. However, the rate tended to fall during December, and was $6\frac{7}{16}$% on 31st January. The three months' euro-dollar rate, after a slight fall from $7\frac{3}{16}$% to 7% during November had been reversed in December, rose during January and ended the month at $7\frac{7}{16}$%. Except for a brief period around the end of November and the beginning of December, the uncovered differential favoured the dollar throughout. The discount on three months' forward dollars reached $2\frac{3}{16}$% in the middle of November, but it turned into a premium at the end of the month when sterling interest rates rose. A discount was re-established in December, and it stood at $\frac{9}{16}$% at the end of January. The covered differential against sterling at three months has been less than $\frac{1}{2}$% for most of the period; interest parity ruled for a few days when the dollar was at its weakest.

Gold

Trading in gold was active in November, but there was little net movement in the price. Thereafter, the price reacted somewhat belatedly to the weakness of the dollar: after reaching the highest point for nearly three years, of $177.50 per fine ounce on 25th January, compared with $161.50 at the end of October, it fell back slightly to $175.75 per fine ounce at the end of the period. The market was able to absorb substantial additions to normal supplies, beyond the IMF auctions, in the latter part of 1977.

International banking and euro-currency markets

Figures published by the Bank for International Settlements show that the domestic and foreign currency business of banks in the Group of Ten countries and Switzerland, and of branches of US banks in certain off-shore centres—the widest available measure of international bank activity—expanded less rapidly in the third quarter of 1977 than in the second: the gross external liabilities and assets of these banks rose by $\$19\frac{1}{2}$ billion and $18 billion respectively, after $30 billion and $\$25\frac{1}{4}$ billion in the previous three months. A slower growth in business between banks within the reporting area

UK banks' liabilities and assets by customer[a]

The underlying growth of the London euro-currency market was probably slower in the fourth quarter than in the third (see text).

$ billions

	1976	1977			
	31 Dec.	31 Mar.	30 June	30 Sept.	31 Dec. [b]
Foreign currency liabilities of UK banks to:					
Other UK banks	46.8	48.0	48.4	50.1	51.2
Other UK residents	5.7	6.3	6.8	6.6	6.7
Overseas central monetary institutions	35.7	36.5	37.0	38.9	41.0
Other banks overseas	92.6	93.8	97.3	100.7	107.4
Other non-residents	20.6	20.7	22.2	23.5	26.1
Other liabilities[c]	1.3	1.3	1.6	1.5	1.5
Total liabilities	202.7	206.6	213.3	221.3	233.9
Foreign currency assets of UK banks with:					
Other UK banks	46.6	47.6	48.5	51.3	53.2
Other UK residents	16.8	18.5	18.4	18.3	19.0
Banks overseas	102.6	102.3	107.1	110.2	117.1
Other non-residents	35.9	36.7	38.3	39.8	42.8
Other assets[c]	2.1	2.2	2.4	2.5	2.8
Total assets	204.0	207.3	214.7	222.1	234.9

[a] Figures differ from those in Table 6 in the statistical annex (see additional notes to Tables 20 and 21).

[b] Provisional.

[c] Mainly capital and other internal funds denominated in foreign currencies.

UK banks' liabilities and claims by country or area

In the fourth quarter oil-exporting countries' outstanding net deposits fell.

$ billions outstanding

Net source of funds to London – /net use of London funds +

	1976	1977			
	31 Dec.	31 Mar.	30 June	30 Sept.	31 Dec. [a]
United States	– 3.2	– 4.7	– 6.7	– 5.7	– 6.2
Canada	– 2.5	– 2.4	– 1.6	– 1.4	– 1.3
European Economic Community	+ 1.4	+ 1.6	+ 3.9	+ 6.4	+ 8.0
Other Western Europe	–11.8	–11.1	–11.4	–12.4	–13.2
Eastern Europe	+ 6.1	+ 6.4	+ 6.9	+ 7.3	+ 7.1
Japan	+12.6	+12.3	+10.8	+ 9.9	+ 9.9
Oil-exporting countries[b]	–22.9	–23.6	–23.7	–23.8	–22.4
Countries engaged in off-shore banking	+ 8.5	+10.2	+10.0	+10.2	+ 8.6
Other countries	+ 1.2	– 0.9	+ 0.8	– 2.3	– 3.0
	–10.6	–12.2	–11.0	–11.8	–12.5

[a] Provisional.

[b] Listed in the footnote to Table 19 in the statistical annex.

Maturity structure of UK banks' net foreign currency position

Net borrowing at less than eight days rose sharply between mid-August and mid-November 1977.

$ billions

Net liabilities – /net assets +

	1977	
	mid-Aug.	mid-Nov.
Less than 8 days [a]	–10.7	–13.6
	– 7.2	*– 9.9*
8 days to less than 3 months	–18.5	–20.1
3 months to less than 1 year	– 6.3	– 5.3
Net borrowing up to 1 year	–35.5	–39.0
Net lending at 1 year and over	+35.9	+38.3
	+ 0.4	– 0.7

[a] Figures in italics include all holdings of London dollar certificates of deposit, regardless of maturity, as these are immediately realisable assets for the holding bank.

was a contributing factor. Excluding such inter-bank activity, some $15 billion of new international bank credit was made available to final users within and outside the area in the third quarter, about $5 billion less than in the second.

Of the total increase in gross external assets in the third quarter, some $8 billion were lent to countries within the reporting area: the United States alone borrowed $\$6\frac{1}{2}$ billion, mainly through the branches of US banks in the off-shore banking centres; a large part of this borrowing was, however, due to temporary factors. Outside the area, funds borrowed from the reporting banks were largely redeposited with them. Thus the developed countries outside the Group of Ten received as much as $\$4\frac{1}{4}$ billion, but redeposited $\$3\frac{3}{4}$ billion. Similarly, the non-oil developing countries (particularly in Asia and Latin America) borrowed over $3 billion of new funds, but the group as a whole redeposited nearly $\$3\frac{1}{2}$ billion: the international reserves of these countries rose by $\$2\frac{3}{4}$ billion over the quarter. By contrast, the oil-exporting countries increased their deposits by less than $\$\frac{1}{2}$ billion while drawing new credit of $\$2\frac{1}{4}$ billion; they were therefore net borrowers for the first time since 1973.

Only limited data are yet available for the fourth quarter. The volume of newly announced medium-term euro-currency bank credits (which enter the BIS figures only when taken up and only to the extent that they are not replacing maturing debt) rose to over $\$11\frac{1}{2}$ billion, after $\$7\frac{3}{4}$ billion in the previous three months. The amount of completed new foreign and international bond issues also increased, from some $\$6\frac{1}{2}$ billion to $\$7\frac{3}{4}$ billion.

Provisional figures suggest that the size of the London euro-currency market, measured by the banks' gross foreign currency liabilities, increased by some $\$12\frac{1}{2}$ billion in the fourth quarter, after $8 billion in the third. Much of the fourth quarter increase, however, was due to currency valuation changes and the seasonal build-up of UK banks' end-year positions (particularly with banks abroad); the underlying growth of the market was probably rather slower than in the previous three months. In the year as a whole, recorded liabilities rose by $\$31\frac{1}{4}$ billion: over $20 billion of these new deposits were from banks abroad (including central monetary institutions).

By area, the EEC countries, which borrowed over $\$1\frac{1}{2}$ billion net from London, and the oil-exporting countries, which reduced their net deposits with UK banks by nearly $\$1\frac{1}{2}$ billion, were the main takers of funds during the quarter. New funds were supplied mainly by the off-shore banking centres, which reduced their outstanding net borrowing from London by over $\$1\frac{1}{2}$ billion, although the countries of 'other Western Europe' and the United States raised their net deposits by $\$\frac{3}{4}$ billion and $\$\frac{1}{2}$ billion respectively.

A quarterly maturity analysis of the foreign currency liabilities and assets of reporting institutions was completed as at 16th November 1977 (see Table 21 in the statistical annex). A large rise of $\$9\frac{3}{4}$ billion in the banks' gross assets up to one year was outstripped by an increase of $\$13\frac{1}{4}$ billion in gross liabilities, so that net borrowing at up to one year grew by $\$3\frac{1}{2}$ billion. Increases in the shorter-term maturities were partly offset by a fall in the three to six months category. Net liabilities at less than eight days rose by $3 billion to stand at 35% of net liabilities at less than one year, compared with 30% at mid-August. This development was accounted for partly by demand for forward sterling by banks' customers. The banks matched forward sales of sterling to customers by switching short-term currency deposits into sterling; they may also have switched short-term currency deposits into sterling on a covered basis on their own account, to take advantage of the attractive opportunities which existed during the period.

A maturity analysis of banks' issues and holdings of US dollar certificates of deposit (together with small amounts of other negotiable paper) is included for the first time in the additional notes to Table 21 in the annex. It shows some shortening of maturities in the most recent analysis, in both outstanding issues and holdings.

Estimated oil revenues of exporting countries

Oil revenues in the fourth quarter were much the same as in the previous two quarters, but over the year they were 14% up on 1976.

$ billions

1976 Year	1977 Year	1st qtr	2nd qtr	3rd qtr	4th qtr
113.2	129.1	31.9	32.6	32.3	32.3

Estimated deployment of oil exporters' surpluses[a]

The total surplus in the fourth quarter of 1977 was the same as in the third but well below the average for the first half of the year.

$ billions	1976 Year	1977 Year [b]	1st qtr	2nd qtr	3rd qtr	4th qtr [b]
United Kingdom						
British government stocks	0.2	—	−0.1	−0.1	0.1	0.1
Treasury bills	−1.2	−0.2	—	−0.1	0.2	−0.3
Sterling deposits	−1.4	0.3	0.2	0.3	−0.2	—
Other sterling investments[c]	0.5	0.4	0.1	0.1	0.1	0.1
British government foreign currency bonds	—	0.2	—	0.2	—	—
Foreign currency deposits	5.6	3.4	2.0	1.4	0.5	−0.5
Other foreign currency borrowing	0.8	—	—	—	—	—
	4.5	4.1	2.2	1.8	0.7	−0.6
United States						
Treasury bonds and notes	4.2	4.3	1.0	1.0	0.7	1.6
Treasury bills	−1.0	−0.8	1.5	−1.0	0.2	−1.5
Bank deposits	1.6	0.4	0.2	−0.2	0.1	0.3
Other[c]	7.2	5.0	1.2	1.4	1.3	1.1
	12.0	8.9	3.9	1.2	2.3	1.5
Other countries						
Bank deposits	7.0	8.5	2.0	3.5	0.5	2.5
Special bilateral facilities and other investments[c] [d]	10.3	11.2	3.5	2.5	2.6	2.6
	17.3	19.7	5.5	6.0	3.1	5.1
International organisations	2.0	0.3	0.1	0.1	0.1	—
Total	35.8	33.0	11.7	9.1	6.2	6.0

[a] This table excludes liabilities arising from net borrowing and inward direct investment, and also, on the assets side, changes in credit given for oil exports. The totals for each period are, therefore, not the exact counterpart of the current account surpluses given on page 20.
[b] Provisional.
[c] Includes holdings of equities and property etc.
[d] Includes loans to less developed countries.

Oil money movements

The total estimated oil revenues of the oil-exporting countries were unchanged in the fourth quarter, a reduction in the volume of exports being offset by the adoption from 1st July by Saudi Arabia and the United Arab Emirates of the higher prices charged since 1st January 1977 by the other oil exporters. Towards the end of 1977 there was some rise in demand, but some exporters were offering increased discounts. The net effect of these two factors on revenues in the first quarter of 1978 may therefore be relatively small.

Oil exporters' net borrowings (see footnote to the second table) were substantial in the fourth quarter and despite higher imports the cash surplus available for investment abroad, for government loans and for additions to financial reserves was much the same as in the third.

For 1977 as a whole, total revenues were $16 billion higher than in 1976, but net borrowings were only slightly larger and credit given for oil exports was unchanged. Because the increased revenues were more than offset by increased imports of goods and services, however, the total surplus for 1977 was smaller than in 1976. With a freeze on oil prices until July 1978, and the likelihood of even higher imports of goods and services, the total cash surplus is likely to be lower still this year.

Sterling holdings were virtually unchanged in the fourth quarter, and there was in fact little change over the year as a whole. Foreign currency deposits with UK banks fell in the fourth quarter, and the increase for the year was thus smaller than in 1976.

Investment in the United States was significantly lower than in the previous quarter. Long-term investment was higher, but there was a large fall in holdings of Treasury bills. Total investment in the United States in 1977 was 25% lower than in 1976.

Bank deposits in other countries rose strongly again in the fourth quarter after their slower growth in the previous three months. In the third quarter there was some diversification into currencies other than the US dollar and this may have continued in the fourth. The increase in deposits in other countries during the year as a whole was bigger, reflecting the large placements (mainly in US dollars) in the first half-year.

Special bilateral facilities and other investments were much the same as in the third quarter. The total for the year was higher than in 1976; project loans to developing countries were smaller but loans for balance of payments support increased.

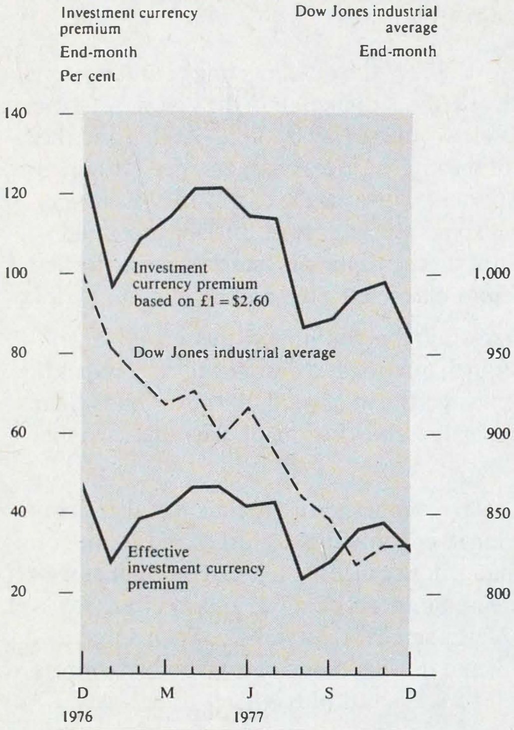
Commodity markets

The markets remained generally quiet during November to January. *The Economist* sterling index of commodity prices rose steadily until mid-December but then fell back as sterling strengthened. Over the period it fell by 0.6%.

In the futures markets, trading in coffee and cocoa was generally much lower than in the early months of 1977. Stocks of cocoa eligible for delivery on the futures contract were still short at the beginning of the period, and minimum deposits were sharply increased to ensure the smooth liquidation of December positions; but the arrival of the first West African main crop deliveries substantially eased the pressure on the market.

Investment currency premium

The effective investment currency premium fluctuated during 1977, but fell on balance.



Transfers of foreign currency to the official market from the 25 % surrender requirement

£ millions equivalent

1965	53
1966	70
1967	88
1968	104
1969	109
1970	87
1971	128
1972	138
1973	158
1974	265
1975	180
1976	177
1977 [a]	177

[a] Provisional.

For most of November and December, metals prices were steady after a period when they had been generally low. In spite of quiet trading, copper was helped by an increase in US prices in December: tin, however, fell, after record prices had attracted increased supplies from the Far East. In January, metals prices again came under pressure; one leading US copper producer rescinded part of the December rise, and tin again fell sharply, reaching a low of £6,005 per tonne on 26th January, but recovering to £6,375 by the end of the month.

The investment currency premium in 1977

The effective premium was 44 % at the beginning of 1977, [1] but it fell sharply to 29 % at the end of January, as UK institutions switched their attention from Wall Street, where prices were declining, to rising domestic markets, particularly the gilt-edged market. It then gradually recovered to reach 48 % towards the end of April, the highest point for the year.

For the next three months, the premium generally fluctuated between 40 % and 45 %, but in August it again fell sharply, this time to 24 %, its lowest since March 1974. There were several reasons for this: in the first place, the US dollar, and Wall Street, were already weak and both were expected by many to continue to weaken; secondly, sterling was strengthening, and the gilt-edged market was particularly buoyant; furthermore, there were strong rumours that the 25 % surrender requirement might be revoked, and also there was general uncertainty about the future of investment currency in view of the United Kingdom's obligations to the EEC to reduce restrictions on outward investment by the end of the year.

The premium remained low for several weeks, but in October it started to rise again and reached around 40 % in November and December, largely because of bargain hunters in Wall Street and the 'topping-up' of loan portfolios. [2] On 21st December, the Treasury announced that the 25 % surrender requirement, introduced in April 1965, would be abolished with effect from 1st January 1978: the premium fell at once, ending the year at 32 %. The accompanying table gives figures of transfers of foreign currency to the official market during the operation of the 25 % surrender rule.

[1] Based on the current exchange rate rather than on $2.60=£1 (see September 1976 *Bulletin*, page 315).

[2] See September 1976 *Bulletin* (page 319).