Financial review

Introduction

The review describes developments in various markets, mainly during the period February to April.

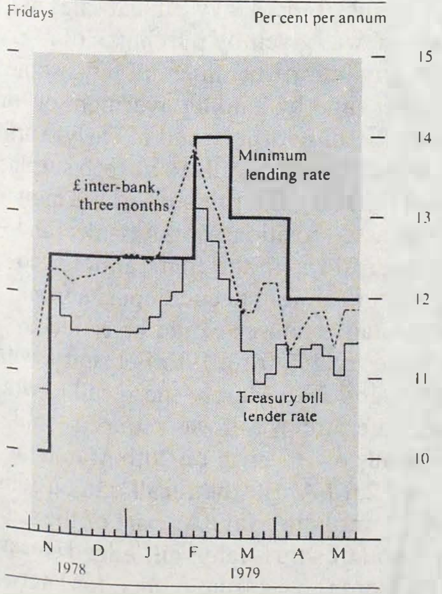
At the beginning of February, financial markets were overshadowed by doubts about the prospects for the Government's monetary, fiscal and pay policies; during the month, however, a reassessment of all three led to a sharp turn-round in sentiment. The Bank's minimum lending rate (MLR), after being raised from 12½% to 14% early in February, was reduced to 12% in two steps in March and April. There were heavy sales of gilt-edged stocks, and over the period yields fell sharply throughout the maturity range.

In the foreign exchange markets (page 129), there was a marked strengthening in sterling. The US dollar also appreciated in effective terms in spite of a reversal of the earlier pattern of substantial central bank support.

The review contains the usual sections on oil money movements (page 132), on the commodity markets (page 133) and on international banking and the euro-currency markets (page 134).

Short-term interest rates in London

MLR was raised again in February; it was lowered in March and April, but not to the pre-November level.



Inter-bank sterling deposit rates

For much of the period, longer-term market rates were below shorter-term rates.

Per cent per annum; mean of range over day

	One week rate	One month rate	Three months rate	Six months rate	One year rate
1979 Jan. 31	12.25	12.59	13.28	13.28	12.94
Feb. 28	13.88	13.25	12.44	11.72	11.69
Mar. 30	12.94	12.66	12.19	11.53	11.09
Apr. 30	12.25	12.09	11.72	11.34	11.09

The money market

At the beginning of February, money-market rates were rising in response to the deterioration in the prospects for the Government's incomes policy; there was concern, too, over the possibility of a rise in the public sector borrowing requirement (PSBR) and over the preliminary indications of the January money supply figures. On the 8th, MLR was raised from 12½% to 14%, to bring it into line with market rates and to support the policy of monetary restraint.

After some initial doubts as to whether the rise was sufficient, there was a marked turn-round in sentiment in financial markets. The demonstration of the Government's commitment to monetary targets was reassuring, and the subsequent official sales of gilt-edged stocks eased the worries about the money supply. As described in the next section, there was also a reassessment by the markets of the Government's fiscal policy and of pay developments. Furthermore, the fact that the clearing banks' base rates went up by only 1% (see below) helped to convince the markets that interest rates had risen far enough. By the end of the month, money-market rates had fallen generally (see table),[1] and there was talk of a cut in MLR.

On 1st March, the Bank matched the fall in market rates by bringing MLR down to 13%, but indicated that a period of stability in rates should ensue, in order to support the continuing policy of monetary restraint; to underline this, the

[1] Very short-term rates were constrained by the liquidity shortages caused by the continuing official sales of stock.

Bank's lending to the market that day included some loans for seven days at MLR. Market rates, however, continued to decline in the first half of March. The Bank lent for seven days at MLR on five further occasions during the month, and after the Treasury bill tender on the 16th further emphasised the message by keeping its dealing rates for Treasury bills unchanged, instead of reducing them in line with the drop in the average discount rate at the tender that day. As a consequence, and with money-market shortages persisting, interest rates turned up again, and by the end of the month the three-month inter-bank rate was only a little below what it had been at the beginning.

By early April, however, a further factor was influencing official policy and market expectations: there was persistent upward pressure on sterling in the foreign exchange market, and a danger that continuing currency inflows would lead to a rise in the monetary aggregates. Accordingly, market interest rates resumed their downward trend. Nevertheless, because of the need for domestic monetary restraint, interest rates could not be allowed to fall too far. On the 5th, MLR was reduced to 12% and the authorities' exchange market tactics were modified to allow wider fluctuations in the exchange rate (see page 130). The Bank's view that the new level of interest rates should be maintained was emphasised during April by further lending for a week at MLR. The Bank also kept its Treasury bill dealing rates unchanged throughout the month at the level established after the tender on 30th March, despite the two downward movements which occurred in the average rate of discount at the Treasury bill tenders on 6th and 27th April. Partly as a consequence, inter-bank rates were slightly higher by the end of April than immediately after the reduction in MLR.

Conditions in the money market were extremely tight for much of the period, as a result of the heavy official sales of gilt-edged stocks. Assistance was given by purchases of Treasury bills, local authority bills or commercial bills, some for resale at fixed later dates, and by lending overnight or for a week. Only very occasionally, in February and in early April, was the Bank required to sell Treasury bills to absorb surplus funds. To assist further in relieving the pressure in the money market and on the reserve asset positions of the banks (and thus on very short-term interest rates) the Bank announced on 15th February that the rate of call for special deposits from banks and deposit-taking finance houses would be reduced from 3% of eligible liabilities to 1% from 19th February, with recalls, of 1% each, on 9th and 30th March; the recall on 9th March was cancelled, and the rate of call was reduced to nil from 19th March, with recalls of 1% each on 30th March (as previously announced) and 23rd April; the recall due on 30th March was later postponed until 8th May. As part of the same operation, some £200 million of short-dated gilt-edged stocks were bought by the Bank from the clearing banks, for later resale to them.[1] All these were technical smoothing operations and implied no change in monetary policy.

At the beginning of February, the clearing banks' base and deposit rates were 12½% and 10% respectively; in mid-February, both rates were raised by 1% (to 13½% and 11%), and early in March, both were reduced by ½% (to 13% and

[1] This was done because, in consequence of the release of a proportion of special deposits to the clearing banks in August 1978 (see the additional notes to Table 4 in the statistical annex), the temporary reduction in special deposits to nil did not assist them.

$10\frac{1}{2}\%$). Early in April, base rates were reduced to 12% and deposit rates to $9\%–9\frac{1}{2}\%$.

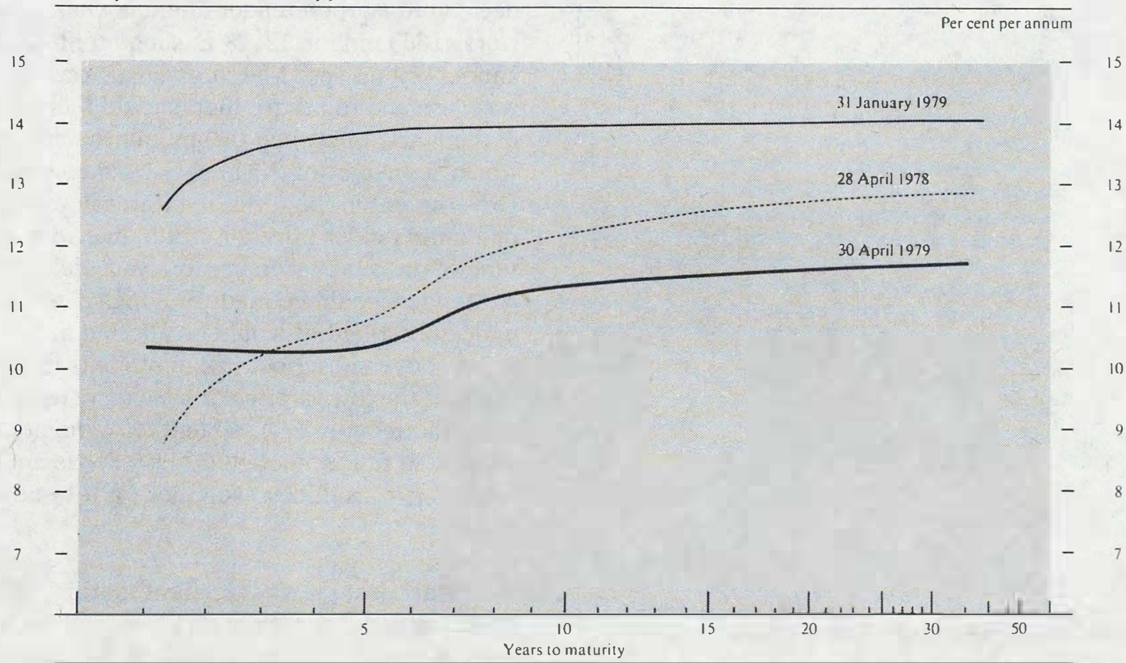
Capital markets

The gilt-edged market

In the gilt-edged market, yields fell sharply during February to April; those on short-dated stocks fell by about three and a half percentage points, and those on long-dated by about two and a half points. Turnover rose strongly in February and continued at a high level in March; in April, it fell back, most noticeably in stocks with more than five years to maturity.

Time/yield curves of British government stocks [a]

Yields on short-dated stocks fell by rather more than those on long-dated during the period, but the yield curve remained very flat.



[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.

At the beginning of February, prices were falling in quiet conditions. Trading was affected by industrial troubles, by the outlook for inflation, and by concern about the prospect of a rise in the PSBR for 1979/80. Institutional liquidity was very high, but in a market of falling prices there was an unwillingness to invest. However, following the rise of $1\frac{1}{2}\%$ in MLR on 8th February, it seemed possible that long-term yields would rise no further and investors became more active. The market was very short of stock, and demand for tap stocks built up. Official supplies of $12\frac{1}{2}\%$ Treasury Stock 2003/2005 were exhausted on 9th February; on the 15th, the short-dated tap stock (a second tranche of 12% Treasury Loan 1983) and the low-coupon stock (3% Exchequer Stock 1981) were also both exhausted.

By 16th February the market was showing some hesitation, but it remained sufficiently stable for the issue of two new partly-paid stocks to be announced, £500 million $13\frac{1}{4}\%$ Exchequer Stock 1987 and £800 million $13\frac{3}{4}\%$ Treasury Stock 2000/2003, both at £96.00 per cent.[1] The terms of the issues were in line with the market at the time of the announcement, but by the day of issue, the 22nd, there had been a very sharp turn-round in sentiment, which resulted in the heavy over-

[1] For the 1987 stock, £15 per cent was payable on application, £35 on 19th March and £46 on9th April. For the long-dated stock, £15 per cent was payable on application, £35 on 13th March and £46 on 4th April.

subscription of both stocks. This shift in market expectations was the result of a combination of several factors—the strength of sterling on the foreign exchanges and press comment on overseas interest in gilt-edged stocks, encouraging developments in the local authority workers' dispute, and the Chancellor's undertaking to hold the PSBR for 1979/80 at no more than £8.5 billion. With further improvements on the industrial front, a strong bull market continued. Yields fell by over two percentage points before the market steadied.

Although market circumstances surrounding the issue of the two stocks on 22nd February were exceptional, and a repetition of them seemed unlikely, it was nevertheless decided to adopt a tender method when a new long-dated stock, £800 million 12¼% Exchequer Stock 1999, was announced on 16th March, for issue on the 22nd. This method was designed to ensure that, should there be an improvement in the market between the announcement and the issue of the stock, some part of the benefit would accrue to the Government in the form of a lower borrowing cost. The minimum tender price was set in line with the market at the time of the announcement to give a yield of just over 12½%, but tenders could be made at a higher price. If the stock were undersubscribed, it would be allotted at the minimum tender price; if oversubscribed, all allotments of the stock would be made at the lowest price at which any tender was accepted (the 'allotment price'), all tenders at higher prices being allotted in full. Although this stock was not fully subscribed, tenders left insufficient supplies for it to be operated as a tap stock.[1]

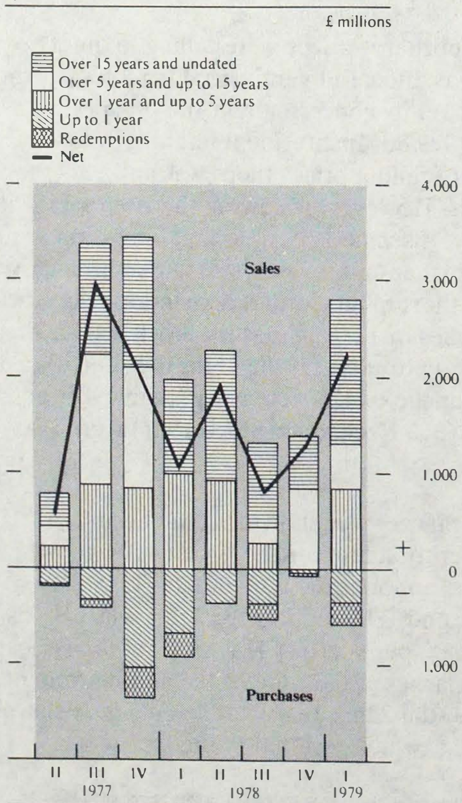
After this issue, it was apparent that the Government's financing needs for April and May had been met, and the market moved further ahead with the new stock trading at a premium. The prospect of a general election maintained market buoyancy, but official dealings were limited until a new medium-dated stock, £800 million 11% Exchequer Stock 1991, was issued on 11th April, using the same tender method. This stock was oversubscribed.[2] During the latter half of April, prices fluctuated with the varying predictions of the outcome of the election and with the corresponding reactions of sterling, and by the turn of the month the market was uneasy, with yields rising slightly.[3]

For the first two months of the period, the prices of the three variable rate stocks remained relatively stable. In April, however, demand increased, and their prices rose steadily.

In the first quarter of 1979, net official sales of stock amounted to some £2,250 million:[4] sales of long-dated stocks amounted to £1,500 million, of medium-dated to £485 million, and of stocks within one to five years of maturity to £825 million. Purchases of stocks within one year of maturity totalled £325 million. One stock matured during the quarter, 11½% Treasury Stock 1979, with about £235 million in market hands.[5]

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

In the March quarter, net sales of stocks by the authorities rose to over £2,250 million.



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

[1] The issue was thus made at the minimum tender price of £97.50 per cent, with £40 per cent payable on tender and the balance on 2nd May.

[2] The issue was made at an allotment price of £97.50, £0.50 above the minimum tender price of £97.00 per cent. £15 per cent was payable on tender, £30 on 14th May and the balance on 4th June.

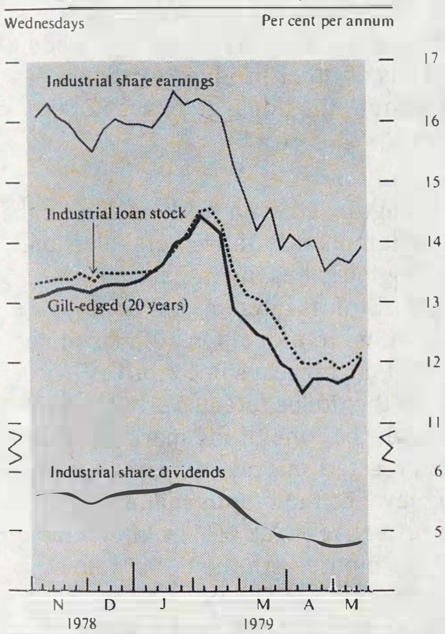
[3] On 18th May, a new long-dated stock was announced, £800 million 11¾% Treasury Stock 2001/2004, payable in full on tender. The minimum tender price was £95.50 per cent.

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

[5] Of cial purchases of 11½% Treasury Stock 1979 before redemption formed the major part of the £325 million near maturities bought during the quarter.

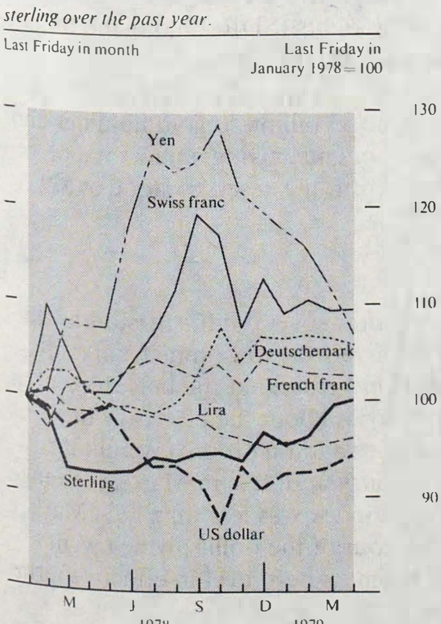
Security yields

Yields on long-dated gilt-edged and on debentures fell during February to April.



Effective exchange rates

The chart shows the relative stability of sterling over the past year.



Other markets

Although there was one local authority stock issue[1] during the period (the first since October 1978), and issues of negotiable bonds exceeded redemptions, transactions in the local authority market were modest.

Turnover in the company debenture market almost doubled during February to April; yields fell by about one and three-quarter percentage points. New issues by companies by way of loan capital and preference shares were small, and were again exceeded by redemptions.

The equity market was encouraged by the strength of the gilt-edged market, and prices rose. The FT-Actuaries industrial (500) share price index, which stood at 242 at the end of January, rose by 61 points to 303 at the end of April, having shown its biggest daily gain for eighteen months in early March. Turnover was higher than in the previous three months.

New money raised by issues of equity capital in the period amounted to £172 million, of which £144 million was in March. In the first half of that month, the Rank Organisation made a rights issue of £65 million. The queue of prospective borrowers lengthened markedly during the period.

Net sales of unit trust units fell back sharply to £16 million, compared with £36 million in the previous three months. Gross sales were buoyant at £140 million, but gross repurchases were also very high at £124 million, compared with £61 million in the previous period. In March there was a net repurchase for the month, for the first time since 1961, amounting to £2 million.

Foreign exchange and gold markets

Summary

During February to April, the US dollar was generally strong, in marked contrast to the turbulence of earlier months, and the pattern of substantial central bank support for the dollar was reversed. Sterling was usually in heavy demand, causing it to rise steadily against the dollar, and the index of sterling's effective rate touched 68.0 in mid-April, its highest for three years. The European Monetary System (EMS) began to operate on 13th March. After a quiet start, two participating currencies soon reached their bilateral intervention points, although in fact only modest intervention was necessary to keep them within the permitted limits. Among non-European currencies, the Japanese yen was weak, and the Canadian dollar recovered some ground lost earlier.

Sterling

Sterling's effective index was 63.5 at the close of business on 31st January. It remained near that figure for the first half of February, with the dollar rate at around $1.98. The market's confidence in the pound then seemed to strengthen, as some of the major industrial disputes were settled and as the level of UK interest rates became more attractive. The dollar rate moved above $2.00 on the 7th and stayed at about that level for most of the month, gaining almost two cents in the last few days, when both the volume of official sales of gilt-edged stocks (with their implications for monetary control) and the

[1] A placing of £5 million County of Cleveland Variable Rate Redeemable Stock 1984 at £99.75 per cent.

prospect of higher oil prices were seen as favourable to the pound.

In March, the pound made more substantial gains, appreciating against all the major currencies and rising in effective terms by 2.7%. The upward pressure was interrupted only for a few days in mid-month when there was a little profit-taking. Domestic economic news, although mostly unfavourable, had little effect on the exchange rate; the OPEC decision to bring forward the scheduled rise in oil prices was also discounted, because North Sea oil was seen as providing protection against the effects of other producers' price increases. At the end of March, the dollar rate was $2.0665 and the effective index 66.1.

In early April, sterling strengthened even further, despite the reduction in MLR and the imminence of a general election. The Bank, after intervening fairly heavily in February and March, changed the emphasis of its intervention policy, allowing the rate more freedom to move. On 10th April, the effective index reached 68.0, its highest since April 1976, before closing at 67.8, with the dollar rate at $2.1028. As the general election approached, the tone of the market became uneasy, and sterling often reacted sharply to opinion poll results. Its lowest closing level of the month against the dollar was $2.0427 on the 26th (effective index 66.1). After a rapid recovery, sterling ended the month with the dollar rate at $2.0685 and the effective index 67.1. The pound was strong against European currencies and before Easter it touched DM 4.00, after which some profit-taking brought the rate down; at the end of the month it was DM 3.93.

Over the three-month period, the reserves rose by $716 million after repayments to the International Monetary Fund (IMF) of $1,085 million, $1,004 million of which was a repayment ahead of schedule, announced in the April Budget. New borrowing by the public sector under the exchange cover scheme amounted to $569 million and repayments (including early ones) were $633 million.

At the end of March, the components of the reserves other than dollars—special drawing rights (SDRs), gold and other currencies—were revalued.[1] The revaluation, which will henceforth be carried out annually as at 31st March, resulted in an upward revision of some $3 billion to gold holdings and $1½ billion to the other components, giving a new total of $21.9 billion; at the end of April, the reserves stood at $21.5 billion.

US dollar

Having steadied in January after several difficult months, the US dollar moved within relatively narrow limits from mid-February, although it lost some ground at the beginning of the month, when there were worries about the effects of the situation in Iran on oil supplies and on orders for military equipment. From 14th February until late in March the range of movement in the effective index was less than ¾%. Market sentiment then moved in favour of the dollar, which went ahead in quiet trading to reach its best level in effective terms since July last year.

[1] Gold was valued at the average of London fixing prices over the three months ended 31st March; SDRs and other currencies were valued in dollars at the average of midday exchange rates over the three months.

The underlying strength of the dollar was not fully revealed by movements in its effective index. During March and April, as other currencies came under pressure, central banks largely reversed the massive support they had provided for the dollar between November and February. It was in spite of the scale of such official sales that the dollar appreciated by around 2¼% in effective terms over the two months to end-April, to achieve a net gain of 1¾% over the three-month period. The Federal Reserve and the US Treasury again repaid some swap debt to other central banks, and by the end of April all outstanding swap liabilities had been liquidated.

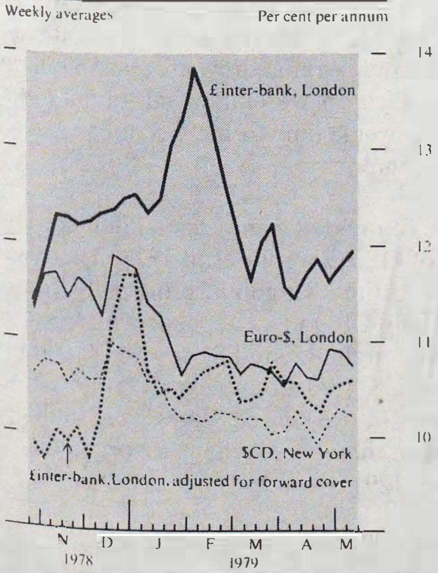
Other currencies

The Japanese yen weakened sharply, and by the end of April its effective index had fallen by nearly 9% since end-January, in spite of considerable intervention by the authorities. This weakness reflected the sharp deterioration in Japan's balance of payments on current account, accompanied by continuing capital outflows, together with worries about future oil supply difficulties. The Swiss franc also showed a weaker tendency, particularly in March and April, because of concern about the rate of inflation; the Swiss National Bank provided heavy support at times. In Western Germany, there were similar anxieties about prices, and the deutschemark weakened a little against the dollar. However, the relationship between the Swiss franc and the deutschemark remained fairly stable at around DM 100 = Sw.Fr.90. The Canadian dollar strengthened markedly in March and April, gaining nearly 4 cents to stand at US$ 0.8759 at the end of the period.

The European currency 'snake' operated until mid-March and was seldom under pressure. On 13th March, the EMS came into operation.[1] The system started quietly, but by late March there was some divergent pressure amongst the participant currencies, and in the following weeks some intervention was necessary to contain them within their declared bilateral limits. For most of the period, the Belgian franc took the bottom position, displaying the greatest deviation from its central rate against the European Currency Unit. Of the others, the Danish krone was highest among those with declared bilateral margins of 2¼% and the lira, operating on a 6% bilateral margin, held the top position overall. The lira's strength enabled the Italian authorities to add further to their dollar reserves. The strength of sterling (not a participant in the new intervention system) forced the Irish authorities to break the link between the Irish pound and sterling on 30th March.

UK and US three-month interest rates

The uncovered differential in sterling's favour varied quite sharply during February to April; the covered differential was usually marginally against sterling.



Interest rates and differentials

Sterling interest rates rose in early February (see above), the three-month inter-bank rate standing at 14% before the rise in MLR on the 8th. From then until mid-March, it fell back, to reach 11½%; after a renewed firmer tendency in late March, it eased again in April, ending the month at 11⅝%. In contrast, the three-month euro-dollar rate was stable throughout the period, fluctuating narrowly between 10½% and 11%. The uncovered differential in sterling's favour ranged between 3$\frac{5}{16}$% at the beginning of the period and $\frac{9}{16}$% in the second week of April. The cost of three months' forward cover fell from a peak of 3½% in February to around 1½% for most of April, and the covered differential, which was slightly against

[1] The eight participating currencies are: the Irish pound, the Belgian franc, the Luxembourg franc, the Danish krone, the deutschemark, the Italian lira, the Dutch guilder and the French franc. For a description of the EMS exchange rate intervention arrangements, see the article on page 190.

Estimated oil revenues of exporting countries

Oil revenues in the first quarter were affected by the disruption to Iranian oil production.

$ billions

1977	1978					1979
Year	Year	1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr
129.1	123.9	31.9	29.1	30.1	32.8	32.3

Estimated deployment of oil exporters' surpluses[a]

The estimated surplus for 1978 was much smaller than in previous years.

$ billions

	1976	1977	1978			
	Year	Year	Year	1st half	3rd qtr	4th qtr
United Kingdom						
British government stocks	0.2	—	−0.3	−0.3	—	—
Treasury bills	−1.2	−0.2	0.2	0.2	0.1	−0.1
Sterling deposits	−1.4	0.3	0.3	−0.2	0.2	0.3
Other sterling investments[b]	0.5	0.4	0.1	0.1	—	—
British government foreign currency bonds	—	0.2	—	—	—	—
Foreign currency deposits	5.6	3.4	−2.0	−1.9	0.5	−0.6
Other foreign currency borrowing	0.8	—	—	—	—	—
	4.5	4.1	−1.7	−2.1	0.8	−0.4
United States						
Treasury bonds and notes	4.2	4.3	−1.6	−0.8	−0.2	−0.6
Treasury bills	−1.0	−0.8	−0.9	−0.8	−0.5	0.4
Bank deposits	1.6	0.4	0.7	−0.2	−1.3	2.2
Other[b]	7.2	5.3	3.1	2.1	0.6	0.4
	12.0	9.2	1.3	0.3	−1.4	2.4
Other countries						
Bank deposits	6.5	7.5	3.6	1.5	−0.1	2.2
Special bilateral facilities and other investments[b][c]	12.2	12.4	8.6	3.7	2.7	2.2
	18.7	19.9	12.2	5.2	2.6	4.4
International organisations	2.0	0.3	0.1	—	—	0.1
Total	37.2	33.5	11.9	3.4	2.0	6.5

[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

	1976	1977	1978[a]
Current account surpluses	36	26	−2
Net borrowing	8	9	12
Oil sector capital transactions[b]	−6	−1	1
Cash surpluses available for investment	38	34	11
'Deployment' table estimates	37	34	12
Errors and omissions	1	—	−1

[a] The figures for 1978 are likely to be revised as fuller information becomes available.

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

sterling until late March, then hovered about parity for the first half of April, before re-emerging marginally against the pound in the third week of the month.

Gold

At first, gold took strength from the political unrest in Iran and a boom in demand for other metals. On 8th February, a new record of $254 per fine ounce was seen at the fixing in London. After a short relapse, the price went above $250 again later in the month, but the Chinese withdrawal from Vietnam and better prospects of a peace treaty between Israel and Egypt appeared to depress the price at the beginning of March. The quieter tone continued into April, and the price fell as low as $231.75 on the 17th; by the end of the month, however, it had recovered to $245.30, after the US Treasury had announced that it would reduce the amount offered in its monthly auction to 750,000 ounces. During the period, 1,500,000 ounces of gold were auctioned monthly by the US Treasury and 470,000 ounces by the IMF.

Oil money movements

The slight fall in total estimated oil revenues in the first quarter of 1979 (see the first table) must be viewed against the background of developments affecting world oil supplies. The disruption in Iran in December was followed by a complete halt to oil production for a period, and exports were not resumed in significant volume until March. Part of the world shortfall in December and January was met by increased exports from other OPEC countries, notably Saudi Arabia.

The estimated fall of some $5 billion in OPEC oil revenues between 1977 and 1978 contributed to the deterioration in these countries' aggregate balance on current account (see the third table). Higher imports in 1978 (notably by Saudi Arabia, Nigeria and Iran, in connexion with their continuing programmes of industrialisation) will have been another factor.

The total identified cash surplus for 1978 is now estimated to have been $11.9 billion (see the second table), markedly lower than in 1977. OPEC oil revenues in 1978 were probably some 4% lower than in 1977, but imports are provisionally estimated to have increased by around 15% in value terms. A notable feature of 1978 was that Saudi Arabia drew around $3 billion from her reserves: several factors were involved—a fall in the volume of oil exports, the weakening of the US dollar and a continued high growth in imports.

The decline in the value of the dollar may have influenced the pattern of deployment of OPEC surpluses in 1978. There was a small outflow from the United Kingdom, principally from foreign currency (especially US dollar) deposits with UK banks. The surplus placed in the United States was small, with an outflow of funds from US Treasury bonds and other short-term paper; bank deposits in the United States were built up in the fourth quarter when there was some recovery in the dollar (see chart on page 129).

There was an increase over the year in bank deposits in countries other than the United Kingdom and the United States. A large part of the rise in the fourth quarter was in US dollar accounts.

Project loans to developing countries were the largest element in identified placements. The volume of this lending has held up well compared with earlier years—perhaps at the expense of grant-aid—and thus in 1978 formed a much greater proportion of the sharply reduced overall cash surplus (1977, 17%; 1978, 46%). The sources of these funds were Saudi Arabia, Kuwait and the United Arab Emirates, together with their associated development agencies, such as the OPEC Special Fund.

The prospects for 1979 must be examined in the light of the turmoil caused by the revolution in Iran and the pricing policies adopted by OPEC thereafter. There have been sharp increases in oil prices,[1] partly offset, in terms of oil revenues, by cut-backs in production by several exporting countries. In particular, Saudi Arabia has cut back her production to 8.5 million barrels per day, both for conservation reasons and because Iranian oil exports have resumed, even though at a lower level than before. These developments may be reflected in the sizable placement of funds, particularly short-term deposits, in the first half of 1979. The pattern for the year as a whole, however, will depend on developments in Iran and on the possibility that some oil exporters may increase their imports of capital goods once more because of the larger oil revenues at their disposal. Most expectations are that the cash surplus for 1979 as a whole will be much larger than for 1978, perhaps in the region of $20-25 billion.

Commodity markets

The main feature during February to April was a sharp rise in the earlier part of the period in the prices of metals (particularly copper, aluminium and lead). In the soft commodity markets, prices were generally steadier throughout. With the strength of sterling helping to moderate the rise in the general level of prices, the Economist sterling all-items index ended the three months only 3% higher.

On the London Metal Exchange (LME), trading in copper was particularly active. Cash prices, which had already increased from £770 to £900 a tonne by the end of January, rose above £1,000 at the end of February for the first time since 1974, before stabilising and then weakening slightly over the following two months. The rise reflected both the strength of industrial demand and supply difficulties in a number of producing countries. LME stocks of copper continued to fall, to well below half the peak of January 1978. The steep rise in the price of lead continued in the first half of the period, reflecting sustained demand, especially from eastern Europe, and reduced production associated with cuts in output of the co-product zinc. Cash prices rose above £600 a tonne for the first time in mid-March, but weakened during the remainder of the three months. Aluminium, like copper and lead, ended the period significantly dearer, despite some weakening of prices in the latter half; prices of both tin and zinc were also higher at the end of the period. Trading in nickel for three months ahead began on 23rd April; cash transactions are to commence on 20th July.

In the soft commodity markets, cocoa prices declined substantially in March and April because of improved supplies

[1] See page 114.

and lower consumption. Sugar remained depressed: the London Daily Price rose in February to its highest for four months following a large Soviet purchase from the free market, but fell back in March and April under the pressure of a further prospective surplus in 1978-79. Coffee rose in price in the latter half of the period because of problems with supplies from Uganda. Wool was also firmer, reflecting the recovery of demand at the Australian and New Zealand auctions.

International banking and euro-currency markets

Data published by the Bank for International Settlements (BIS) for the fourth quarter of 1978 show a record increase in international bank lending[1] of $100 billion. The BIS estimates that $56 billion of this lending was attributable to inter-bank activity within the reporting area, an element usually boosted in the fourth quarter by end-year operations; and that a further sum was accounted for by the statistical effects of currency valuation changes. Thus the net growth in international bank lending, that is new credit to non-bank residents of the reporting area and all new credit to countries outside the area, is estimated to have been a little over $35 billion. This compares with underlying increases of $15 billion and $25 billion in the preceding two quarters.

There was a considerable net outflow of funds from the United States in the period. External claims of US banks increased by $21.4 billion, and their liabilities by $10.7 billion, much of the net outflow going to the European component of the reporting area.

Outside the reporting area there was a further marked acceleration in lending to non-oil developing countries, although half of these funds were re-deposited; oil-producing countries also increased both their borrowing and depositing sharply, but remained net borrowers; but Eastern European countries borrowed less than in recent quarters and re-deposited an almost equivalent amount.

Market conditions in the first quarter of 1979 and data on the London market (see below) suggest that the growth in international bank lending in the first quarter will have been very small.

The only data yet available for international banking activity in the first quarter relate to newly-announced medium-term euro-currency bank credits. As pointed out in previous issues of the *Bulletin*, not all announcements represent new borrowing, since some borrowers have taken advantage of favourable market conditions to restructure or refinance loans.[2] The total of such credits in the first quarter was over $17 billion (much in line with the record figure in the third quarter of 1978). The average size showed little change from the fourth quarter, but the average maturity lengthened further, from 8.5 to 8.9 years. The downward pressure on spreads continued.[3] The non-oil developing countries continued to account for nearly half of total funds raised; the balance was fairly widely spread among the various groups of countries.

[1] 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. See Table 15 in the statistical annex.

[2] The Bank of England records 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 the next paragraph of the text) are recorded by the Bank of England on completion.

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

UK banks' liabilities and assets by customer[a]

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

$ billions

	1978				1979
	31 Mar.	30 June	29 Sept.	29 Dec.	30 Mar.
Foreign currency liabilities of UK banks to:					
Other UK banks	55.2	56.5	59.9	63.0	65.0
Other UK residents	7.3	8.7	8.7	9.4	9.5
Overseas central monetary institutions	42.0	42.3	45.0	41.9	40.0
Other banks overseas	109.7	110.5	123.8	139.8	140.3
Other non-residents	26.3	27.8	29.4	33.0	36.2
Other liabilities[b]	1.8	2.3	2.6	2.7	2.6
Total liabilities	**242.3**	**248.1**	**269.4**	**289.8**	**293.6**
Foreign currency assets of UK banks with:					
Other UK banks	56.4	56.8	60.7	63.0	63.4
Other UK residents	19.2	19.4	19.9	20.8	22.1
Banks overseas	118.6	121.9	135.2	149.2	149.4
Other non-residents	46.2	48.3	51.8	54.9	55.8
Other assets[b]	2.9	3.5	3.8	3.8	4.2
Total assets	**243.3**	**249.9**	**271.4**	**291.7**	**294.9**

[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 increased by $2¼ billion in the first quarter.

$ billions outstanding

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

	1978				1979
	31 Mar.	30 June	29 Sept.	29 Dec.	30 Mar.
BIS reporting area:					
European area	− 7.9	− 8.7	− 7.8	− 2.4	− 4.0
Canada	− 2.0	− 1.0	− 1.8	− 1.5	− 1.8
Japan	+10.0	+ 8.9	+ 8.9	+ 9.6	+ 9.8
United States	−10.2	− 9.1	− 9.8	−14.1	−12.0
Off-shore banking centres	+ 7.6	+ 7.3	+ 9.6	+ 8.4	+ 9.0
Other Western Europe	+ 2.2	+ 1.9	+ 0.5	+ 0.1	+ 0.6
Australia, New Zealand and South Africa	+ 3.8	+ 3.5	+ 3.3	+ 3.2	+ 2.7
Eastern Europe	+ 7.3	+ 8.3	+ 9.0	+ 8.4	+ 8.0
Oil-exporting countries	−21.6	−18.9	−18.1	−16.2	−17.7
Non-oil developing countries	− 0.6	− 0.4	− 1.8	− 1.3	− 1.6
Other[b]	− 0.6	− 1.7	− 2.3	− 4.6	− 5.9
Total	**−12.0**	**− 9.9**	**−10.3**	**−10.4**	**−12.9**

[a] The breakdown corresponds to that in Table 12 in the statistical annex.

[b] Includes international organisations and certain unallocated items.

Maturity structure of UK banks' net foreign currency position

Banks net borrowing at up to one year remained almost unchanged.

$ billions: *percentages in italics*

	1978		1979	
	Mid-Nov.		Mid-Feb.	
Less than 8 days[a]	−13.7	*28.2*	−16.1	*33.5*
8 days to less than 3 months	−25.7	*53.0*	−19.9	*41.4*
3 months to less than 1 year	− 9.0	*18.8*	−12.1	*25.1*
Net borrowing up to 1 year	−48.4		−48.1	
Net lending at 1 year and over	+48.8		+48.1	
	+ 0.4		—	

[a] If all holdings of London dollar certificates of deposit regardless of maturity are included (since these may be regarded as immediately realisable assets for the holding bank), the figures for mid-November and mid-February become −9.9 and −13.0 respectively.

New issues of foreign and international bonds in the quarter were very large at $9¾ billion. Substantial issues of Swiss franc-denominated bonds accounted for about a third of the total, and the revived international dollar sector for a quarter.

The London market

The data for end-March 1979 suggest that the underlying growth of the London euro-currency market slowed in the first quarter. The gross foreign currency liabilities of reporting institutions rose by $3¾ billion (see the first table); however, after allowing for the statistical effects of currency valuation changes and the unwinding of UK banks' end-year positions, the underlying increase is estimated at about $7 billion. This compares with a rise of some $13 billion in the previous three months.

By area, oil-exporting countries ($1¾ billion) and the European component of the BIS reporting area ($1½ billion) were the main suppliers of funds (see the second table). The United States, on the other hand, withdrew over $2 billion.

A quarterly maturity analysis of the foreign currency liabilities and assets of reporting institutions was completed as at 21st February (see Table 13 in the statistical annex). Net liabilities at up to one year fell slightly (see the third table): rises of $2½ billion at less than eight days and of $3 billion at three months to less than one year were accompanied by a fall of almost $6 billion in the eight days to less than three months band. The American banks accounted for half of the increase in net liabilities at less than eight days; the Japanese and 'other overseas' banks for the remainder. Some $4 billion of the fall in net liabilities at eight days to three months was attributable to the American banks, whilst the 'other overseas' banks accounted for the rest.

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-February, outstanding issues rose by over $3 billion.

The central banks of the BIS reporting area[1] conduct detailed half-yearly surveys of the external positions of banks in their territories and provide aggregated data to the BIS. This information is subsequently consolidated and published. The contribution of banks in the United Kingdom to the end-December 1978 analysis appears as Table 14 in the statistical annex in this issue. During the half-year to end-December, the total sterling and foreign currency claims of banks in the United Kingdom on countries outside the reporting area increased by $14¼ billion to $109½ billion. Both geographically and by maturity the distribution showed little change from the position at end-June 1978. As in the general maturity analysis above, 'roll-over' loans[2] are classified according to the remaining period to maturity rather than to the next roll-over date.

[1] For this purpose, the Group of Ten countries, Austria, Denmark, Republic of Ireland and Switzerland.

[2] These are loans made for, say, five years where the interest rate is fixed every three, six or nine months, depending on the agreement between the lender and the borrower.