Financial review

Introduction

The review describes developments in various markets, mainly in the period August to October.

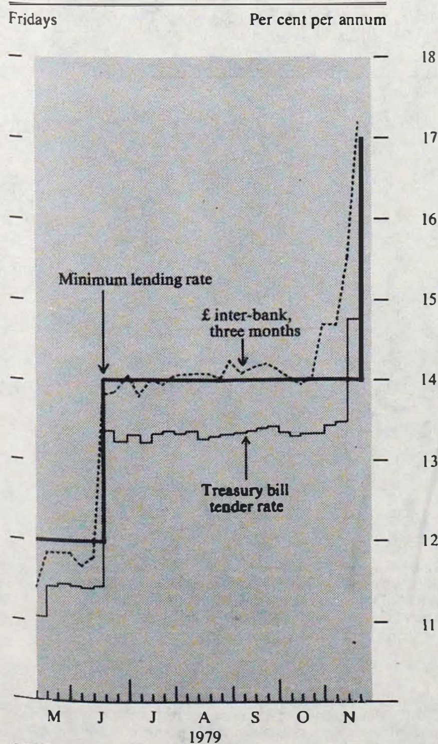
During these three months, the Bank's minimum lending rate (MLR) remained unchanged at 14%: expectations in the market that the next move would be downwards were revised, as US interest rates rose sharply and the remaining UK exchange control restrictions were lifted,[1] and by the end of October UK market rates were going up. Yields on gilt-edged stocks rose over the period by around one percentage point.

In early November, there were renewed worries about the money supply. Interest rates and yields continued to rise, and MLR was raised to 17% on the 15th (see page 372).

In the foreign exchange markets during August to October (page 383), the US dollar came under pressure, and sterling lost the gains of the previous three months.

The review contains the regular sections on international banking and euro-currency markets (page 387), oil money movements (page 389) and the commodity markets (page 389). There is also a brief account of the investment currency market in its last three months (page 387), and a table updating the figures published in the March *Bulletin* of the finance provided for North Sea oil development by banks in the United Kingdom (page 390).

Short-term interest rates in London
MLR was unchanged during August to October, but rose sharply in November.



The money market

MLR, which had been increased to 14% at the time of the June Budget, remained unaltered in the three months August to October. Although there was, initially, an expectation in the market that the next move would be downwards, the Bank took steps to indicate that there was no prospect of an early fall by continuing to hold its dealing rates for Treasury bills steady at a level which was, for the most part, above that implied by the average rate of discount at the weekly tenders. The market's expectations of a cut in MLR continued to find expression in August and the first part of September in a sharply downward-sloping yield curve in the parallel markets, although a flatter pattern of rates became established in September as hopes of an early cut faded. A tendency in the first part of October for rates to ease disappeared, and rates first steadied and then rose sharply, as a cut in MLR seemed an even remoter prospect in the light of the continued rise in US interest rates and the announcement on the 23rd of the lifting of UK exchange control restrictions.

Concern over the monetary aggregates grew in early November and market rates continued to rise. MLR was raised to 17% on the 15th, as described on page 372.

[1] Apart from those required to continue economic sanctions against Rhodesia.

The tightness, which has been a feature of the money market in recent months, persisted during much of the period. A number of factors combined to keep the market short of funds, including calls on issues of partly-paid government stock and the recall in two stages of July's temporary release of special deposits.[1] The Bank provided assistance by the outright purchase of Treasury and local authority bills and, when bills were in short supply, by overnight lending at MLR. It also provided help from time to time during August and again late in October by purchasing Treasury, local authority and commercial bills for subsequent resale at fixed future dates. There were, however, periods early in September and in mid-October when conditions were temporarily easier, and the Bank sold Treasury bills to absorb surpluses on a number of days.

The clearing banks' base rates remained unchanged at 14% throughout August to October. Shortly before the rise in MLR in November, one bank raised its base rate to 15½%; after the MLR rise, all the clearing banks raised their base rates to 17%.

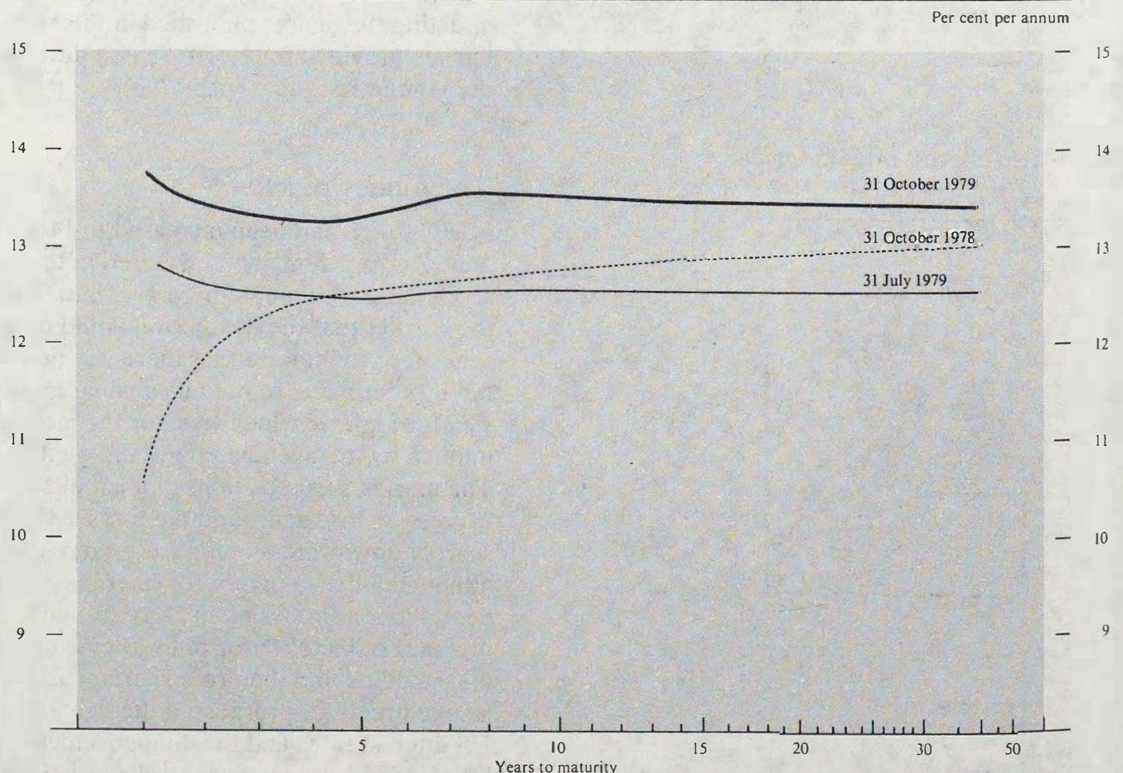
Capital markets

The gilt-edged market

During August to October, yields on long-dated stocks rose by about 1¼% and those on short-dated by about 1%. Turnover in August was much the same as in July, but declined in September and October, especially in stocks with more than five years to maturity.

Time/yield curves of British government stocks[a]

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.

[1] In July, the Bank temporarily reduced the rate of call for special deposits from 2% of eligible liabilities to ½%, with recalls of ½% and 1% due on 3rd and 13th August respectively. The recall on 3rd August was subsequently postponed to 10th September. See the September *Bulletin*, page 267.

At the beginning of August, the market was dull in the face of a reversal in the sterling exchange rate and receding hopes of lower interest rates. However, the publication on 7th August of the July banking figures, which implied some slackening of monetary expansion, led to an improvement in sentiment, and prices rose: the long-dated tap stock, 11¾% Treasury Stock 2003/2007, was exhausted on the 8th, in spite of the fact that a large call on an earlier issue was payable on the same day.[1]

On 10th August, the issue of a new, short-dated stock, £1,000 million 11¼% Exchequer Stock 1984, was announced;[2] this issue was in part intended to contribute to the financing of some forthcoming maturities, particularly that of 10½% Treasury Stock 1979 in November. This was the first time that a short-dated stock had been issued in partly-paid form, the instalments being timed to coincide with the Government's financing needs. With institutional liquidity under pressure (a large call on 11¾% Treasury Stock 2003/2007 was due on 20th August), the announcement of another issue surprised the stock market. Prices were marked down, so that by the day of issue, the 15th, even though prices were moving up again slightly, the new stock looked expensive, and the volume of tenders was only moderate. The following day, however, substantial demand for short-dated stock emerged; prices rose, and the Government Broker accepted some market bids for the new stock.

Around the end of August, the market was again dull, ahead of the publication of the August banking figures, but there was some steadying early in September. On the 7th, two new issues were announced: a medium-dated stock, £400 million 11½% Treasury Stock 1989 at a minimum tender price of £95.50 per cent, and a long-dated stock, a second tranche, of £500 million, of 12% Exchequer Stock 1999/2002, at a minimum tender price of £97.00 per cent.[3] However, by the day of issue, the 12th, the market had moved lower, and initial sales were very slight. With sterling temporarily under some pressure, this uncertain phase continued; but towards the end of the month, sterling began to show some recovery, and institutional liquidity improved (partly because of heavy interest payments on gilt-edged stocks during the month). Demand for gilt-edged stocks re-emerged, and, in response to bids from the market, the Government Broker resumed sales of the short-dated tap stock, 11¼% Exchequer Stock 1984, which was exhausted on 26th September. The next day, substantial amounts of the new tranche of 12% Exchequer Stock 1999/2002 were sold.

In October, gilt-edged prices fell sharply, as rising US interest rates caused hopes of a reduction in UK rates to recede. The lifting of exchange controls, furthermore, led to some uneasiness over the future destination of investment funds.

Prices fell more steeply in the first part of November and yields had risen, to over 15¼% on short-dated stocks and to about 14½% on long maturities, before the measures announced on 15th November (see page 372). Yields moved up somewhat further in response to these measures, but at

[1] See the footnote on page 268 of the September *Bulletin*.

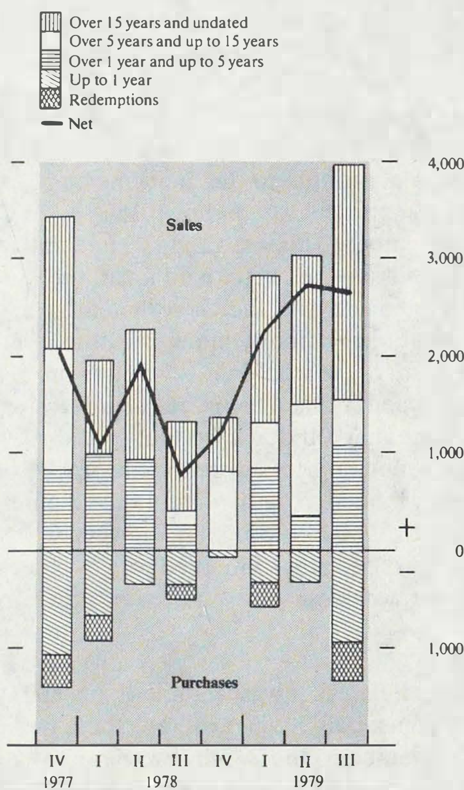
[2] This stock was issued at the minimum tender price of £97.25 per cent, with £30 per cent payable on tender and £67.25 on 14th September. A further £100 million of the stock was reserved for the National Debt Commissioners for public funds under their management.

[3] Both stocks were issued at the minimum tender price. For the 1989 stock, £40 per cent was payable on tender and the balance on 23rd October. For the long-dated stock, £30 per cent was payable on tender and the balance on 30th October. A further £200 million of the 1989 stock was reserved for the National Debt Commissioners for public funds under their management.

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

In the September quarter, net sales of stocks by the authorities amounted to £2,650 million.

£ millions

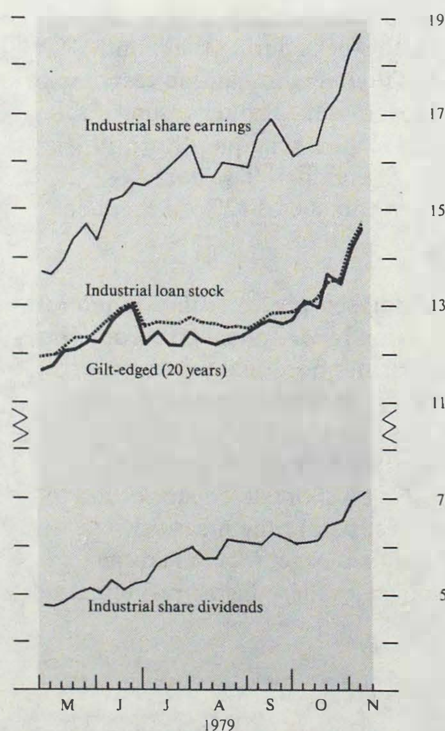


[a] Components are on occasion too small to be shown separately.

Security yields

Yields on long-dated gilt-edged and on debentures have risen significantly since August.

Wednesdays Per cent per annum



the higher levels strong demand for stock emerged. On the 15th supplies of 11½% Treasury Stock 1989 were exhausted and the second tranche of 12% Exchequer Stock 1999/2002 ceased to be offered as a tap stock. A second tranche, of £1,000 million, of 13¾% Treasury Stock 2000/2003 was created immediately and issued to the Bank in order that the demand could be met. It was sold the following day and the issue of £800 million 15% Treasury Stock 1985 was announced (with a further £200 million reserved for the National Debt Commissioners). On the 23rd, the issue of £1,000 million 14% Treasury Stock 1998/2001 was announced.

In the third quarter of 1979, net official sales of stocks amounted to £2,650 million;[1] net sales of long-dated stocks amounted to £2,425 million, of medium-dated to £495 million and of stocks within one to five years of maturity to £1,065 million. Two stocks matured during the quarter, 3% Treasury Stock 1979 on 17th September and British Electricity 4¼% Guaranteed Stock 1974/1979 on 26th September, with £365 million and £85 million respectively in market hands; at the end of the quarter, £20 million of the former stock, and £30 million of the latter, were still outstanding. Purchases of stocks within one year of maturity totalled £935 million, of which just over a third represented purchases of the two maturing stocks in the weeks before redemption.

Other markets

The local authority market continued to be quiet during August to October; there were no new issues of stock, and issues of negotiable bonds were again exceeded by redemptions.

Once again, turnover in the company debenture market fell during the period under review; yields were little changed during August but rose by one percentage point during September and October. New issues of loan capital and preference shares in the period included £15 million raised by the London Trust Company Limited, the first sizable debenture issue since February 1976; even so, issues were exceeded by redemptions, and there was a net overall redemption of £29 million.

In the equity market, prices, which had fallen during May to July, staged a slow and uncertain recovery until early October, only to lose again, thereafter, all the ground gained. The FT-Actuaries industrial (500) share price index, which stood at 260 at end-July, rose hesitantly to 286 on 8th October. After further hesitation, prices fell sharply in reaction to the lifting of exchange controls (which was seen as opening up overseas markets to the investment funds available), and also on continuing uneasiness over the economic and industrial outlook. By the end of October, the index was again standing at 260. Business generally was subdued during the period.

New money raised by way of issues of equity capital in the three months amounted to £163 million, considerably less than the £484 million raised in the previous three. For each period, the figure of issues includes an amount of about £75 million raised by BL Limited (formerly British Leyland)—these amounts being the two calls on a rights issue of nearly £150 million, almost all of which was taken up by the National Enterprise Board.

[1] The figures relate to cash raised, and thus in the case of partly-paid stocks only instalments actually paid are included in the totals.

On 31st October, the Bank announced the offer for sale on 9th November of eighty million ordinary shares at 25p each of The British Petroleum Company Limited (ex interim dividend), being part of the Government's holding, at a price of £3.63 per share, with £1.50 payable on application and the balance on 6th February 1980. The offer, which was oversubscribed, reduced the percentage of the company's ordinary capital held by the Government and the Bank from 51% to approximately 46%.

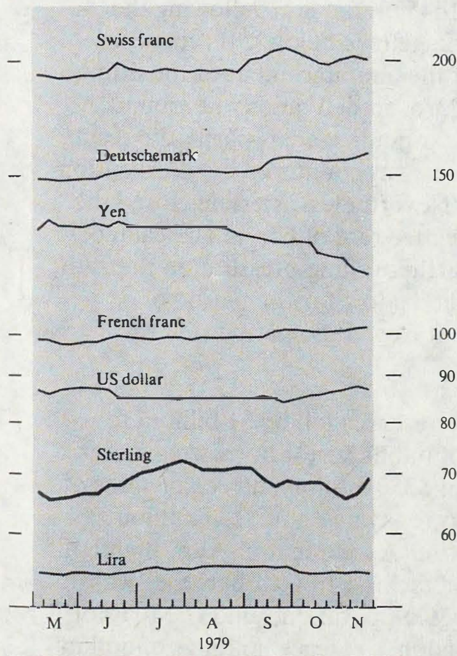
Net sales of unit trust units rose to £20 million, after only £10 million in the previous three months and £16 million during February to April. Both sales and repurchases continued to be subdued, amounting to £94 million and £74 million respectively, compared with £95 million and £85 million during May to July.

Indices of effective exchange rates

Sterling fell during August to October, reversing the rise of the previous three months.

Logarithmic scale — 21 December 1971 = 100

Fridays



Foreign exchange and gold markets

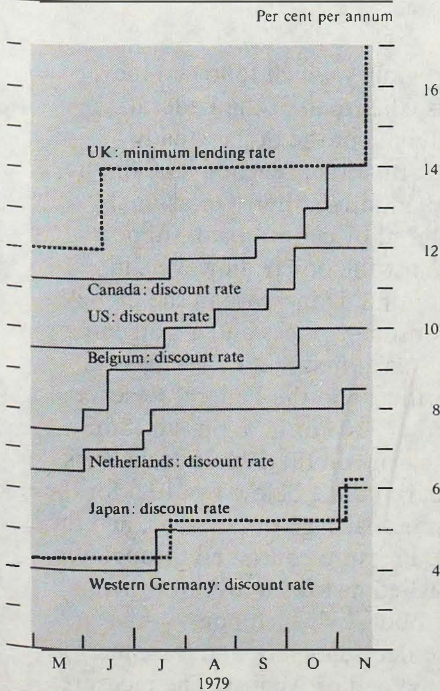
Summary

After a quiet start to the period August to October, conditions became unsettled in the foreign exchange markets as the US dollar came under pressure from the middle of September. In support of their currency, and as part of a set of measures to curb inflation and the growth of money supply, the US authorities raised the Federal discount rate in stages to a record 12%. A number of other countries also raised interest rates to combat inflation or to maintain favourable interest-rate differentials for their currencies. In the United Kingdom, however, MLR was not changed and the interest-rate differential in sterling's favour narrowed and eventually disappeared; and as earlier exchange control relaxations were followed by the removal of the remaining restrictions[1] and uneasiness over the United Kingdom's underlying economic position grew, the rapid gains of the previous three months were reversed and sterling fell from its late-July peak by some 9% against the dollar and by some 9½% in effective terms. As the dollar weakened, pressure on the European Monetary System (EMS) led to a realignment on 24th September between the member currencies. Unfavourable news of oil price rises and an increasing current account deficit led to a further weakening of the Japanese yen. Conditions in the gold market were often hectic and both record daily price movements and record price levels were seen.

International interest rates

A number of countries have raised interest rates to combat inflation or to support their currencies.

Per cent per annum



Sterling

Sterling closed at a four-year high of $2.3290 on 26th July, with the effective index at 74.0; it ended July, however, at $2.2595, after falling six cents on the last day of the month. There was a reaction to this sharp fall, but it was short-lived, and, after the publication of the July wholesale price index and poor banking figures, sterling again fell, closing on 8th August at $2.2170 (effective index 70.6). Although it then rose in thin markets to around $2.23, it fell back on the 16th following the announcement of an increase in the US discount rate. Towards the end of August, however, more general demand for sterling emerged, and it ended the month at $2.2545 (effective index 71.9).

September was a difficult month for sterling. Anxiety about the outcome of the TUC Conference and further poor banking figures for August, followed by rising US prime rates and

[1] Apart from those affecting Rhodesia.

increasing fears about the United Kingdom's industrial performance, brought the dollar rate down to $2.2195 (effective index 70.6) on the 12th. A rumour that the United Kingdom would enter the EMS, but with its currency at a depreciated rate, caused sterling to fall sharply to $2.1285 (and to DM3.85¼) by the afternoon of the 17th: a statement from informed sources that entry to the EMS was still a long way off stopped the decline; but the currency remained weak, closing on the 19th at $2.1440 (effective index 68.2). In the last few days of September, however, sterling rose strongly to end the month at $2.2020 (69.0 in effective terms), following rumours of a diversification of OPEC oil revenues into sterling and as the dollar weakened on news of the August US trade deficit.

Attention was on the US dollar at first in October, during the International Monetary Fund (IMF) meeting in Belgrade. Sterling fell four cents to $2.1445 on the 8th, following the announcement of the US package (see below). It recovered partially and, until the eve of the announcement of the lifting of exchange controls on the 23rd, traded quietly at around $2.15. Heavy selling after the announcement, partly the result also of higher US interest rates, was countered by intervention to preserve orderly markets. Nevertheless, sterling closed the day at $2.1130 (and at an effective rate of 67.9). The calm of the next few days ended in further selling pressure on the 29th, and on the 30th sterling reached a low for the period of $2.0685 (effective rate 66.4). It closed the period slightly better at $2.0808.

During the three months, the reserves fell by $1 billion, to $22.5 billion, after accruals of public sector borrowing under the exchange cover scheme of $350 million and repayments of $355 million. There were also repayments of $125 million under the Anglo-German Offset Agreement in August and of $82 million under the IMF oil facility. In October, the swap with the European Monetary Co-operation Fund (EMCF) of 20% each of the United Kingdom's reserve holdings of dollars and gold in exchange for European currency units (ECU) was renewed. Because the EMCF uses a different system of gold valuation, and because of the increase in the gold price since the original swap, the renewal resulted in an increase in the dollar value of the UK reserves of approximately $200 million.

US dollar

The firmer stance on monetary policy which followed the appointment of Mr Volcker as Chairman of the Federal Reserve Board at the end of July kept the dollar steady throughout August, and its effective rate reached 85.0 on the 29th, an increase of 1½% on a month earlier. Occasional pressure was effectively countered by central bank support. Sentiment turned strongly against the dollar, however, in September, in the light of a continuing increase in the money supply, rising producer and consumer prices and a worsening trade deficit. Selling pressure was at first met by weighty intervention by the US authorities; and the Federal Reserve discount rate was raised a further ½% to 11% on the 18th. Nevertheless, the dollar fell sharply on the 19th in New York, its rate against the deutschemark falling below DM1.80 for the first time since the 1st November package of last year, and the effective index falling to 84.0. Pressure continued throughout the month, and the dollar reached its lowest level for the period by the close on 1st October, by which point it had fallen by some 5% against the deutschemark and by some 7% against the Swiss franc since the end of August. The measures

announced on 6th October reflected the US authorities' concern with the growth of inflation and the money supply: the Federal Reserve discount rate was raised by a further one percentage point to a new record of 12%; increased reserve requirements were imposed on the future growth of 'managed liabilities' (which included borrowing from the euro-currency markets); and the thrust of monetary policy was shifted from an interest-rate target to a target for the growth of bank reserves. The dollar's effective rate rose from 84.2 to 85.2 on the news, and continued to strengthen to touch 87.1 on the 30th, but fell back to close October at 86.9.

Other currencies

Throughout August the deutschemark was at the top of the 2¼% EMS band and the Danish krone at the bottom (the latter closely shadowed by the Belgian franc). At times, both the krone and the Belgian franc diverged from their ECU parities by more than three quarters of their maximum divergence, and thus crossed their divergence thresholds.[1] Limitations, announced at the end of August, on individual banks' access to secured borrowing from the Deutsche Bundesbank at the Lombard rate led to higher call money rates and brought renewed demand for the deutschemark; and, with the US dollar weakening, the system came under pressure, and there was considerable bilateral intervention between the two weakest currencies (the Belgian franc and the Danish krone) and the deutschemark. Although the French franc was neither near its bilateral intervention point against the deutschemark nor near its divergence threshold, there was continued intervention by the French authorities to restrain the divergence of the franc from the deutschemark. In addition, speculative upward pressure on the deutschemark was caused by rumours that the United Kingdom would join the EMS, and a growing belief that a realignment of the member currencies was imminent. As the pressure continued, the Belgian franc replaced the Danish krone at the bottom of the band, following an increase in the Danish discount rate of two percentage points on 17th September. The pressure was finally relieved by the announcement on the 24th of a realignment of member currencies: the deutschemark was revalued by 2%, and the Danish krone devalued by 3%, against the other members, resulting in a 5% movement between the deutschemark and the krone. The Danish krone rose to the top of the band, although it was overtaken by the French franc in the closing days of October; the Belgian franc, apart from a brief period, stayed at the bottom, with the deutschemark in the lower half. For about a month following the realignment, the lira, alone on a 6% margin, was overtaken as the strongest currency by the Danish krone.[2] Outside the EMS, the Swiss franc strengthened at first not only against the dollar but also against the deutschemark, its cross-rate just before the US package reaching DM100 = Sw.Fr.89. Thereafter it eased against both currencies.

The yen, which had been steady around Y217 to the US dollar at the beginning of the period, fell in the third week of August, after the announcement of a current account deficit for July. Thereafter, it continued to fall on balance, reflecting adverse news of oil price rises and supply difficulties, and then the dollar's recovery in October, in spite of substantial intervention by the Japanese authorities. It finished the period

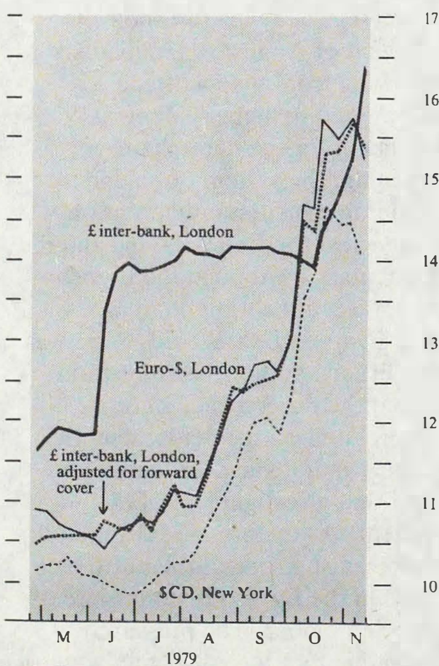
[1] An explanation of the working of the EMS can be found in an article in the June *Bulletin*, page 190; off-prints of the article are available from the Economic Intelligence Department of the Bank at the address given on the reverse of the contents page.

[2] On 30th November, the krone was further devalued, by 5% against the deutschemark.

at Y237.75, a depreciation of some 11% from its late-July peak. Although there were successive increases in the Canadian bank rate, from 11¾% at the end of July to 14% by the end of October, to keep abreast of increases in US interest rates, the Canadian dollar fell on balance against the US dollar. The Irish pound remained at around $2.06, apart from the period of pressure on the dollar in late September and early October, when it strengthened. Its discount against sterling of some 11% towards the end of July narrowed in consequence, as sterling fell, to just 1% by the end of October.

UK and US three-month interest rates

US interest rates rose sharply, and for a time were above UK rates, which remained steady until towards the end of the period.



Interest rates and differentials

Sterling interest rates were steady for most of the period, the three-month inter-bank rate fluctuating narrowly between 14% and 14¼% until the middle of October, when for a brief period it fell below 14%. Thereafter, it rose sharply to close the period at around 14¾%. The three-month euro-dollar interest rate rose from 11% in early August to 15¼% by the end of October, reflecting the increases in US interest rates and the increased US reserve requirements; and the uncovered differential, over 3% in favour of sterling in early August, closed the period at ⅜% against sterling. The premium on three months' forward dollars of 3⅜% at the start of August was transformed into a discount of ¾% by the end of October—the first discount since the middle of March 1978. The discount was much less marked, however, for periods over six months. The covered differential, except on days of rapidly changing US interest rates, was insignificant.

Gold

Rising inflation, increases in oil prices and exchange rate uncertainties all played a part in driving the price of gold to record heights in often hectic trading conditions. Producer supplies appear to have been normal and the US Treasury and the IMF continued to auction gold regularly. After falling to $282½ in early August, from $307 in late July, the price of gold passed $300 again on 22nd August, influenced by the news that one bank had successfully bid for a large proportion of the gold (of lower 'coin' bar quality) on offer at the previous day's US Treasury auction. On 6th September, the price rose over $10 to a record $340.85; although this was followed by a temporary reaction, by the end of the month the price had reached $397.25. The weakening dollar, the increasing impact of the US futures market and continued Middle East buying interest, took the metal to $447 during the morning fixing of 2nd October, an all-time record (though it was finally fixed at $437, a rise of nearly 55% in just two months). A sharp reaction set in, however, and gold was fixed at $367½ on the morning of the 5th, a fall of some 16% in just three days. It touched $413 on the 10th; but news that bids totalled only 666,000 ounces for the 444,000 ounces on offer at the IMF auction that day saw the price fall below $400, around which level it remained until the end of the period in quieter trading conditions.

Each month in the period, 750,000 ounces, all of 'coin' bar quality gold, were auctioned by the US Treasury and 444,000 ounces of 'fine' gold by the IMF. Following the US Treasury auction on 18th October, when some two thirds of the amount on offer was again sold to one bank, it was announced that the amount on offer at, and the date of, future Treasury auctions would be varied in an attempt to combat speculation.

The investment currency market: the end of the story

The investment currency market was generally more stable during the period under review than in the previous seven months.[1] The effective premium[2] fluctuated between 8% and 15% until early October and thereafter drifted downwards: it stood at 9% on the 19th. It then fell rapidly during the next two business days, the second of which (23rd October) saw the announcement of the lifting of exchange controls. As a consequence of this, a separate market for investment currency ceased to exist.

The premium had risen relatively strongly, to 14%, in the first half of August. Thereafter, apart from a temporary drop to 9% in mid-September, it remained relatively constant around 12% until the end of the month before rising to 15% in early October. These movements reflected the two-way pull on the market, the downward influence of the Government's expressed intentions of progressively relaxing exchange controls contrasting with the relative attractions of some overseas stock markets. From early October, however, the premium declined as American share prices fell sharply and expectations of further exchange control relaxations intensified.

International banking and euro-currency markets

Data published by the Bank for International Settlements (BIS) show activity expanding further in the second quarter of 1979, with gross claims of banks in the reporting area rising by $63 billion, to $947 billion.[3] A considerable part of this increase, however, resulted from seasonal inter-bank activity within the area: excluding this element, total outstanding credit rose by $35 billion, to $585 billion.

Some $19 billion of the gross increase in lending was to countries outside the area. Non-oil developing countries absorbed $9.6 billion, the biggest increase yet seen in one quarter, with $5.6 billion going to Latin America (mainly Argentina, Brazil and Mexico), $2.9 billion to the 'other Asia' group, and $0.9 billion to non-oil Middle East countries. Lending to oil-exporting countries[4] (which had risen consistently through 1978 but declined during the first quarter of 1979, partly because of the disturbed situation in Iran) rose once again, by $2.2 billion; lending to Eastern European countries (largely Poland and Romania) rose by $2.5 billion.

On the liabilities side, there was some falling-off in the flow of funds from US non-bank residents (from $9 billion to $3 billion), but this was more than offset by an inflow from US banks of $6 billion (after a withdrawal of $10 billion in the first quarter). The deposits of oil-exporting countries rose only moderately; the effect of the rise in oil prices will not show through until the third quarter (as it has in the UK figures for that period—see below). Liabilities to non-oil developing countries rose by almost $4 billion and, in contrast to lending, the increase was evenly distributed. New deposits of central

[1] See the September *Bulletin*, page 273.

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

[3] Data for the second quarter (and for the first quarter, which were not available when the September *Bulletin* was published) are shown in Table 15 in the statistical annex. The figures cover 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.

[4] See footnote[2] on page 389.

UK banks' liabilities and assets by customer[a]

The underlying growth in the London euro-currency market was greater in the third quarter (see text).

$ billions

	1978		1979		
	29 Sept.	29 Dec.	30 Mar.	29 June	28 Sept.
Foreign currency liabilities of UK banks to:					
Other UK banks	59.9	62.7	65.0	70.3	78.0
Other UK residents	8.7	9.5	9.5	11.1	10.4
Overseas central monetary institutions	45.0	41.9	40.0	53.0	58.4
Other banks overseas	123.8	139.6	140.3	142.1	162.2
Other non-residents	29.4	33.1	36.2	39.6	46.6
Other liabilities[b]	2.6	2.7	2.6	2.8	2.7
Total liabilities	**269.4**	**289.5**	**293.6**	**318.9**	**358.3**
Foreign currency assets of UK banks with:					
Other UK banks	60.7	62.8	63.4	68.6	76.3
Other UK residents	19.9	21.0	22.1	22.9	22.1
Banks overseas	135.2	149.2	149.4	164.0	190.1
Other non-residents	51.8	54.7	55.8	59.2	64.3
Other assets[b]	3.8	3.8	4.2	5.0	5.5
Total assets	**271.4**	**291.5**	**294.9**	**319.7**	**358.3**

[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 rose by $1 billion in the third quarter.

$ billions outstanding

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

	1978		1979		
	29 Sept.	29 Dec.	30 Mar.	29 June	28 Sept.
BIS reporting area:					
European area	− 7.8	− 2.7	− 4.5	− 7.6	− 6.7
Canada	− 1.9	− 1.6	− 1.7	− 0.9	+ 0.4
Japan	+ 8.9	+ 9.6	+ 9.8	+10.9	+11.8
United States	− 9.8	−13.8	−12.0	−14.7	−18.9
Off-shore banking centres	+ 9.7	+ 8.3	+ 9.0	+11.5	+15.9
Other Western Europe	+ 0.6	+ 0.2	+ 0.7	+ 0.3	− 0.1
Australia, New Zealand and South Africa	+ 3.2	+ 3.3	+ 2.7	+ 2.3	+ 2.5
Eastern Europe	+ 9.0	+ 8.4	+ 8.0	+ 9.0	+ 9.2
Oil-exporting countries	−18.1	−16.3	−17.8	−18.3	−24.9
Non-oil developing countries	− 1.7	− 1.4	− 1.8	− 0.7	+ 0.6
Other[b]	− 2.4	− 4.6	− 5.2	− 4.7	− 3.6
Total	**−10.3**	**−10.6**	**−12.8**	**−12.9**	**−13.8**

[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

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

$ billions; *percentages in italics*

Net liabilities−/net assets+

	1979			
	Mid-May		Mid-Aug.	
Less than 8 days[a]	−17.2 [−13.5]	*33.1*	−17.5 [−13.4]	*31.5*
8 days to less than 3 months	−26.4	*50.9*	−26.5	*47.8*
3 months to less than 1 year	−8.3	*16.0*	−11.5	*20.7*
Net borrowing up to 1 year	−51.9		−55.5	
Net lending at 1 year and over	+51.1		+52.7	
	− 0.8		− 2.8	

[a] Figures in brackets 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.

monetary institutions approximately doubled during the quarter, to $7.8 billion, of which $3.5 billion was placed in the United States.

Data available for the third quarter suggest that international bank lending continued to grow rapidly.

The London euro-currency market, as measured by the banks' gross foreign currency liabilities, increased by an underlying $35 billion in the third quarter, after adjustment for the statistical effects of currency valuation changes. Much of this growth resulted from inter-bank activity with the main reporting centres, but there was also a large inflow of funds from oil-exporting countries, as they benefited from oil-price increases earlier this year, and, to a lesser extent, from shorter credit terms.

The maturity analysis of the foreign currency positions of UK banks at mid-August shows that there was a marginal increase in net liabilities at less than eight days and a fall in the eight days to less than one-month band (see Table 13 in the statistical annex). Both the one-to-three and the three-to-six-month bands showed increases in net liabilities, the latter being particularly marked. The increase in net liabilities in the three months to less than six months band was spread through all bank groups apart from the Americans.

In the shorter maturities only the Japanese banks increased their net liabilities both at less than eight days and in the eight days to less than one-month band. At less than eight days the British-owned banks replaced the 'other overseas' banks as the group with the greatest short-term mismatch as measured by net liabilities as a proportion of total assets. However, in the recent past, no group has had the degree of mismatch at the shortest maturity which often occurred two to three years ago.

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. The contribution of banks in the United Kingdom to the end-June 1979 analysis appears as Table 14 in the statistical annex to this issue. Between end-December 1978 and end-June 1979, the total sterling and foreign currency claims of banks in the United Kingdom on countries outside the reporting area increased by $11 billion to $120½ billion, following a $14¼ billion increase during the previous half-year. Both geographically and by maturity the distribution showed little change from the position at end-December 1978. Unused credit facilities, which include informal, revocable facilities as well as those which are legally binding, rose by $6½ billion to nearly $31 billion. 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.

Medium-term euro-currency credit markets

The value of medium-term credits[3] announced in the third quarter of 1979 was $18 billion—only slightly lower than the record figure of $19 billion in the second quarter, despite a

[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.

[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 data only when they are taken up and only to the extent that they are not replacing maturing debt.

significant pause in borrowing activity during the holiday period. The market continued to be highly attractive to borrowers; although euro-dollar interest rates[1] increased further—thus adding to the overall debt servicing costs for borrowers—spreads remained very small and average maturities remained long at 9.5 years. The average size of loans fell during the quarter, but this reflected to some extent the easier access to the markets enjoyed by many smaller borrowers. By the end of October, however, developments were leading some market participants to suggest that the 'borrowers' market' might be coming to an end.

Deployment of oil money[2]

Estimated deployment of oil exporters' surpluses[a]

$ billions

	1977	1978			1979	
	Year	Year	1st half	2nd half	1st qtr	2nd qtr
United Kingdom						
British government stocks	—	−0.3	−0.3	—	0.1	—
Treasury bills	−0.2	0.2	0.2	—	0.1	0.3
Sterling deposits	0.3	0.2	−0.2	0.4	0.2	0.1
Other sterling investments[b]	0.4	0.1	0.1	—	—	0.2
British government foreign currency bonds	0.2	—	—	—	—	—
Foreign currency deposits	3.4	−2.0	−1.9	−0.1	1.9	1.4
Other foreign currency borrowing	—	—	—	—	—	—
	4.1	−1.8	−2.1	0.3	2.3	2.0
United States						
Treasury bonds and notes	4.3	−1.6	−0.8	−0.8	−1.1	−0.6
Treasury bills	−0.8	−0.9	−0.8	−0.1	—	0.5
Bank deposits	0.4	0.7	−0.2	0.9	−1.1	0.8
Other[b]	5.3	3.1	2.1	1.0	0.3	0.1
	9.2	1.3	0.3	1.0	−1.9	0.8
Other countries						
Bank deposits	7.5	5.0	1.9	3.1	1.7	−0.6
Special bilateral facilities and other investments[b][c]	12.4	8.6	3.7	4.9	3.7	2.7
	19.9	13.6	5.6	8.0	5.4	2.1
International organisations	0.3	0.1	—	0.1	−0.2	−0.1
Total	**33.5**	**13.2**	**3.8**	**9.4**	**5.6**	**4.8**

[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.

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

[c] Includes loans to less developed countries.

The identified cash surplus of oil-exporting countries for the first half of this year is estimated to have been $10.4 billion, compared with only $13.2 billion in 1978 as a whole (see table).

During the second quarter, funds held in the United Kingdom rose by $2 billion; most of this was attributable to an increase in foreign currency deposits. Investment in the United States went up by $0.8 billion in the same period, after a net outflow in the first quarter of nearly $2 billion. Around $2½ billion was placed in the form of special bilateral facilities and other investments: a large part of these funds came from Saudi Arabia, Kuwait and the United Arab Emirates.

Preliminary indications of the deployed surplus in the third quarter show that funds placed in the United Kingdom were higher than in the second, primarily because of a large flow into foreign currency deposits (mainly US dollars). There was continued investment in the United States.

Revised projections of total oil revenues have been the main elements influencing the latest forecasts of the oil-exporting countries' aggregate current account surplus for this year, which is now estimated to be in the region of $50–55 billion. The growth in the invested cash surplus will not necessarily correspond with the growth in the current account surplus, for the reasons set out in the September *Bulletin* (page 277).

Commodity markets

The Economist sterling all-items index of commodity prices rose by 12% in the three months August to October. Part of the rise can be explained by the fall in the value of sterling during that period, but there were significant changes in the pattern of commodity price movements.

For most foodstuffs, prices were steadier than in the previous three months, but tending to ease somewhat. The major exception was sugar: free-market prices of sugar rose by over 60% from what was, admittedly, a very low level, as temporary market shortages seemed to be emerging after several years of surplus. Another exception was coffee, where support-buying by producers has stabilised the market since fears of extensive frost damage to the Brazilian crop proved unfounded.

[1] Medium-term euro-currency loans are usually raised with the interest based upon the London inter-bank offered rate (LIBOR), which is variable throughout the life of the loan, plus a fixed margin, or 'spread'.

[2] For an analysis of the financial flows of oil-exporting countries as a whole, see page 361. These countries are defined for the purpose of these statistics as the thirteen members of OPEC, plus Bahrain, Brunei, Oman, and Trinidad and Tobago.

The markets for industrial materials were, for a time, somewhat disturbed, as pressures spilled over from the foreign exchanges and from trading in precious metals overseas: indeed, London silver prices (not a component of the Economist index), ended the period 90% higher than at the start. For other metals, however, prices generally fell back in October from the peaks they had reached at the end of September, as growing anxieties over future world industrial activity again made themselves felt: the main exceptions were tin and lead where supplies remained tight. Industrial materials as a whole showed a net gain in sterling terms of 11%, rather more than could be accounted for by the fall in sterling.

The financing of North Sea oil

The following tables bring up to date the figures in Tables D and E in the article 'The financing of North Sea oil 1975–1980' in the March *Bulletin* (page 31). They give details of the finance provided for North Sea oil development by banks in the United Kingdom as at 15th August 1979. The latest Bank estimate of the outstanding North Sea financing requirement is £7.0 billion for 1979 and £6.8 billion for 1980 (at current prices).

Loans and commitments by banks in the United Kingdom for North Sea oil development[a]

£ millions

	Loans outstanding			Additional firm commitments [b]		
	Sterling	Foreign currencies	Total	Sterling	Foreign currencies	Total
Sector						
London clearing banks:						
17 August 1977	243	230	473	95	123	218
16 August 1978	263	231	494	152	102	254
15 August 1979	348	225	573	113	139	252
Scottish clearing banks:						
17 August 1977	24	52	76	15	28	43
16 August 1978	18	51	69	6	10	16
15 August 1979	15	46	61	24	31	55
Accepting houses, other British banks and consortium banks (excluding clearing banks' subsidiaries):						
17 August 1977	41	67	108	25	24	49
16 August 1978	42	89	131	42	8	50
15 August 1979	56	109	165	7	66	73
American banks:						
17 August 1977	229	409	638	32	215	247
16 August 1978	289	381	670	53	216	269
15 August 1979	305	353	658	94	216	310
Other overseas banks:						
17 August 1977	83	271	354	40	111	151
16 August 1978	184	268	452	47	65	112
15 August 1979	169	208	377	41	26	67
Total						
17 August 1977	620	1,031	1,651	207	500	707
16 August 1978	796	1,020	1,816	300	401	701
15 August 1979	893	941	1,834	279	478	757

Source: Bank of England/British Bankers' Association.

[a] Loans and commitments are included where lending is for an identifiable project or where it is reasonable to assume that the purpose of the borrower is to finance North Sea commitments. They include bill finance and loans to finance companies interposed between lenders and the ultimate borrowers.

[b] Firm commitments, in addition to actual loans outstanding, based on the existence of an agreed facility or of a loan not yet fully drawn down.

North Sea lending as a share of total advances to UK residents

£ millions; *percentage in italics*

	Banks in the United Kingdom					
	Total advances to UK residents as at 15 August 1979			North Sea lending as a proportion of total advances [a]		
	Sterling	Foreign currencies	Total	Sterling	Foreign currencies	Total
Sector						
London clearing banks	23,860	2,880	26,740	*1*	*9*	*2*
Scottish clearing banks	2,607	270	2,877			
Accepting houses, other British banks and consortium banks (excluding clearing banks' subsidiaries)	4,855	1,147	6,002	*1*	*10*	*3*
American banks	3,470	2,743	6,213	*9*	*13*	*11*
Other overseas banks	2,474	3,186	5,660	*7*	*7*	*7*
All banks	37,265	10,227	47,492	*2*	*9*	*4*

Source: Bank of England.

[a] Excluding bill finance and loans to non-resident finance companies.