CORRECTIONS

Bank of England Quarterly Bulletin

Volume 19 Number 1 March 1979

Economic commentary

Page 17, second paragraph, lines 1 and 5: for 'M_3' read 'M_1'.

Financial review

Page 26, second paragraph, line 9: for '2%' read '$2\frac{7}{8}$%'.

Financial review

Introduction

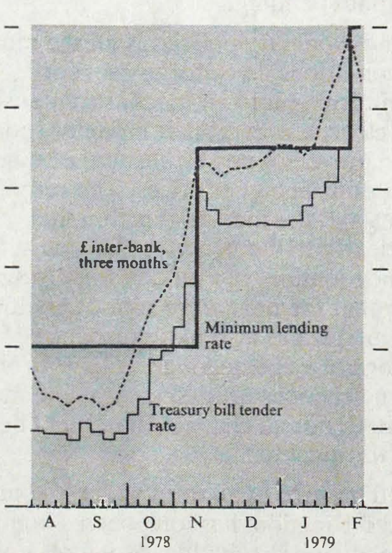
The review describes developments in various markets, mainly during the period November to January.

Early in November, the Bank's minimum lending rate (MLR) was raised from 10% to 12½%. This was followed by heavy official sales of gilt-edged stocks and it was generally felt that MLR would fall back after a few weeks. By the end of January, however, disquiet over the prospects for wages and prices was pushing short-term interest rates higher, and on 8th February MLR was raised further, to 14%.[1] These pressures, together with growing unease over the Government's fiscal position, also caused a general rise in yields on gilt-edged stocks.

In the foreign exchange markets (page 24) there was on balance some strengthening in effective terms of both sterling and the US dollar.

The review contains the usual sections on international banking and the euro-currency markets (page 27), oil money movements (page 29) and the commodity markets (page 29). There is also a brief account of movements in the investment currency premium in 1978 (page 27): over the year, the effective premium rose on balance from 32% to 42%.

Short-term interest rates in London
The Bank's minimum lending rate was raised sharply in November and in February.



The money market

At the beginning of November, short-term interest rates had already been rising for more than a month under the combined influence of sharp rises in US rates and growing domestic uncertainty about the future of incomes policy.[2] On the 9th, MLR was raised by 2½%, an increase rather greater than that which had already taken place in market rates, in order to establish a new level appropriate for the continuing restraint of monetary expansion.

The balance of opinion in the market was that MLR would stay at this level for only a few weeks and then fall back: accordingly, although three-month rates rose by about three quarters of a percentage point (from over 11½% to under 12½%), six-month rates rose by only a quarter of a point (from just below 12% to under 12¼%) and one-year rates hardly changed (remaining just below 12%), producing a downward-sloping yield curve for money rates.

By the end of December, as US rates continued to rise and pressures on incomes policy grew, a fall in MLR seemed more remote, and at the end of the month, six-month rates were in line with three-month rates at around 12½%, both remaining rather above one-year rates.

Towards the end of January, the further deterioration in the prospects for the Government's incomes policy led the market to feel that an increase in MLR might be imminent, and both three and six months' inter-bank rates rose to over 13¼%. The rise continued into early February, and on the 8th MLR was raised to 14% to bring it into line with market rates and to support the Government's policy of monetary restraint.[1]

The average discount rate at the Treasury bill tender jumped sharply on 10th November after the rise in MLR, but by the end of the year it had fallen back a little, as a result of aggressive

[1] MLR was reduced to 13% on 1st March.
[2] See the December 1978 *Bulletin*, page 503.

bidding at the tenders. In January the rate rose steadily and by the first tender in February it had reached almost 12½%, only just below MLR.

Conditions in the market in November were relatively comfortable, the authorities giving assistance on half the working days in the month; in December, the market required assistance more frequently, but not usually in large amounts; in January, with heavy payments of tax, conditions were considerably tighter. Help, when required, was usually given during the period by the purchase of Treasury bills or local authority bills; on five occasions the Bank purchased small amounts of commercial bills for resale at fixed later dates, and overnight lending at MLR also took place five times. On 10th November, because of large sales of gilt-edged stocks by the authorities on that day, £200 million of the £500 million bills on offer at the tender were not allotted; this was the first time the full amount on offer had not been allotted since June 1976.[1] Surpluses which occurred during the period were absorbed by sales of Treasury bills, sometimes on a large scale.

Shortly before the rise in MLR in November, the clearing banks raised their base rates from 10% to 11½%, and their deposit rates from 6½%–7% to 8½%–9%; after the rise in MLR, they raised base rates further, to 12½%, and deposit rates to a common 10%. These rates were unchanged until mid-February when, in the week following the increase in MLR, base rates were raised to 13½% and deposit rates to 11%.

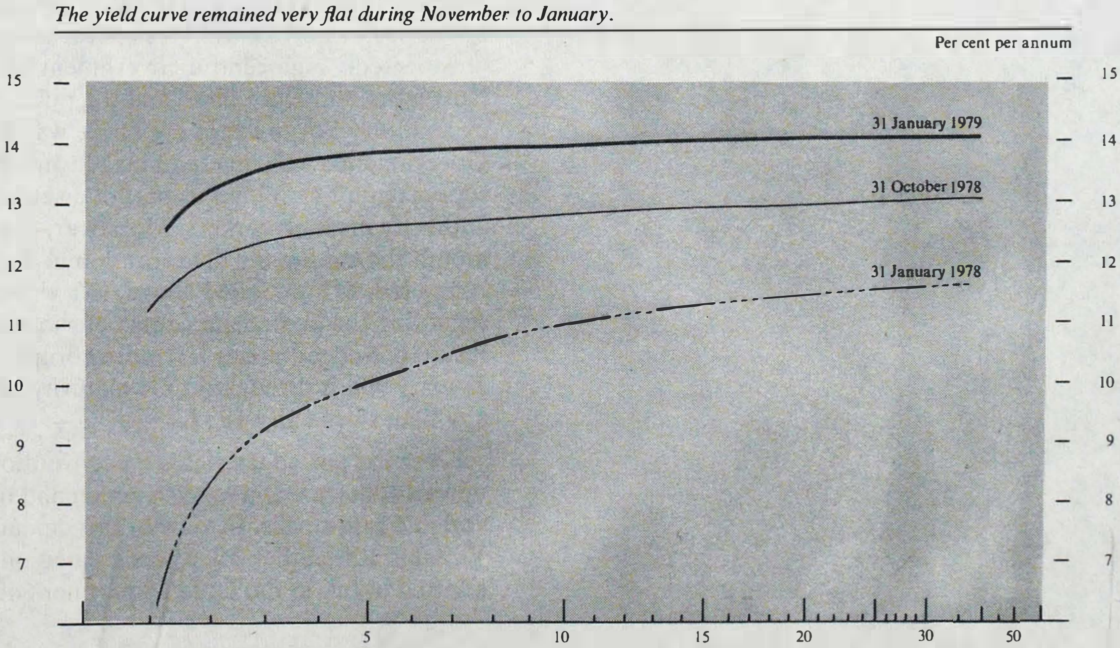
Capital markets

The gilt-edged market

In the gilt-edged market, yields rose further during November to January, by about one percentage point on long-dated stocks, but by slightly more on short-dated. Turnover, particularly in stocks with more than five years to maturity, rose strongly in November, but fell back in December; there was some recovery in January, most noticeably at the shorter end of the market.

Time/yield curves of British government stocks [a]

The yield curve remained very flat during November to January.



[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.

[1] See the September 1976 *Bulletin*, page 300.

The rise in MLR on 9th November stimulated heavy demand for stock: official supplies of 12% Exchequer Stock 1999/2002 and 10% Exchequer Stock 1983 were exhausted on the 10th and the 14th respectively. Two new stocks were issued on 23rd November—£500 million 12¼% Exchequer Stock 1985 at £97.25 per cent, payable in full on application, and £800 million 12½% Treasury Stock 2003/2005 at £95.00 per cent, payable in instalments.[1] The 1985 stock introduced a high-coupon central government issue into the medium maturity range at a time when the local authorities, who are a traditional source of medium-dated stocks, had been absent from the market for some months. At first, demand for the two stocks was limited.

After the initial response to the rise in MLR, the market remained stable and reasonably active for the remainder of November and in December, absorbing official sales of stock fairly steadily. Purchases of stock by the non-bank private sector, which rose sharply in the month to mid-November, remained moderately high in the month to mid-December. In the latter part of December and around the New Year, there was a good deal of switching, largely for tax considerations, and, although the market's net demand for stock moderated, prices did not move significantly. The market remained resilient in early January in spite of a worsening of the industrial climate and of prospects for the pay round. This resilience owed something to continuing evidence that monetary growth was within the Government's targets, but also reflected a high level of institutional liquidity. With a shortage of stock in the market, demand emerged which exhausted 12¼% Exchequer Stock 1985 on 9th January.

On 12th January, the issue of a new short-dated stock, a second tranche of £750 million 12% Treasury Loan 1983, was announced at a price of £97.25 per cent, payable in full on application.[2] The stock was designed to attract reinvestment demand from holders of 11½% Treasury Stock 1979, maturing on 9th March, as well as fresh demand.

In the period between the announcement and the issue on 17th January, however, there was a shift in market sentiment. The change in mood reflected concern over the development of public sector borrowing. This concern was prompted by the unexpectedly high central government borrowing requirement in November and December, and the publication of the public expenditure White Paper.[3] There was also disquiet over the Government's willingness to make some adjustment in the rate support grant cash limit as part of a settlement with the local authority manual workers. Moreover, towards the end of the month the continuing deterioration in the prospects for the pay round led, as mentioned above, to a change in expectations regarding the immediate course of short-term interest rates. As a result, gilt-edged prices fell more abruptly, and by the end of January yields throughout the maturity range were higher than at any time since early 1977.

Over the period, as yields on conventional stocks tended upwards, there was a moderate demand in the market for variable rate stocks. In view of this demand, £400 million Variable Rate Stock 1983 was created on 26th January, and allotted in full to the Issue Department of the Bank to replenish

[1] A further £200 million of the 1985 stock was reserved for the National Debt Commissioners for public funds under their management. For the long-dated stock, £15 per cent was payable on application, £30 on 8th December and £50 on 8th January.

[2] Under the terms of the original issue, holders had the option to convert stock into bearer bonds, and there was provision for exemption from UK taxation for non-resident holders; the same options are therefore to apply to holders of the tranche recently issued. These terms were general for some years before March 1977 but have not applied to stocks issued since that date (see the June 1977 *Bulletin*, page 164). A further £200 million of this stock was reserved for the National Debt Commissioners.

[3] See page 12.

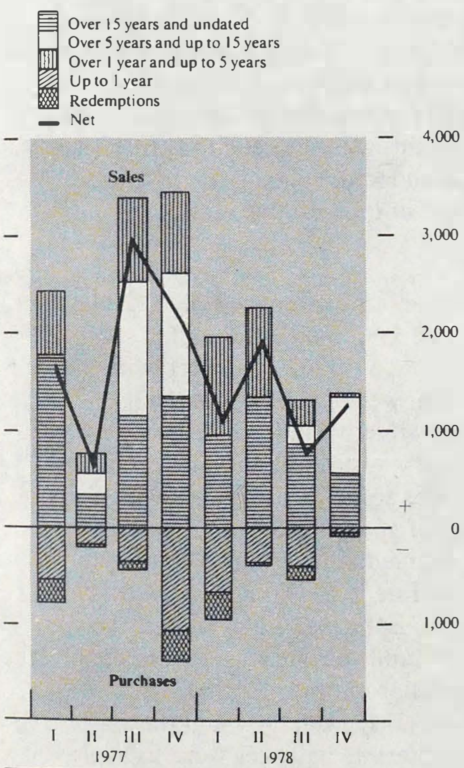
the Bank's holdings of this type of stock. Bids through the market could be made from the 29th. Apart from the dates of maturity and interest payments, the terms of the new issue were identical to those of the two existing variable rate stocks.

In the period following the rise in MLR on 8th February, there was a gradual revival of demand in the gilt-edged market; official supplies of 12½% Treasury Stock 2003/2005 and of the fresh tranche of 12% Treasury Loan 1983 were exhausted, as were remaining supplies of the low-coupon stock, 3% Exchequer Stock 1981, issued in October 1977. Two new issues, £500 million 13¼% Exchequer Stock 1987 and £800 million 13¾% Treasury Stock 2000/2003, were made on 22nd February and oversubscribed.

During the December quarter, the authorities sold £1,290 million net of stock.[1] Net sales of long-dated stocks amounted to £555 million and of medium-dated to £800 million. Sales of stocks within one to five years of maturity were negligible. Purchases of stocks within one year of maturity totalled £55 million. There were no stocks maturing during the quarter, but redemption money amounting to over £15 million in respect of 5% Exchequer Stock 1976/78, which was outstanding at the end of the previous quarter, was paid out and is included in the figures.

Official transactions in gilt-edged stocks by maturity

In the December quarter, net sales of stock by the authorities amounted to nearly £1,300 million.



National savings

In late November a new issue of national savings certificates was announced—the eighteenth—which has been available from 29th January, when the fourteenth issue was suspended. The new issue yields a return of 8.45% per annum, free of tax, if held for five years, compared with 7.59% per annum over four years for the fourteenth issue.[2] Also, the interest rate on National Savings Bank investment accounts was raised from 9½% to 12% on 1st January.

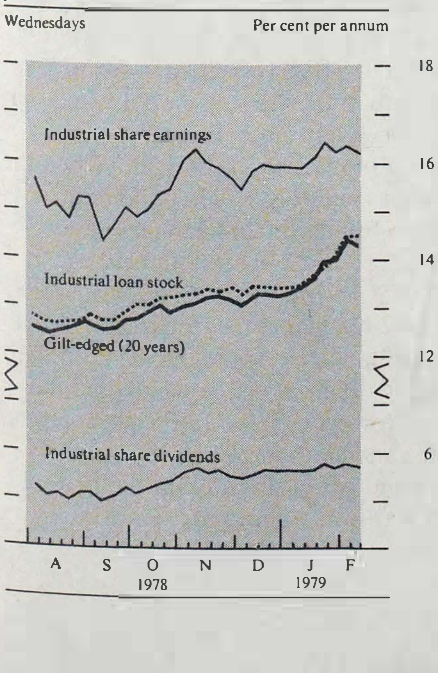
Other markets

There were no new issues of stock by local authorities during November to January (although two calls were made on previous issues), and issues of negotiable bonds were exceeded by redemptions.

In the debenture market, turnover fell back on average in November to January, and yields rose by about three quarters of a percentage point. New issues by companies by way of loan capital and preference shares were once more exceeded by redemptions.

Security yields

The gap of about a quarter of a percentage point between yields on long-dated gilt-edged and those on debentures was closed during the period.



Although turnover in the equity market fell back, with trading at times very thin indeed, prices were sustained by the amount of funds available for investment and showed considerable steadiness in the face of wage demands and industrial stoppages. The FT-Actuaries industrial (500) share price index, which stood at 240 at the end of October, exceeded 249 on 8th and 11th December, and finished the period at 242. New money raised by issues of equity capital in the period amounted to £147 million, compared with £295 million in the previous three months (of which £180 million was part of a rights issue by BL Limited, virtually all of which was taken up by the National Enterprise Board).

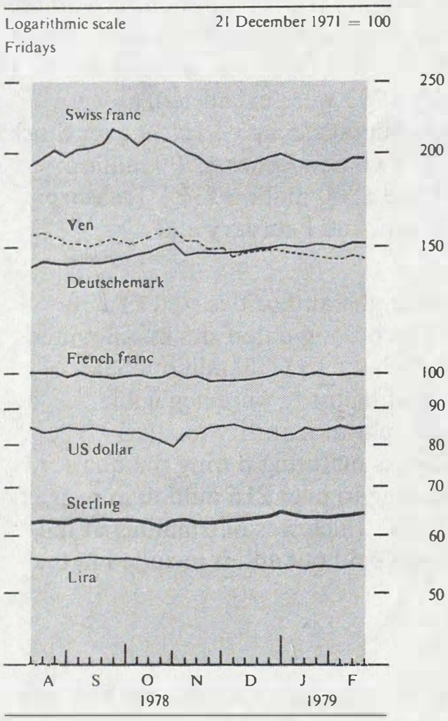
Net sales of unit trust units rose to £36 million, compared with £25 million in the previous three months.

[1] The figures relate to cash raised, and for partly-paid stocks, therefore, incorporate only instalments actually paid.

[2] For comments on inflows into national savings, and on sales of certificates of tax deposit, see page 16.

Indices of effective exchange rates

Both sterling and the US dollar strengthened on balance over the period.



Foreign exchange and gold markets

Summary

The November to January period opened dramatically with the surprise announcement on 1st November of support measures for the US dollar. The actual weight of central bank support which resulted, together with the promise of more to come if necessary, led during the month to a general fall in the value of most currencies, measured against the dollar. Sterling fell by over fourteen cents (though in effective terms by only $\frac{3}{4}$%). In early December, movements in European currencies were influenced by discussions on the European Monetary System (EMS), but attention switched back to the dollar in the middle of the month with the news of OPEC's decision to raise oil prices, and the worsening political situation in Iran. The further weakening of the dollar helped the pound and by the end of December sterling's effective index had reached 64.0, its highest since March. The dollar recovered a little during January, although the market's anxieties led to some rather volatile day-to-day movements. Despite this and a worsening industrial situation, sterling remained fairly buoyant, without need for official support. The dollar rate stayed for the most part close to $2.00 and the effective index closed at 63.5 on the 31st.

Sterling

Following the announcement, on the afternoon of 1st November, of the measures to support the US dollar, sterling fell sharply against that currency, to close at $1.9962 compared with $2.0565 at noon; the effective index, however, fell by less than 1%, to close at 62.3. By the 3rd, the effective index had recovered to 62.9, but then anxieties about wages and industrial problems brought an uneasier tone; after some recovery following the rise in MLR and the publication of good trade figures for October, pressure was temporarily resumed, and by the 20th the index stood at 62.2, with the dollar rate at $1.9305 (the lowest closing rate during the period). In the last days of November, the markets were generally quiet, and sterling was not affected by the announcement by the Chancellor on the 21st that the International Monetary Fund (IMF) stand-by and the Basle facility related to the official sterling balances were to expire on 2nd January and 7th February respectively. The news of a vote by Ford workers to end their strike benefited the pound, which then improved steadily; at the end of the month, the effective index was 62.7 and the dollar rate $1.9443.

In early December, the announcement of the United Kingdom's intention not to join the EMS at its inception did not affect sterling. The dollar rate rose to just over $1.97 where it settled for a few days, edging up to $1.98 (effective index 63.2) before the OPEC conference; however, the substantial rise in oil prices announced at the conference left the dollar sharply weaker, and the pound moved up to $2.00 on the 18th. When the markets reopened after Christmas, sterling was in good demand, which took the rate above $2.05 briefly on 2nd January. The dollar then recovered some lost ground, but sterling held up better than many other currencies; by the close on the 9th, it was 63.8 in effective terms and $2.0239 against the dollar. Industrial problems, in particular the road haulage dispute, which until then had been largely shrugged off by the markets, now affected the foreign exchanges for a while. However, pressure on sterling was only slight: rising interest rates and confidence in UK monetary policy seemed to outweigh the industrial situation in the market's view and official intervention was rarely necessary. On 31st January, the effective index stood at 63.5 and the dollar rate closed at $1.9920.

The reserves rose by $287 million in the three months from end-October. New borrowing by public sector bodies under the exchange cover scheme totalled $348 million, and in January an allocation of special drawing rights, equivalent to $367 million, was made to the United Kingdom by the IMF. Repayments by the public sector under the exchange cover scheme totalled $204 million (of which $15 million was ahead of schedule). In addition, an early repayment of $150 million was made by the British National Oil Corporation: although the original borrowing had not been guaranteed under the exchange cover scheme, the funds had been taken into the reserves to avoid the disruptive effects on the market of the conversion; for the same reason funds for repayment were made available from the reserves. Finally, end-year payments made in respect of long-term North American loans amounted to $208 million.

US dollar

The period opened with the announcement of a support package on 1st November[1] which took the markets by surprise and had an immediately favourable effect on the value of the dollar. Substantial intervention, most of it by the US Treasury, the Federal Reserve and the central banks of Western Germany, Switzerland and Japan, was required to sustain the recovery. Intervention in support of the dollar by all major central banks was heavy in November, after the measures, and only slightly less than that in October. The scale of intervention, and the promise of more to come if necessary, led to marked gains in the value of the dollar against all major currencies. Disappointing US trade figures released at the end of the month had little adverse effect. In the second week of December, it was announced that DM3 billion had been subscribed for deutschemark bonds issued by the US government in Western Germany. This news was helpful, but by the end of that week some nervousness returned as dealers awaited the OPEC conference, and its outcome caused a sharp drop in the dollar on the 18th. Substantial central bank support helped to steady the fall in the week before Christmas, but the currency slipped further on the 27th as the situation in Iran grew worse.

Although the dollar was still weak as the New Year began, some of its earlier losses began to be recouped when an end-year rise in US interest rates generated expectations of further increases. In fact, the dollar was oversold and, though interest rates held steady, its firmer tendency was sustained without much intervention. It was further helped on 11th January by the announcement of a US government issue of Swiss franc-denominated bonds to Swiss residents. In the third week some volatility returned to the market, but the dollar gradually firmed as market sentiment seemed to shift in its favour. Even the announcement of a large trade deficit for December was well received, as an even larger deficit had been expected. In effective terms, the dollar recovered by 2½% during January, after comparatively modest intervention. In the second half of the month, the Federal Reserve and the US Treasury repaid some swap debt to other central banks.

Other currencies

Measured against their closing rates on 31st October, all the major currencies lost ground against the US dollar over the period. The Japanese yen, which had been very strong in the previous three months, now fared less well, notably because of the recovery of the dollar and signs of decline in Japan's trade surplus; by the end of January, the yen had depreciated by 12%

[1] The measures comprised a $7.6 billion expansion of swap lines with the West German, Swiss and Japanese central banks; drawings on the US reserve tranche in the IMF and sales of SDR holdings; the issue of US government securities denominated in foreign curencies; a further increase in US gold sales; and an increase in the Federal Reserve discount rate to 9½%.

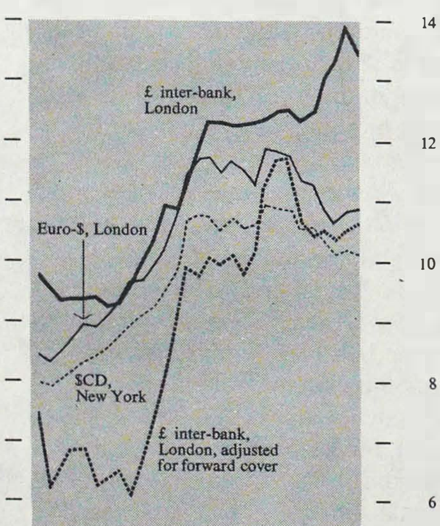
against the dollar and by $9\frac{3}{4}$% in effective terms. The Canadian dollar at first drew strength from the US currency, but became somewhat weaker during December and January, being at times alone in losing ground against the US dollar. The Swiss franc fell against the deutschemark and at the end of January the cross rate stood at DM 100 = Sw.Fr.$90\frac{3}{4}$, compared with Sw.Fr.$85\frac{1}{2}$ at the beginning of the period.

The 'snake', though occasionally stretched, was generally under less strain than in the previous three months, with the Danish krone consistently at the top, and the bottom position taken at first mainly by the deutschemark, to be replaced by the Belgian franc in early December. There were periods of heavy demand for the deutschemark, especially in early December ahead of the EMS talks. Developments among the 'snake' currencies had as a back-cloth the discussions on the EMS. On 11th December, Norway announced its decision to withdraw from the 'snake' and to peg the krone to a trade-weighted basket of currencies. Of those currencies proposing to join the EMS, the French franc and the Italian lira were rather volatile. The lira is, initially, to be the only participating currency with a wide margin (6%) against its EMS parity; the others, including the Irish pound, will undertake to keep within a narrower ($2\frac{1}{4}$%) range of their declared parities. For the time being, the Irish authorities will keep their currency at parity with sterling.

UK and US three-month interest rates

The uncovered differential moved sharply in sterling's favour during the period and the covered differential against sterling narrowed.

Weekly averages Per cent per annum



Interest rates and differentials

Sterling interest rates moved up sharply in November after the rise in MLR to $12\frac{1}{2}$% on the 9th. The three-month inter-bank rate was around $12\frac{1}{4}$% at the end of the month and increased further during December and January to $13\frac{5}{16}$%. Euro-dollar rates also rose in November and December, but did not reach the level of UK rates; the three-month uncovered differential, which had been marginally against sterling at the beginning of the period, moved in sterling's favour. By end-January, when euro-dollar rates had become easier, the differential had reached $2\frac{7}{8}$%. The three months' forward premium on dollars increased early in November, ranging between 2%–$2\frac{1}{2}$%. A peak of $2\frac{11}{16}$% was reached on 5th December. For a time the premium fell back, to stand at $\frac{5}{8}$% at the start of the New Year, but it then rose again and was just over 3% at the end of January. The three months' covered differential against sterling was around $1\frac{1}{2}$%–2% for most of November and early December; it then dropped and had reached parity by the turn of the year, and although it reappeared during January as the United Kingdom's industrial troubles worsened, the margin was relatively small and had fallen back to $\frac{3}{16}$% by the 31st.

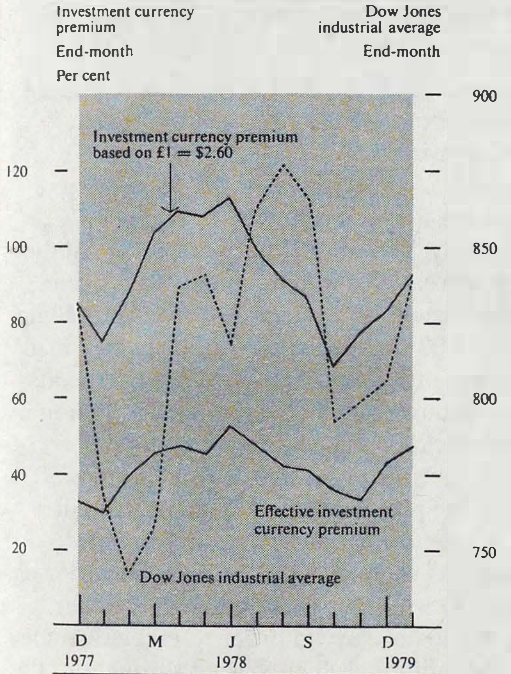
Gold

Renewed confidence in the dollar in November, coupled with the provision in the 1st November measures for increased US Treasury gold sales from December, led to a fall in the gold price, from $238.65 per fine ounce at the beginning of the month to below $200 on the 16th. A strong upward movement following the IMF auction on 6th December was helped by the news of higher OPEC prices, and was carried further as the situation in Iran adversely affected the dollar. The end-year quotation of $226 represented a 37% increase in the price of gold during 1978. After reaching $227.15 on 2nd January, the price fell back slightly, but renewed investment and speculative interest later in the month took the fixing up to $236.

In November, 750,000 ounces of gold were auctioned in the United States by the US Treasury and 470,000 by the IMF. As from December, US Treasury sales at monthly auctions were increased to 1,500,000 ounces as a result of the November measures; and now include 'coin' bars in addition to bars of normal (higher) fineness. The increase brought combined monthly sales to 1,970,000 ounces.

Investment currency premium

The effective investment currency premium rose on balance during 1978.



The investment currency premium in 1978

The effective premium[1] remained low for some weeks after the announcement on 21st December 1977 that the 25% surrender requirement would be abolished with effect from 1st January 1978: it began 1978 at 30%. Over the next few months it rose steadily, touching 54% in April when Wall Street was strengthening: much of the demand came from institutional investors. Between April and August the premium fluctuated around 50%, reaching its highest point of the year, 56%, in the middle of August. Largely because of profit-taking, it then fell rapidly, to 42% at the end of the month. During September the premium remained around this level, apart from a brief rise to 47% in the middle of the month when the Dow Jones Industrial Average was at its highest point of the year. During the last three months of 1978, the premium fluctuated mainly between 34% and 42%, although early in December it fell to 31%, influenced by the weakness of Wall Street and the dollar, and by Irish sales of investment currency in the expectation that exchange controls would be introduced against the Republic of Ireland by the United Kingdom (see below), so depriving Irish residents of continued access to the market. Towards the end of the year, the premium strengthened and it ended the year at 42%.

In October and November there was substantial UK investment in Irish government stocks. Part of this was speculative, on the grounds that if the Republic of Ireland joined the EMS and the United Kingdom did not, parity between the two currencies might no longer be maintained and exchange controls between the two countries might be introduced: in that event, and particularly if Irish securities were to attract the investment currency premium, investors might receive windfall benefits. However, on 18th December, the Treasury announced that the United Kingdom would not impose exchange controls on capital transactions with the Republic for the time being. It also warned that, even if exchange controls were introduced, it should not be assumed that Irish securities held by UK residents would attract the investment currency premium.

International banking and euro-currency markets

Figures published by the Bank for International Settlements (BIS) show that international bank activity[2] expanded very rapidly in the third quarter of 1978. The gross external assets of the reporting banks rose by $68 billion; however, this overstates the underlying increase in lending for two reasons. First, the statistical effects of currency valuation changes account for some $18 billion of the increase. Secondly, some $25 billion is attributable to inter-bank activity within the reporting area. Thus, new credit to non-bank residents within the reporting area and to borrowers outside the area rose by $25 billion, compared with an underlying $15 billion in each of the preceding two quarters.

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

[2] Defined as the external business in domestic and foreign currency of banks in the Group of Ten countries, Austria, Denmark, Republic of Ireland and Switzerland, and of branches of US banks in certain off-shore centres. Data for the second quarter, which were not available when the December 1978 *Bulletin* was published, together with those for the third quarter, are shown in Table 14 in the statistical annex.

UK banks' liabilities and assets by customer[a]

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

$ billions

	1977	1978			
	31 Dec.	31 Mar.	30 June	29 Sept.	29 Dec.
Foreign currency liabilities of UK banks to:					
Other UK banks	51.2	55.2	56.5	59.9	63.0
Other UK residents	7.1	7.3	8.7	8.7	9.4
Overseas central monetary institutions	41.0	42.0	42.3	45.0	41.9
Other banks overseas	108.6	109.7	110.5	123.8	139.8
Other non-residents	24.5	26.3	27.8	29.4	33.0
Other liabilities[b]	1.5	1.8	2.3	2.6	2.7
Total liabilities	**233.9**	**242.3**	**248.1**	**269.4**	**289.8**
Foreign currency assets of UK banks with:					
Other UK banks	53.2	56.4	56.8	60.7	63.0
Other UK residents	19.0	19.2	19.4	19.9	20.8
Banks overseas	116.6	118.6	121.9	135.2	149.2
Other non-residents	43.3	46.2	48.3	51.8	54.9
Other assets[b]	2.8	2.9	3.5	3.8	3.8
Total assets	**234.9**	**243.3**	**249.9**	**271.4**	**291.7**

[a] Figures differ from those in Table 6 in the statistical annex (see additional notes to Tables 12 and 13).

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

UK banks' liabilities and claims by country or area[a]

Outstanding net liabilities were unchanged overall in the fourth quarter.

$ billions outstanding

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

	1977	1978			
	31 Dec.	31 Mar.	30 June	29 Sept.	29 Dec.
BIS reporting area:					
European area	− 8.8	− 7.9	− 8.7	− 7.8	− 2.4
Canada	− 1.3	− 2.0	− 1.0	− 1.8	− 1.5
Japan	+ 9.9	+10.0	+ 8.9	+ 8.9	+ 9.6
United States	− 6.1	−10.2	− 9.1	− 9.8	−14.1
Off-shore banking centres	+ 8.6	+ 7.6	+ 7.3	+ 9.6	+ 8.4
Other Western Europe	+ 2.3	+ 2.2	+ 1.9	+ 0.5	+ 0.1
Australia, New Zealand and South Africa	+ 3.7	+ 3.8	+ 3.5	+ 3.3	+ 3.2
Eastern Europe	+ 7.1	+ 7.3	+ 8.3	+ 9.0	+ 8.4
Oil-exporting countries	−22.7	−21.6	−18.9	−18.1	−16.2
Non-oil developing countries	− 0.9	− 0.6	− 0.4	− 1.8	− 1.3
Other[b]	− 4.0	− 0.6	− 1.7	− 2.3	− 4.6
	−12.2	−12.0	− 9.9	−10.3	−10.4

[a] The breakdown corresponds to the revised format of Table 12 in the statistical annex.

[b] Includes international organisations and certain unallocated items.

Maturity structure of UK banks' net foreign currency position

Net borrowing at up to one year rose by $3½ billion between mid-August and mid-November.

$ billions

Net liabilities −/net assets+

	1978	
	mid-Aug.	mid-Nov.
Less than 8 days[a]	−15.2	−13.7
	−11.5	*− 9.9*
8 days to less than 3 months	−20.1	−25.8
3 months to less than 1 year	− 9.8	− 9.0
Net borrowing up to 1 year	−45.1	−48.5
Net lending at 1 year and over	+45.7	+48.9
	+ 0.6	+ 0.4

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

Some $50 billion of the gross increase was lent to countries within the reporting area. Claims on the United States rose by $7½ billion, so that, although liabilities also increased, by $2½ billion, there was a net flow of funds to the United States of $5 billion. Gross lending increased sharply to all groups of countries outside the reporting area. Non-oil developing countries borrowed $6 billion; however, some of these countries appear to have added part of the funds borrowed to their reserves, for on a net basis the group as a whole were suppliers of funds to the market. The oil-exporting countries were net takers of funds, borrowing $4¾ billion and depositing only $¼ billion. Claims on Eastern European countries also rose rapidly, by $4 billion; liabilities to these countries, however, also rose, by $1 billion.

Only very limited data are yet available for the fourth quarter. The volume of newly-announced medium-term euro-credits amounted to $14 billion, considerably below the record $17 billion in the third quarter.[1] In the year as a whole, such credits totalled $58¼ billion, an increase of nearly 60% over the 1977 figure (which was itself nearly 50% above that for 1976). All the main groups of countries were active in obtaining credits during 1978. The non-oil developing countries arranged credits totalling $23¾ billion ($11 billion in 1977): Mexico ($7 billion) and Brazil ($5½ billion) were responsible for about half of this sum. Credits for the OECD countries amounted to $21½ billion ($15¼ billion in 1977); and those for the oil-exporting countries accounted for $9¾ billion ($7¼ billion). Countries in Eastern Europe borrowed $3¼ billion, the same as in the previous year. As mentioned in previous issues of the *Bulletin,* not all these announcements represent new borrowing: it is estimated that at least a quarter of the credits announced in 1978 resulted from borrowers either restructuring or refinancing loans early in order to take advantage of the favourable market conditions which existed throughout the year. In 1978 the average size of announced credits rose ($104 million compared with $96 million in 1977); the average maturity lengthened (8½ years compared with 6¾ years); and the downward pressure on spreads continued.[2]

New issues of foreign and international bonds totalled $6½ billion in the fourth quarter of 1978, slightly less than in the previous three months. Total issues in the year as a whole amounted to $29½ billion, after $28¼ billion in 1977.

The London market

The size of the London euro-currency market, as measured by the gross foreign currency liabilities of reporting institutions, rose by $20 billion in the final quarter of 1978 (see the first table). However, after allowing for the statistical effects of currency valuation changes and the seasonal build-up of UK banks' end-year positions (mainly with banks abroad), the underlying growth was probably a little slower than in the previous three months. In the year as a whole, gross liabilities increased by some $56 billion; about $30 billion of these new deposits were from banks abroad.

By area, the United States was the main supplier of funds ($4¼ billion), and the decline in borrowing by the off-shore centres released an additional $1¼ billion to the market (see the second table). The largest users of funds were countries in the BIS European reporting area ($5½ billion) and the oil-exporting countries ($2 billion); in both cases there was a fall in UK banks' liabilities to the area rather than a rise in lending.

[1] The Bank of England record medium-term euro-credits with maturities of three years or more on the date of announcement, but such credits show up in the BIS figures only when they are taken up and only to the extent that they are not replacing maturing debt. Foreign and international bond issues (see next paragraph) are recorded by the Bank of England on completion.

[2] The 'spread' is the amount by which the interest rate is to exceed the London inter-bank offered rate (LIBOR).

A quarterly maturity analysis of the foreign currency liabilities and assets of reporting institutions was completed as at 15th November (see Table 13 in the statistical annex). Net liabilities at up to one year rose by $3½ billion (see the third table on the previous page): an increase of almost $6 billion in the eight days to less than three months band more than offset decreases in the other two categories. The 'other overseas' banks and the American banks were mainly responsible for the increase in net liabilities at eight days to less than three months, accounting for some $2 billion each. The fall of $1½ billion in net liabilities at less than eight days was largely due to the activities of the Japanese and the 'other overseas' banks.

A maturity analysis of institutions' issues and holdings of US dollar certificates of deposit (and small amounts of other negotiable paper) is included in the additional notes to Table 13 in the statistical annex. In the period to mid-November, outstanding issues rose by $4 billion.

Estimated oil revenues of exporting countries

Oil revenues rose strongly in the fourth quarter.

$ billions

1977	1978				
Year	Year	1st qtr	2nd qtr	3rd qtr	4th qtr
129.1	123.9	31.9	29.1	30.1	32.8

Estimated deployment of oil exporters' surpluses[a]

There was a modest cash surplus in the third quarter.

$ billions

	1976	1977	1978		
	Year	Year	1st qtr	2nd qtr	3rd qtr
United Kingdom					
British government stocks	0.2	—	—	-0.2	-0.1
Treasury bills	-1.2	-0.2	—	0.2	0.1
Sterling deposits	-1.4	0.3	0.2	-0.4	0.1
Other sterling investments[b]	0.5	0.4	—	0.1	—
British government foreign currency bonds	—	0.2	—	—	—
Foreign currency deposits	5.6	3.4	-0.3	-1.6	0.5
Other foreign currency borrowing	0.8	—	—	—	—
	4.5	4.1	-0.1	-1.9	0.6
United States					
Treasury bonds and notes	4.2	4.3	-0.1	-0.7	-0.2
Treasury bills	-1.0	-0.8	0.3	-1.1	-0.5
Bank deposits	1.6	0.4	0.5	-0.7	-1.3
Other[b]	7.2	5.3	0.8	1.3	0.6
	12.0	9.2	1.5	-1.2	-1.4
Other countries					
Bank deposits	6.5	7.5	1.5	—	-0.1
Special bilateral facilities and other investments[b][c]	12.2	12.4	1.5	2.2	2.8
	18.7	19.9	3.0	2.2	2.7
International organisations	2.0	0.3	—	—	—
Total	37.2	33.5	4.4	-0.9	1.9

[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. A table reconciling the figures with the estimates for current account surpluses is given below.

[b] Includes holdings of equities, property, etc.

[c] Includes loans to less developed countries.

Reconciliation between 'deployment' table and current account surpluses

$ billions

	1975	1976	1977
Current account surpluses	31	36	30
Net borrowing	3	8	9
Oil sector capital transactions[a]	1	-6	-1
Cash surpluses available for investment	35	38	38
'Deployment' table estimates	35	37	34
Errors and omissions	—	1	4

[a] Includes credit given for oil exports and oil companies' investment/disinvestment in oil-exporting countries.

Oil money movements

The total estimated oil revenues of the oil-exporting countries rose strongly in the fourth quarter because of higher demand for oil, reflecting both higher consumption during the summer and stockpiling in anticipation of price rises. Revenues in the first quarter of 1979 will have been affected by the disruption to oil production in Iran.

The identified deployment of the oil-exporting countries' funds in the third quarter suggests that they had a small overall surplus (see the second table). Investment in the United States was run down by $1½ billion but this was more than offset by loans to developing countries.

Preliminary data indicate a larger surplus in the fourth quarter, with a significant inflow into US bank deposits and continued investment in 'other countries'. From the figures for the first nine months of 1978, it is clear that the oil exporters' surplus for the year as a whole will prove to have been much lower than was generally expected, probably amounting to no more than $10 billion.

Commodity markets

Trading was again active in a number of markets during November to January, and some prices changed quite sharply. But the changes were to a large degree mutually offsetting, and the Economist sterling all-items index rose by only 1%.

On the London Metal Exchange (LME), there were substantial increases in price for both copper and lead. The rise in the price of copper, chiefly in January, was caused by supply difficulties in a number of producing countries, expectations of US stockpile purchases during 1979, and particular shortages of high-quality grades; in mid-January, the cash price rose above £800 a tonne for the first time since May 1977. The increasing shortage of lead, due in part to the closure of a West German refinery at the end of December, took the cash price above £500 a tonne in January for the first time. The increasing shortages of both metals were reflected in large declines in LME stocks: in particular, lead stocks fell by half over the three months. In contrast, the shortage of tin, which had been a feature of the previous quarter, eased over the period, and the cash price declined from the all-time peak of over £8,000 a tonne in early November to below £7,000. Spot trading in aluminium began on 29th December.

In the soft commodity markets, prices were generally weaker than on the LME. Coffee was cheaper in November and December because of increased sales by some producing countries. For sugar, higher estimates of European production in 1978–79 and in consequence more confident expectations of a world surplus were the main influence, and in November much of the price-rise in the previous period was reversed.