Financial review

Introduction

The review describes developments in various markets, mainly during the period May to July.

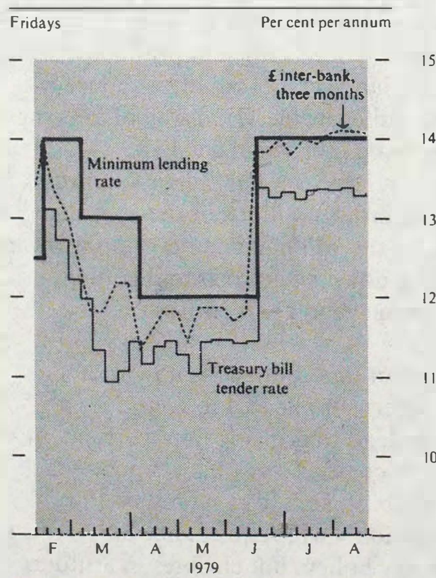
The period under review was dominated by the Budget on 12th June and by a growing awareness of the problems facing the economy in the months ahead. Interest rates rose sharply in the wake of the increase of two percentage points in the Bank's minimum lending rate (MLR) announced at the time of the Budget. Sales of gilt-edged stocks were very large.

In the foreign exchange markets (page 270), sterling was in demand throughout the period, and the effective exchange rate reached a four-year peak on 26th July. The US dollar eased noticeably between mid-June and mid-July.

The review contains the regular sections on oil money movements (page 276), the euro-currency markets (page 275) and the commodity markets (page 277). There is also a brief account of movements in the investment currency premium during the first half of 1979 (page 273).

The money market

Short-term interest rates in London
Short-term interest rates rose sharply in June in line with MLR.



MLR was raised from 12% to 14% at the time of the Budget on 12th June (see page 261). The Bank's policy in the money market beforehand was to hold rates steady, pending the announcement of his policies by the new Chancellor; and afterwards, to hold them steady at their new higher level, in order to moderate bank lending and to demonstrate that the new rates would be maintained until the pace of such lending fell.

Conditions in the money market were generally tight during the period: the main causes were the recall of special deposits on 8th May,[1] the calls falling due from time to time on earlier issues of gilt-edged stocks, and some new, large official sales of stocks (see the next section). The Bank pursued its policy of stabilising rates by giving assistance as required by the purchase of Treasury bills, local authority bills and commercial bills, some for resale at fixed later dates, or by lending overnight; on 14th June, when the market was exceptionally short of funds as a result of heavy official sales of gilt-edged stocks the previous day, bill purchases were on a larger scale than ever before. There were, however, brief periods when conditions were easier, especially during June; and the Bank sold Treasury bills to absorb surpluses, or did not intervene at all, on thirteen days during the period. The Bank's dealing rates for Treasury bills were kept unchanged during the weeks preceding the Budget; they were raised after the increase in MLR on 12th June and then held at the new higher level during the weeks that followed. On 5th July,

[1] See the June *Bulletin*, page 126.

another temporary reduction in the rate of call for special deposits from banks and deposit-taking finance houses was announced. The reduction was from 2% of eligible liabilities to ½%, with effect from 11th July, with recalls of ½% on 3rd August[1] and 1% on 13th August: as on previous occasions, it was made clear that this was a technical smoothing operation, to relieve pressures on short-term interest rates and on the reserve asset positions of the banks.

Inter-bank sterling deposit rates

The gap between shorter-term market rates and longer-term rates grew wider after the Budget.

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 Apr. 30	12.25	12.09	11.72	11.34	11.09
May 31	11.56	11.78	11.81	11.75	11.53
June 29	14.31	14.25	14.03	13.44	12.72
July 31	14.06	14.31	14.25	13.97	13.06

During May, inter-bank rates were very stable, though tending to move upwards for terms of three months and longer (see table), as published financial and economic statistics caused hopes of an early fall in MLR to fade: the shorter-term rates fell back a little at the end of May as money-market shortages eased, to register a slight decline over the month. In June, rates rose in the wake of the MLR increase. Longer-term rates, however, rose by significantly less than shorter-term rates, reflecting the expectation that MLR would fall before long. Rates for periods up to three months were affected by liquidity shortages and the pressure on the banks' reserve asset positions, and these factors continued to have effect until the end of the period. Further adverse statistics and the buoyancy of bank lending caused hopes of an early fall in MLR to ebb once more, and by the end of July there were signs of a hardening of longer rates, though the interest curve remained downward-sloping.

Following the rise in MLR, the clearing banks raised their base rates from 12% to 14%; and their deposit rates from 9%–9½% to 11½%–12%.

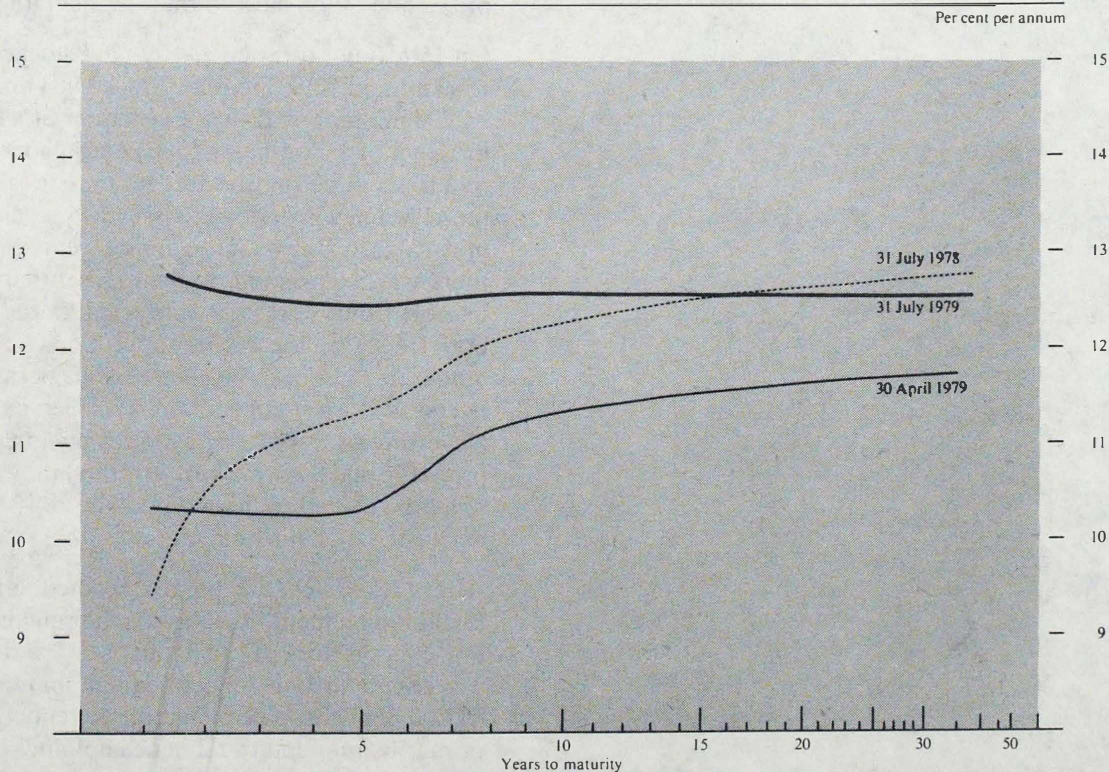
Capital markets

The gilt-edged market

During May to July, yields on short-dated stocks rose by about two percentage points, and those on long-dated stocks by

Time/yield curves of British government stocks [a]

Yields on short-dated stocks rose by more than those on long-dated during May to July.



[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] The recall on 3rd August was subsequently postponed to 10th September.

about one percentage point. Turnover fell in May, particularly in stocks with less than five years to maturity; it recovered in June and continued at this higher level for the rest of the period.

At the beginning of May, attention in the market centred on the general election. Shortly after the announcement of a change of government, prices fell away quite sharply as the market re-evaluated the economic outlook and the likely policies of the new administration in the light of the publication of some disappointing economic and financial statistics. In these unsettled conditions, official supplies of Variable Rate Treasury Stock 1983 were exhausted on the 8th.

By 18th May, prices appeared to have stabilised sufficiently for a new long-dated stock to be announced—£800 million 11½% Treasury Stock 2001/2004, to be issued at a minimum price of £95.50 per cent, payable in full on tender. The terms of the issue were broadly in line with the market at the time of the announcement. By the day of issue (23rd May), however, prices in general had eased, and tenders were negligible.

In very quiet trading, there was little further movement in prices before the Budget on 12th June. On the morning after the Budget, prices were marked down sharply as the market sought to establish a new yield structure consistent with the measures announced in the Chancellor's speech. In response to bids from the market, the long-dated tap stock was activated at a price giving a yield to redemption of just under 13%. At this price, demand exceeded the amount of available stock and orders received from brokers by jobbers had to be cut down.

With the exhaustion of the tap stock, it was apparent to the market that the Government's immediate financing needs had been met and prices moved ahead on a broad front. This buoyancy was only short-lived, however, and within two weeks prices had fallen back to their immediate post-Budget level.

On 15th June, two new partly-paid stocks were announced, £800 million 12% Treasury Stock 1984 and a second tranche, of £1,000 million, of 12¼% Exchequer Stock 1999.[1] Given the prospect of a continuing high central government borrowing requirement before the Budget measures could take effect, these two new stocks were issued to secure funding through to mid-August. Between the announcement and the day of issue, there were suggestions in the market that the weight of interest from overseas would result in the oversubscription of both stocks. In the event, applications on 21st June were only moderate, and, as on some previous occasions, the extent of overseas interest appears to have been exaggerated. Nevertheless, reports of overseas buying persisted and probably played some part in stimulating domestic demand towards the end of the month. The 1984 stock was declared exhausted on 29th June, and the 1999 stock on 2nd July.

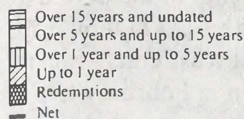
After these sales, the market steadied, and there was little further movement in yields for the remainder of the period. A low-coupon stock, £1,000 million 3% Exchequer Stock 1984, was issued on 19th July at a minimum tender price of £77.00 per cent, payable in full on tender. This stock was primarily intended to refinance holdings of three low-coupon

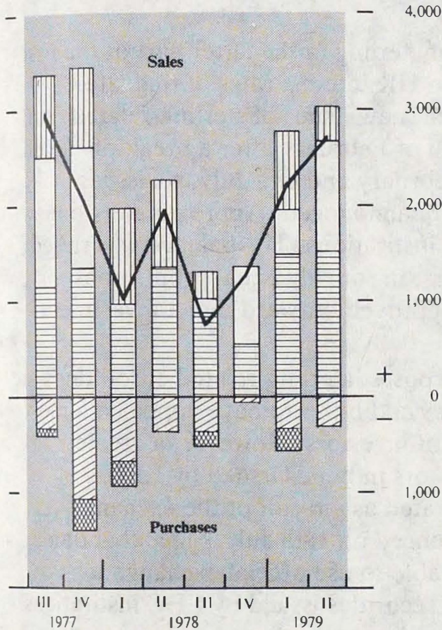
[1] For the 1984 stock, allotments were made at the minimum tender price of £97.50 per cent, with £50 per cent payable on tender, and £47.50 on 11th July. A further £250 million of this stock was reserved for the National Debt Commissioners for public funds under their management. For the 1999 stock, allotments were made at the minimum tender price of £95.50 per cent, with £15 per cent payable on tender, £25 on 6th July and £55.50 on 8th August.

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

In the June quarter, net sales of stocks by the authorities rose further.

£ millions



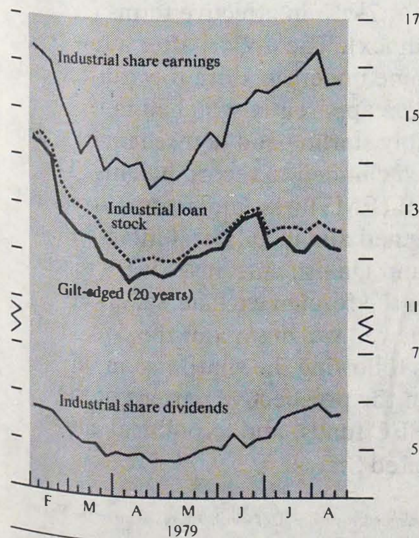


[a] Components are on occasion too small to be shown separately.

Security yields

Yields on long-dated gilt-edged and on debentures rose on balance during the period in spite of some easing back in July.

Wednesdays | Per cent per annum



stocks, totalling £1,175 million, maturing between September and November. Initial tenders were small. On the 20th, the largest-ever single issue for cash was announced, £1,500 million 11¾% Treasury Stock 2003/2007.[1] As with other recent issues, the timing of the instalments reflected the expected pattern of the Government's borrowing needs. Although tenders were substantial, the issue was undersubscribed and therefore all allotments were made at the minimum tender price. There were no further sales of this stock until 8th August when strong demand exhausted remaining official supplies.[2]

In the second quarter of 1979, net official sales of stock amounted to some £2,735 million:[3] sales of long-dated stocks amounted to £1,530 million, of medium-dated to £1,160 million, and of stocks within one to five years of maturity to £360 million. Purchases of stocks within one year of maturity totalled £315 million. No stocks matured during the quarter.

Certificates of tax deposit

In the second quarter, net sales of certificates of tax deposit amounted to £24 million. This low figure partly reflected substantial surrenders of certificates by oil companies in payment of petroleum revenue tax on 1st May. Interest rates on certificates were raised on 25th June, from 12¼% to 13½% if used in payment of tax, and from 9½% to 10¾% if surrendered for cash.[4] At the same time, with the yield curve on alternative investments for periods of up to two years sloping steeply downwards, the bonus applicable to certificates held for more than six months was dropped. On 20th July it was announced that petroleum royalties were to be added to the list of taxes for which certificates could be used in payment.

Other markets

The local authority market was quiescent during the period May to July, with no new issues of stock and with issues of negotiable bonds exceeded by redemptions.

Turnover in the company debenture market fell in the period; yields rose by about one percentage point in May and June but fell back slightly in July. Net new issues of loan capital and preference shares totalled £20 million: this is the first time for nearly two years that new issues have exceeded redemptions in the period under review, but this was only because of one large rights issue of £25 million.

The equity market, which had risen very sharply in March and April, continued to advance in early May. The FT-Actuaries industrial (500) share price index, which stood at 303 at the end of April, reached 308 on 4th May, the day following the general election. Thereafter, however, the market was increasingly depressed; the influences included awareness of the country's economic problems (underlined by adverse statistics), fears of industrial unrest, the low profitability of

[1] The minimum tender price was £96.50 per cent, of which £15 per cent was payable on tender, £40 on 20th August and £41.50 on 6th September.

[2] The issue of a short-dated stock, £1,000 million 11¼% Exchequer Stock 1984, with a further £100 million reserved for the National Debt Commissioners, was announced on 10th August.

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

[4] On 6th August, interest rates on certificates were increased to 14% if used in payment of tax and to 11% if encashed.

companies (and the expected effects on exporters' profits of the strength of sterling), the Budget increases in MLR and VAT and the pressure of rights issues. By the end of July, the index had fallen to 260.

New money raised by issues of equity capital in the period rose strongly to £484 million,[1] compared with £172 million in the preceding three months. Net sales of unit trust units again fell, to £12 million, compared with £16 million in February to April, and £36 million in the three months before that.

With the strengthening of sterling in the latter part of the first quarter and the decline in UK interest rates during late February and early March, new issues of sterling-related euro-bonds resumed at the end of February after a break of eleven months. Between end-February and end-July, six issues totalling £140 million were announced. Approximately one third was raised by EEC institutions. The balance was raised by UK resident borrowers, in roughly equal proportions for domestic purposes and approved outward direct investment.

For exchange control purposes, sterling-related euro-bonds are foreign currency securities and hitherto have appealed almost exclusively to non-resident investors. However, a greater interest by resident investors in bonds issued by EEC institutions may be generated as a result of the exchange control relaxations announced on 18th July. Since that date, UK residents have been able to use official exchange to acquire foreign currency securities issued by EEC institutions whereas they were previously required to use investment currency or the proceeds of foreign currency borrowing.

Foreign exchange and gold markets

Summary

Most major currencies experienced sizable movements in the May to July period. Sterling appreciated considerably, reaching a four-year peak against the dollar of almost $2.34 in late July. The underlying reasons for this strength appear to have been the existence of the North Sea energy assets and the attraction of UK interest rates. These factors apparently outweighed economic problems, which included indications of escalating inflation and a deterioration in the non-oil account of the balance of payments. Not until the end of the period did the upward pressure slacken, and then the dollar rate fell by nearly six cents in one day. Despite this fall, over the three months sterling gained about 7½% in effective terms (see Table 18 in the statistical annex). The dollar, after a few months of relative calm, came under pressure towards the end of the period as some holders apparently switched into European currencies, notably sterling and deutschemarks, and into gold, the price of which climbed to record heights. The European Monetary System (EMS) was under some stress as the deutschemark strengthened and its bilateral intervention limits against the Belgian and Danish currencies were reached. The unsettled conditions in the foreign exchange markets probably owed most to renewed worries about the course of inflation in many countries following the sharp rise in oil prices, to uncertainty about the prospective pattern of the placement of increased OPEC funds, and to political and economic events in the United States.

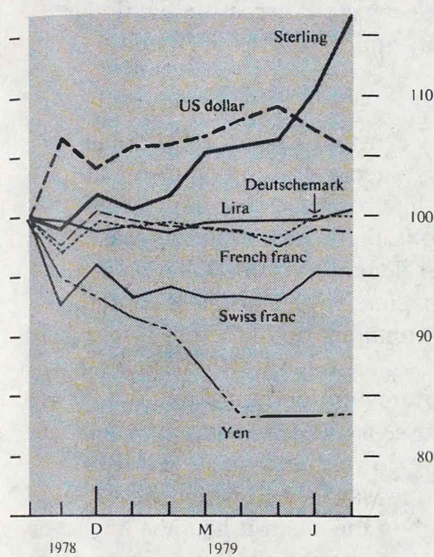
[1] This includes £75 million raised by BL Limited, virtually all of which was taken up by the National Enterprise Board.

Effective exchange rates

Both sterling and the US dollar stood higher at the end of July than at the end of October 1978.

Last Friday in month

Last Friday in October 1978 = 100



In the adjacent chart, effective exchange rate indices (21st December 1971 = 100) have been arithmetically rebased on the last Friday in October 1978, when the dollar was approaching a record low point, just before President Carter's support measures were announced. The chart shows that by the end of July the US dollar had on balance risen by 5% and sterling by 17%.

Sterling

At the end of April, the pound stood at $2.0685 against the dollar, with the effective index at 67.1. Its fortunes were rather mixed in May: it closed at $2.0759 (effective index 67.5) on the 3rd, the day of the general election, but some profit-taking followed and poor retail price and banking statistics added to the downward pressure. By the close on the 14th, the effective index had reached a low point for the period of 66.1, with the dollar rate at $2.0429. On the following day, the Queen's Speech was well received and, for the rest of May, sterling edged upwards in rather thin markets, ending the month at $2.0720 (67.4 in effective terms).

The publication on 8th June of the poor trade figures for the three months February to April was not followed by any significant selling of sterling, and there was only a small drop in the effective index, to 67.2. After the Budget on the 12th, sentiment turned in the pound's favour, with relatively high interest rates the principal contributory factor. Sterling closed at $2.0870 on Budget day, and by the third week of June a dollar rate of above $2.10 had become established. The dollar then began to experience a bout of weakness, partly because of anxieties about the outcome of the OPEC conference; persistent buying resulted in further gains for sterling both against the dollar and in terms of its effective measure, and it ended June at $2.1715 and 69.5.

Widespread demand for the pound continued into July and by the 5th, with the dollar at its weakest for several months and a rumour of a new oil discovery in the North Sea, sterling rose above $2.25 for the first time since June 1975; and the effective index reached 71.6. The upward pressure then eased a little but resumed in the third week of the month as the dollar weakened sharply. On the 19th, sterling closed at $2.3005 and 72.8 in effective terms. It rose still higher in the following week amidst widespread heavy demand against most major currencies. On 26th July, the dollar rate touched $2.3355 before closing at $2.3290 with the effective index at 74.0, the highest since late 1975. Sterling remained strong—cross rates as high as DM 4.24½ and Y 503¼ were recorded on the 30th—until heavy selling, apparently originating in the United States, led to a sharp fall on the last day of the month. At the close on 31st July, the dollar rate stood at $2.2595 and the effective index at 72.1, representing gains of 9.2% and 7.4% respectively compared with end-April.

During the period, the reserves rose by $2,030 million, to $23,500 million, after accruals of public sector borrowing under the exchange cover scheme of $440 million and repayments of $920 million. July saw a scheduled repayment equivalent to $80 million under the IMF oil facility and the deposit of 20% of the United Kingdom's reserve holdings of dollars and 20% of gold holdings on a revolving swap basis

with the European Monetary Co-operation Fund (EMCF) in exchange for European Currency Units. Management of the dollars and the gold is retained by the UK authorities, who continue to be free to invest the dollars and retain income from them. Because the EMCF uses a different system of gold valuation, the swap had the effect of increasing the dollar value of the UK reserves by approximately $350 million.

US dollar

Despite continuing sales by central banks, the US dollar became firmer in late May; a general rise in oil prices at this time did not weaken it, as had been the case in previous months, because traders took the view that the increased cost of oil would lead to greater demand for the dollar as the international currency of payment. This firmness continued until mid-June and then a combination of factors resulted in a decline. These included a large rise in the US money supply, a narrowing of favourable interest differentials, and doubts as to whether inflationary pressures in the US economy would, after all, be relieved by a slowing down in activity. The OPEC conference at the end of June was viewed with some apprehension and, although in the event it had less impact on the dollar than might have been expected, the market's overall assessment of the currency remained rather gloomy; in the early days of July there was uncertainty about US energy policy, and widespread selling brought the effective index lower, despite weighty central bank support. The impact of the news that all the members of President Carter's Cabinet had offered to resign was felt on the 18th; by the close of business on that day, the dollar had fallen by 9% against sterling since the end of April, by 5% against the deutschemark and by 3½% against the yen. From then until the end of July the dollar recovered, helped by higher domestic interest rates and the market's favourable reaction to the appointment of Mr Volcker as Chairman of the Federal Reserve Board, announced on the 25th. Having recouped some of its earlier losses, the dollar ended the month 2% lower in effective terms over the period.

Other currencies

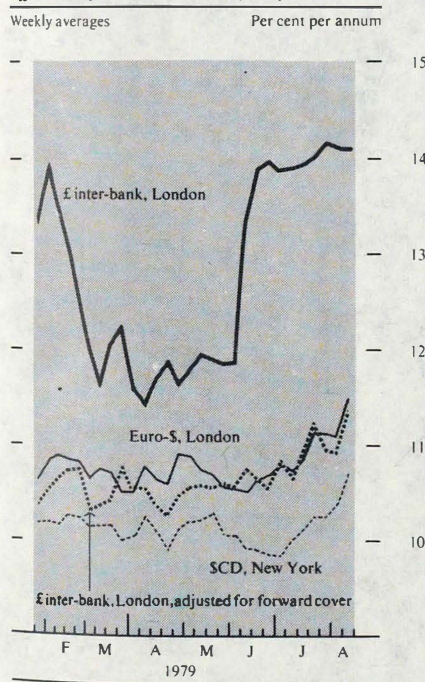
The EMS came under some internal strain during the period. For the first three weeks of May, the Danish krone and Belgian franc were respectively top and bottom of the 2¼% band of currencies. The deutschemark then moved to the top position and remained there for the rest of the period, while the Danish krone slipped down to reach the bottom in early June; thereafter its weakness persisted, as did that of the Belgian franc, despite attempts by the authorities in both countries to counter the downward pressure by raising interest rates. Intervention at the margins of the system was heavy at times as the bilateral intervention points were reached by the two weakest currencies and the deutschemark. The French franc remained in the upper half of the band as the French authorities intervened to restrain its divergence from the deutschemark. The lira, which alone operates on a wider (6%) margin in the EMS, was the overall strongest currency, although its lead over the deutschemark narrowed somewhat, to about 1½%. Outside the EMS, the Swiss franc remained steady against the deutschemark, the cross rate staying close to DM 100=Sw.Fr. 90½.

As the period opened, the yen was at its weakest against the dollar for nearly a year, at about Y 225. Reports that Prime

Minister Ohira considered Y 200 an appropriate level seemed to have a temporary beneficial effect and the rate appreciated, touching Y 212 after some central bank assistance. In late May it eased back to Y 220: Japan's inflation and trade position continued to cause anxiety, as did the increase in the price of oil. As the dollar weakened in the latter part of June, the yen's appreciation was less than proportionate; it remained steady around Y 216 during July, and by the end of the month had gained 1% in effective terms over the period as a whole. The Canadian dollar was firm at first but then fell steadily, dropping briefly below US$0.85 during June, with the downward pressure attributable to disappointing trade figures, before closing July at $0.85½. Over the three-month period its trade-weighted index declined by 3¼%.

UK and US three-month interest rates

After MLR was raised, the uncovered differential in sterling's favour widened sharply, while the covered differential fluctuated around parity.



Interest rates and differentials

Sterling interest rates were fairly stable until mid-June, the three-month inter-bank rate staying within the range 11½%–12%. Rates adjusted quickly after the MLR rise announced in the Budget, and from then until mid-July the three-month rate was mostly just below 14%. The three-month euro-dollar rate was steady within the range 10½%–11% until late July when it firmed to end the period at 11$^{5}/_{16}$%. The uncovered differential in sterling's favour ranged between ½% in early May and 3⅝% just after the Budget. The cost of three months' forward cover was about 1%–1½% for the first six weeks of the period, but it jumped to over 3% in mid-June when UK interest rates rose. The covered differential, which was marginally against sterling during May, subsequently fluctuated narrowly around parity.

Gold

The price of gold moved steadily upwards. Its lowest London fixing per fine ounce was $245.90 in early May and by the end of that month it had reached $277.15. The advance was stimulated by inflation, commodity price considerations (including higher oil prices) and currency uncertainty. New record prices were set during June and July, and the renewed weakness of the dollar spurred the rise; the highest fixing of the period was $307.00 on 26th July.

A reduction in supplies coming on to the market may also have played a part in raising the price: during the period, 750,000 ounces of gold were auctioned monthly by the US Treasury (all of lower, 'coin' bar, quality) and 444,000 ounces by the International Monetary Fund; this compares with a combined total of 1,970,000 ounces a month from December until April. In addition, although the market appeared to expect substantially increased Russian sales to finance purchases of grain, these did not in the event materialise.

The investment currency market, January to July

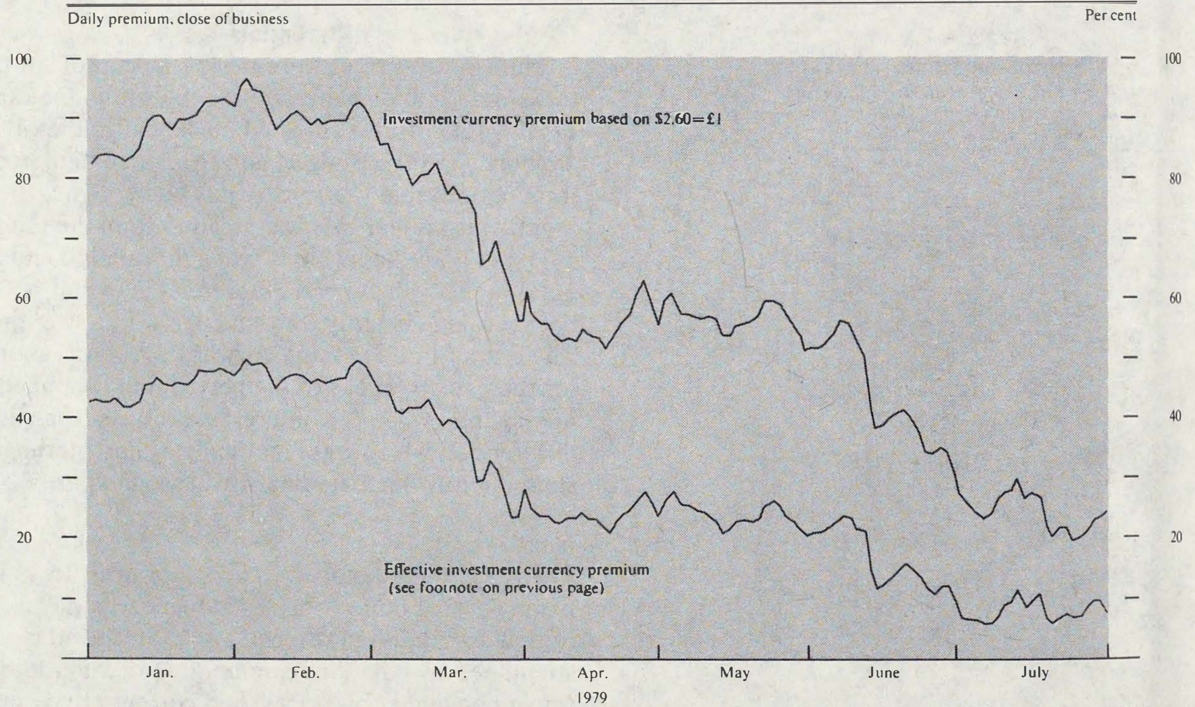
The investment currency market was unusually volatile between January and July; on balance, the premium fell sharply (from an effective[1] 50% in February to 8% at the end of July), although there were times when it had fallen low enough to encourage some demand for investment currency, with a consequent temporary hardening of the premium. Subsequently, in August, the premium recovered somewhat, to around 12%.

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

Apart from a lack of interest in Wall Street by UK residents, speculation that a change of government might bring about early relaxations of controls on outward portfolio investment was the main factor in the fall of the premium through March and April to around 25%. After the election, ministerial statements about the future of exchange controls contributed to the lack of demand for investment currency, and the relaxations (see below) announced on 12th June and 18th July (effective in each case from the following day) on both occasions caused further sharp falls in the premium.

Investment currency premium

The effective premium has fallen sharply since February.



On 12th June it was announced that interest and other charges on foreign currency borrowing for portfolio investment abroad could be paid with official exchange, and the requirement to hold 115% cover for such borrowing in the form of foreign currency securities and/or investment currency was removed. The further relaxations on 18th July were more far-reaching: the main provisions were to allow, first, the repayment with official exchange of foreign currency borrowing for portfolio investment which had been outstanding for at least one year as at 19th July; and, secondly, the purchase with official exchange of most quoted foreign currency securities denominated and payable in the currencies of EEC member states, and of foreign currency securities issued by EEC institutions and other international bodies of which the United Kingdom is a member.

In addition, the requirement to use investment currency to purchase private property abroad was abolished (12th June) and all remaining restrictions were removed on the financing of outward direct investment and on the repayment of foreign currency borrowing taken to finance such investment (12th June and 18th July): but these measures will have had a negligible effect on the investment currency premium because

the investment currency market has not been a large provider of funds for these purposes in recent years.

International banking and euro-currency markets

Although Bank for International Settlements (BIS) quarterly data beyond the end of 1978 were not available at the time of writing,[1] there are a number of indications that international banking activity, which began the year at a relatively low level, has since accelerated. The figures that are available, in particular those for the London market, suggest fairly slow growth in the market in the first quarter, with a marked pick-up in activity towards the end of the second quarter.

Medium-term euro-currency bank credits continued to be announced in the second quarter at a rate above the quarterly average for 1978. The most obvious results of the refinancing and balance of payments borrowing which underlay much of this activity were already apparent in the BIS half-yearly maturity analysis for December 1978,[2] which showed that borrowing countries had both significantly improved the maturity structure of their debt and at the same time increased their euro-market deposits. Thus, borrowing countries, taken in aggregate, have built up their reserves, and this could help them in the short term to finance the higher import bills caused by the rise in oil prices. The demand for new loans, however, is likely to remain high as current account deficits increase.

Total credits[3] announced in the second quarter were $19 billion. The average size of loans and the average maturity remained at the levels of the first quarter, although if certain substantial, relatively short-term borrowing is excluded the average size of loan fell and the average maturity lengthened noticeably from 8.9 to 9.7 years. The pressure on spreads continued,[4] not only in absolute terms but also in the differentials between varying classes of borrower.

The London market

The data for end-June 1979 suggest that the London euro-currency market expanded rapidly in the second quarter after marking time in the first. The gross foreign currency liabilities of reporting institutions rose by about $25 billion (see the first table); however, after adjustment for the effects of currency valuation changes the underlying increase is estimated to have been about $23 billion, compared with $7 billion in the previous three months. This increase is as large as any quarterly increase in 1978, and there was a very clear acceleration in activity within the quarter.

By area (see the second table), most of the funds came from the European component of the BIS reporting area ($3¼ billion net) and the United States ($2½ billion net). Oil-exporting countries placed some $1½ billion in London but increased their borrowing by $1 billion. Among the net borrowers, the off-shore centres absorbed $2½ billion and Japan and Eastern Europe each took about $1 billion.

[1] Figures for end-December 1978 were published in Table 15 in the statistical annex to the June *Bulletin*.

[2] The UK contribution to this half-yearly analysis appeared as Table 14 in the June *Bulletin*.

[3] 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.

[4] 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 greater in the second quarter.

$ billions

	1978			1979	
	30 June	29 Sept.	29 Dec.	30 Mar.	30 June
Foreign currency liabilities of UK banks to:					
Other UK banks	56.5	59.9	63.0	65.0	70.3
Other UK residents	8.7	8.7	9.4	9.5	11.1
Overseas central monetary institutions	42.3	45.0	41.9	40.0	53.0
Other banks overseas	110.5	123.8	139.8	140.3	142.1
Other non-residents	27.8	29.4	33.0	36.2	39.6
Other liabilities[b]	2.3	2.6	2.7	2.6	2.8
Total liabilities	**248.1**	**269.4**	**289.8**	**293.6**	**318.9**
Foreign currency assets of UK banks with:					
Other UK banks	56.8	60.7	63.0	63.4	68.6
Other UK residents	19.4	19.9	20.8	22.1	22.9
Banks overseas	121.9	135.2	149.2	149.4	164.0
Other non-residents	48.3	51.8	54.9	55.8	59.2
Other assets[b]	3.5	3.8	3.8	4.2	5.0
Total assets	**249.9**	**271.4**	**291.7**	**294.9**	**319.7**

[a] Figures differ from those in Table 6 in the statistical annex (sec 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 showed little change in the second quarter.

$ billions outstanding

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

	1978			1979	
	30 June	29 Sept.	29 Dec.	30 Mar.	29 June
BIS reporting area:					
European area	− 8.7	− 7.8	− 2.4	− 4.4	− 7.6
Canada	− 1.0	− 1.8	− 1.5	− 1.8	− 0.9
Japan	+ 8.9	+ 8.9	+ 9.6	+ 9.8	+10.9
United States	− 9.1	− 9.8	−14.1	−12.0	−14.6
Off-shore banking centres	+ 7.3	+ 9.6	+ 8.4	+ 9.0	+11.5
Other Western Europe	+ 1.9	+ 0.5	+ 0.1	+ 0.6	+ 0.2
Australia, New Zealand and South Africa	+ 3.5	+ 3.3	+ 3.2	+ 2.7	+ 2.4
Eastern Europe	+ 8.3	+ 9.0	+ 8.4	+ 8.0	+ 9.0
Oil-exporting countries	−18.9	−18.1	−16.2	−17.7	−18.3
Non-oil developing count ies	− 0.4	− 1.8	− 1.3	− 1.6	− 0.7
Other[b]	− 1.7	− 2.3	− 4.6	− 5.4	− 4.8
Total	**− 9.9**	**−10.3**	**−10.4**	**−12.8**	**−12.9**

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

[b] Includes international organisations and certain unallocated items.

A quarterly maturity analysis of liabilities and assets in foreign currencies was completed as at 16th May (see Table 13 in the annex). Net liabilities at up to one year had risen since the analysis in February (see table), with net liabilities in the three months to less than one year range falling by nearly $4 billion and those in the eight days to three months range rising by $6½ billion. These changes appear to reflect a quarterly pattern, with the breakdown of total net liabilities up to one year presenting a picture similar to that in November 1978. The British and American banks were mainly responsible for the increase in net liabilities in the eight days to three months category.

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-May, outstanding issues rose by over $2¼ billion.

Maturity structure of UK banks' net foreign currency position

Banks' net borrowing at up to one year rose by $3¾ billion between mid-February and mid-May.

$ billions: *percentages in italics*

	1979			
	Mid-Feb.		Mid-May	
Less than 8 days[a]	−16.1	*33.5*	−17.2	*33.1*
8 days to less than 3 months	−19.9	*41.4*	−26.4	*50.9*
3 months to less than 1 year	−12.1	*25.1*	− 8.3	*16.0*
Net borrowing up to 1 year	−48.1		−51.9	
Net lending at 1 year and over	+48.1		+51.1	
	—		− 0.8	

[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-February and mid-May become −13.0 and −13.5 respectively.

Oil money movements

Oil revenues

Estimated OPEC oil revenues in the second quarter of 1979 were $2.7 billion higher than in the first (see table). The rise reflected oil price and supply developments in the February-April period. The bringing forward by the March OPEC ministers' meeting of price increases scheduled for the fourth quarter of 1979, and the subsequent imposition of surcharges by all OPEC countries except Saudi Arabia, materially affected prices.[1] Production showed an overall increase with the continuing recovery of Iranian exports in April.

Estimated OPEC oil revenues

Oil revenues rose in the second quarter.

$ billions

1977	1978					1979	
Year	Year	1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr	2nd qtr
129.1	123.9	31.9	29.1	30.1	32.8	32.3	35.0

The cash surplus

Following an identified OPEC cash surplus in 1978 of some $13 billion, the surplus for the first quarter of this year was an estimated $6½ billion (see table). Funds held in the United Kingdom went up by over $2 billion, after a net outflow of $½ billion in the previous quarter: most of the change was attributable to an increase in foreign currency deposits. The reduction in investment in the United States reflected continuing net sales of US Treasury bonds and other government paper, together with sizable withdrawals from deposits with American banks.

Over half the total surplus in the first quarter—some $4 billion—took the form of 'special bilateral facilities and other investments'. Much of this came from the main 'surplus' oil-exporting countries, Saudi Arabia, Kuwait and the United Arab Emirates—perhaps as much as $2 billion was lent by these three countries to the Third World.

Preliminary indications of the deployed surplus for the second quarter of 1979 show, *inter alia*, that funds placed in the United Kingdom were smaller than in the first, mainly because foreign currency deposits increased at a lower rate. The reduction in investment in the United States in the first quarter was followed by moderate new investment in the second.

Estimated deployment of OPEC surpluses[a]

$ billions

	1976	1977	1978			1979
	Year	Year	Year	1st half	2nd half	1st qtr
United Kingdom						
British government stocks	0.2	—	−0.3	−0.3	—	0.1
Treasury bills	−1.2	−0.2	0.2	0.2	—	0.1
Sterling deposits	−1.4	0.3	0.2	−0.2	0.4	0.2
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	−0.1	1.9
Other foreign currency borrowing	0.8	—	—	—	—	—
	4.5	4.1	−1.8	−2.1	0.3	2.3
United States						
Treasury bonds and notes	4.2	4.3	−1.6	−0.8	−0.8	−1.1
Treasury bills	−1.0	−0.8	−0.9	−0.8	−0.1	—
Bank deposits	1.6	0.4	0.7	−0.2	0.9	−1.1
Other[b]	7.2	5.3	3.1	2.1	1.0	0.3
	12.0	9.2	1.3	0.3	1.0	−1.9
Other countries						
Bank deposits	6.5	7.5	5.0	1.9	3.1	2.1
Special bilateral facilities and other investments[b][c]	12.2	12.4	8.6	3.7	4.9	3.9
	18.7	19.9	13.6	5.6	8.0	6.0
International organisations	2.0	0.3	0.1	—	0.1	—
Total	**37.2**	**33.5**	**13.2**	**3.8**	**9.4**	**6.4**

[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 on the next page.

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

[c] Includes loans to less developed countries.

Prospects for 1979

Revised projections of total oil revenues in 1979, following the OPEC oil ministers' meeting in June, have been the main new element influencing forecasts of this year's aggregate OPEC current account surplus, now estimated to be in the region of

[1] See the June *Bulletin*, pages 114-15.

Reconciliation between 'deployment' table and current account surpluses

$ billions

	1976	1977	1978
Current account surpluses	36	26	2
Net borrowing	8	9	12
Oil sector capital transactions[a]	−6	−1	1
Cash surpluses available for investment	38	34	15
'Deployment' table estimates	37	34	13
Errors and omissions	1	—	2

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

$35–40 billion. The growth of the invested cash surplus will not necessarily correspond with the increase in the current account surplus for several reasons. First, allowance must be made for a time-lag between oil exports and payments by the consuming nations. Saudi Arabia's decision, announced at the June meeting, to reduce the allowed period of credit from sixty days to thirty days will have reduced but not eliminated this time-lag.[1] In addition, account needs to be taken of net external borrowing by OPEC. Such borrowing amounted to an estimated $12 billion in 1978 (see table), with some nations running balance of payments deficits because of large industrialisation programmes. Syndicated credits announced in the first half of this year indicate that external borrowing may still be significant in 1979, despite the large increase in oil revenues.

Oil producers will be receiving markedly larger revenues from the third quarter of 1979 onwards. In the short term, the resulting cash balances will probably remain unspent, with the exception of Saudi Arabia's; Saudi Arabian budgetary expenditure has exceeded revenue in the last two financial years. In the longer term, the size of the cash surplus will depend on the ability of the other traditional 'surplus' countries to absorb their higher revenues; this may be limited, and to that extent their additional funds will continue to swell the cash surplus.

Commodity markets

The Economist sterling all-items index of commodity prices ended the three months May to July 3% lower than at the start; a steady weakening in raw materials prices throughout the period and the strength of sterling more than offset a sharp rise in world food prices in June. The latter were also showing signs of easing back towards the end of the period.

On the London Metal Exchange, the most significant feature was the almost continuous decline in copper prices, from £1,000 to below £800 per tonne, in spite of successive falls in warehouse stocks; the declining price largely reflected growing pessimism about the prospects for industrial demand. Most of the other metals followed suit, although lead continued to strengthen for a while in the earlier part of the period, as supplies remained tight, and tin moved into heavy backwardation[2] on one or two occasions as stocks available for immediate delivery dwindled to exceptionally low levels. Although this backwardation disappeared when supplies became more readily available, and a contango[3] was briefly established, three months' tin again stood at a very small backwardation on 31st July. Cash transactions in nickel commenced on 20th July.

The dominant influence in the strengthening of food prices was the emergence, real or expected, of shortages of supply. This was initially the result of the severe and prolonged winter in the Northern Hemisphere, which mainly affected grains. Frost in Brazil caused a very sharp rise in the price of coffee during June but subsequently, particularly towards the end of July, quotations in the terminal markets fell away as conflicting weather reports were received. Cocoa continued to ease during most of the period, and although sugar recovered a little from its depressed position, this improvement was not maintained.

[1] Nigeria has followed suit, and other countries are reported to be considering doing so.

[2] The amount by which the price of cash metal exceeds that for forward delivery.

[3] The reverse of a backwardation, i.e. when the forward quotation is higher than that for cash.