Financial review

Introduction

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

Conditions in the UK money markets remained very tight, and the Bank provided regular and heavy assistance to relieve the excessive pressure on liquidity. Minimum lending rate (MLR) remained at 17% throughout the period, but three-month market rates rose to over 18% in March, before easing in April.

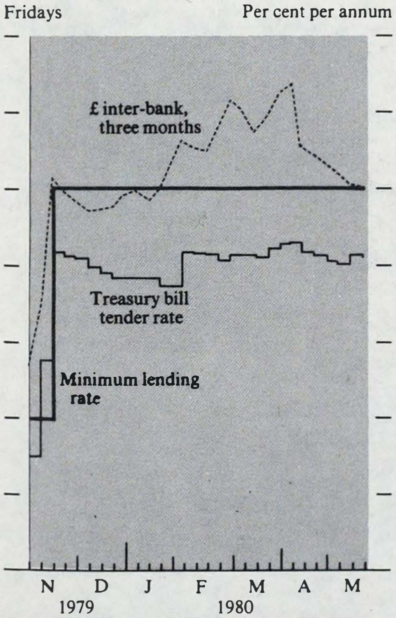
The gilt-edged market was generally steady. Net official sales of stock were much smaller in the first quarter than in the fourth, but there were heavy sales after 31 March.

On the foreign exchange markets, sterling was mostly firm. In line with most other currencies, there was a sharp, but temporary, fall against the dollar at the end of March.

The review contains the usual sections on international banking and the euro-currency markets, oil money movements and the commodity markets.

Short-term interest rates in London

Fridays — Per cent per annum



Money markets

Conditions in the money market during the February to April period remained very tight. The Bank provided regular and substantial assistance by purchasing, on a very large scale, Treasury, local authority and commercial bills; the last were all for resale at later dates. The authorities also lent at MLR, generally overnight but very occasionally for periods of up to five days. There were only two days during the period when no intervention was necessary.

In a move to ease some of the pressure at the beginning of the period (as tax payments and heavy official sales of gilt-edged stocks drained funds from the banking system), the Bank entered into a purchase and resale agreement for gilt-edged stocks with the clearing banks.[1] Under this arrangement, some £500 million was injected into the market on 15 February, with the initial intention that it would be repaid on 13 March. But at the beginning of March the arrangement was extended to 14 April, and on 9 April it was again extended, to 19 May. On 11 April a second agreement with the clearing banks, for the purchase (on 14 April) and resale (on 12 May) of a further £500 million of gilt-edged stocks was announced. Both agreements were extended on 8 May, the first to 17 June and the second to 12 June.

Further assistance was provided by the postponement, from 8 April to 16 June,[1] of the recall of special deposits, equal to 1% of eligible liabilities, and by the cancellation, on 8 May, of the second 1% recall (due on 14 May).

(1) See the March *Bulletin*, page 20.

Rates in the parallel money markets were, in general, above MLR at the beginning of the period. The announcement of the agreement with the clearing banks for the purchase and resale of gilt-edged stocks resulted in only a temporary easing, and by the end of February rates for six months and more were rising sharply, thus reducing the unusually large negative differential between twelve-month and one-month rates. During most of March there was some easing, but near the end of the month, with the payment of petroleum revenue tax, rates moved up sharply, with three-month rates standing at over 18%. Towards the end of the period under review, however, rates eased in response to the continuing assistance from the Bank, and the three-month inter-bank rate fell to about 17¼% at the end of April.

Throughout the period, MLR (which was last changed on 15 November 1979) remained at 17%. Bank base rates likewise remained unchanged.

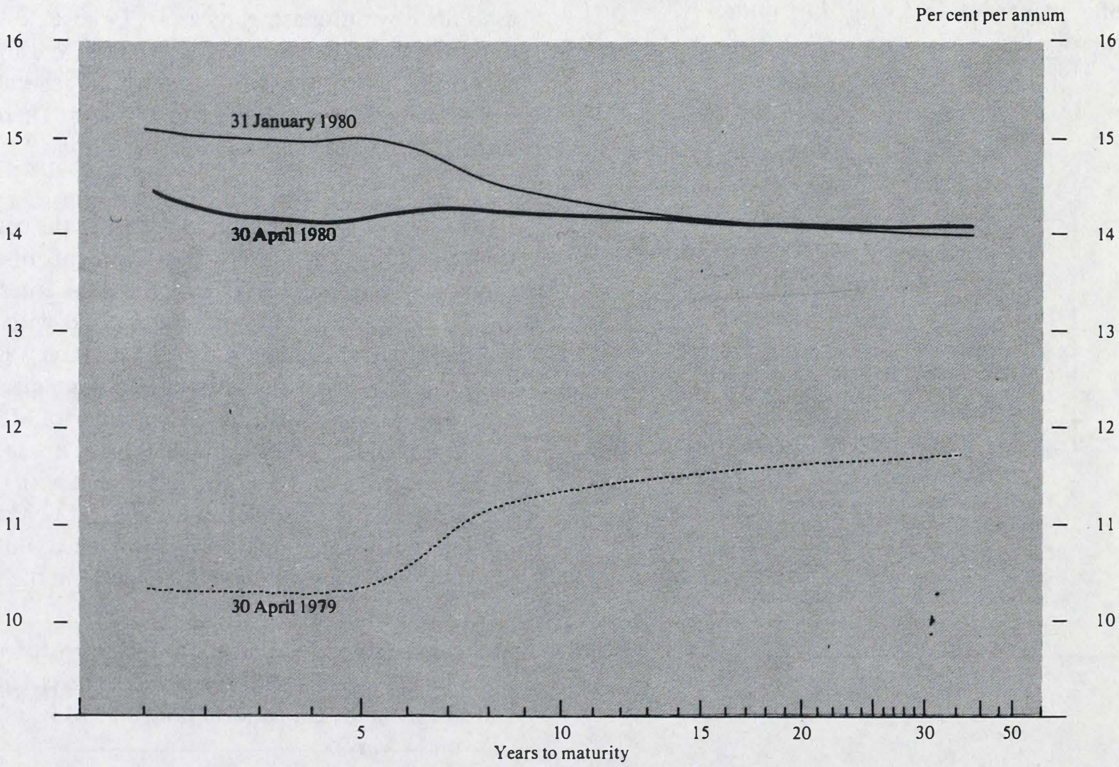
Capital markets

The gilt-edged market

During the February to April period, yields fell by nearly one percentage point on shorter-dated stocks, but were virtually unchanged on longer maturities, so that there was a distinct flattening in the yield curve. Turnover fell in all maturity bands in February, and continued at the lower levels during March; in April, however, there was a marked increase, especially in stocks with less than five years to maturity.

At the beginning of February, despite a general expectation that yields would fall over the course of the year, the market was dull in the face of continuing industrial problems (notably in the steel industry) and acute money-market shortages. Prices weakened

Time/yield curves of British government stocks[a]



(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 program is available from the Bank at the address given on the reverse of the contents page.

further on the publication, on 14 February, of disappointing banking and money supply statistics for January. There was speculation that the clearing banks would need to raise their base rates, but, after the announcement of the purchase and resale agreement with the clearing banks, gilt-edged prices improved briefly before turning moderately easier again—on low turnover—for most of the rest of February. The market was affected during this period by rising interest rates abroad (see the section below on the foreign exchange markets), persistently tight domestic money-market conditions, and concern about the outlook for inflation.

On 22 February, a new issue, £800 million of 14% Treasury Stock 1996, was announced.(1) Applications were modest, with the market discouraged by a further rise in US prime rates; nevertheless, following the tender, a small amount was sold at £$\frac{1}{16}$ per cent premium in £20 per cent paid form.

The market remained weak at the beginning of March. The banking statistics for February brought little encouragement, and sentiment was also depressed by the continuing steel strike. Thereafter, the market steadied in very quiet trading ahead of the Budget; it was encouraged by expectations that the public sector borrowing requirement would be contained and it was unaffected by a further sharp rise in US interest rates following the US monetary measures of mid-March.

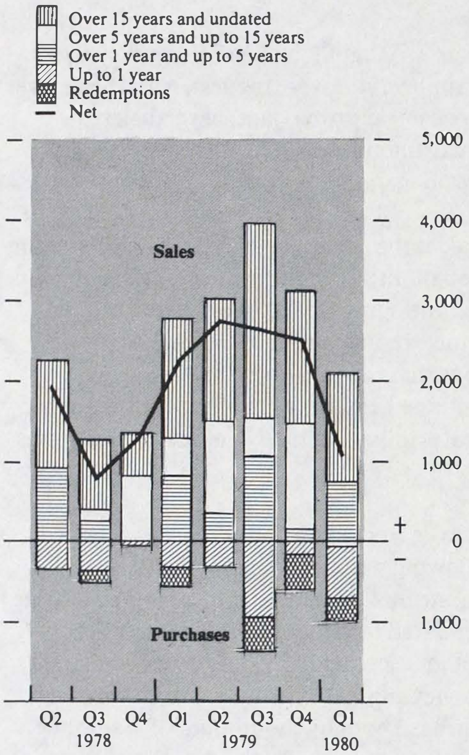
The immediate reaction to the Budget on 26 March was subdued, but reflection over the following weekend, together with the settlement of the steel dispute on 1 April, brought a marked change in sentiment, and the long-dated tap stock, 14% Treasury Stock 1996, was quickly sold out at prices up to £$\frac{5}{16}$ per cent premium. Despite the continuing money-market shortages, prices remained firm, with investors encouraged both by the amount of assistance given by the authorities to the money market and by the publication of favourable March banking figures (which suggested to the market a slackening in the rate of growth of bank lending). In these circumstances, the Government Broker reactivated the short-dated tap stock, 13$\frac{1}{2}$% Exchequer Stock 1983. This stock had last been supplied to the market shortly after issue in January at a price £$\frac{1}{8}$ per cent above the minimum tender price. It had subsequently fallen to a discount of up to £2$\frac{3}{16}$ per cent and the gilt-edged jobbers had built up a substantial short position. After a series of earlier bids had been declined, the stock was reactivated at £95$\frac{1}{2}$ per cent (£1$\frac{3}{8}$ per cent below its earlier price) and, in response to further bids, the price moved upwards until the stock was exhausted at £95$\frac{3}{4}$ per cent on 14 April. There were also large sales of the low-coupon short-dated stock, 3% Exchequer Stock 1984 (which had been issued on 19 July 1979), and it was exhausted on 21 April.

On 11 April, a new stock, £1,000 million of 13$\frac{1}{2}$% Treasury Stock 2004/08, was announced. With the market now more confident that the rate of monetary growth was being held within the target range (a view reinforced by the release on 17 April of the full money supply statistics for March), the issue was enthusiastically received. The stock was heavily oversubscribed and was allotted at a price of £95.75%,(2) to give a yield of 14.24%. (The minimum tender

(1) On issue on 27 February, allotments were made at the minimum tender price of £95.50 per cent (to give a yield of 14.74%) with £20 per cent payable on tender, £30 on 18 March and £45.50 on 11 April.

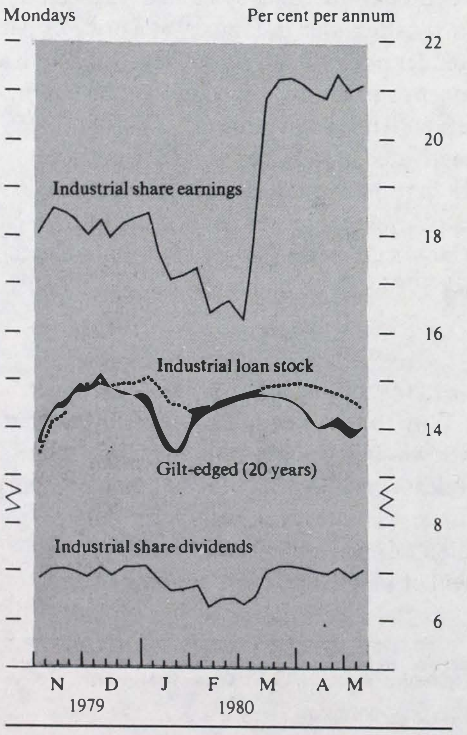
(2) £20 per cent was payable on tender, £30 on 16 May and £45.75 on 6 June.

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



(a) Components are on occasion too small to be shown separately.

Security yields



price was £95%.) After these very heavy sales, prices remained buoyant, with the market further encouraged by the strength of sterling and by a general feeling that US interest rates had reached their peak; by the end of the month, yields throughout the maturity range were about one half to one percentage point lower than at the end of March.[1]

In the first quarter of 1980, net official sales of stocks amounted to £1,085 million.[2] Sales of long and medium-dated stocks amounted to £1,275 million and of short-dated to £755 million. There were net official purchases of £645 million of stocks within one year of maturity. One stock matured in the period, 9% Treasury Convertible Stock 1980, with about £300 million in market hands.

National savings

Net receipts from national savings nearly doubled from £241 million in the final quarter of 1979 to £463 million in the first quarter of 1980. This sharp increase reflected further substantial sales of index-linked retirement certificates and the introduction of the nineteenth issue of national savings certificates on 4 February. Towards the end of the quarter, however, there was less demand for both types of certificates, and receipts from national savings declined accordingly.

Other markets

The local authority market continued to be generally quiet during the February to April period. There were again no new issues of stock, but for the first time in a year issues of bonds exceeded redemptions.

Turnover in the company debenture market fell still further in the three months, the total value of transactions being little over half that in the same period of 1979. Yields rose by three quarters of a point between the beginning of February and early April, but then fell back. The rise over the period as a whole was about one third of a point. Redemptions of loan capital and preference shares, including £20 million by one property company, exceeded new issues by £27 million. There were no new debenture issues, but gross issues of preference shares totalled £22 million.

Prices in the equity market, which had risen sharply during January, continued to advance in February, but more erratically. The FT-Actuaries industrial (500) share price index, which stood at 268 at end-January, rose to 282 by the end of February. During March, turnover fell and the market steadily weakened, losing much of the ground gained in the first two months of the year. Investors were influenced by the continuing steel strike, by developments in the Middle East, and also by pre-Budget uncertainties, especially rumours of a 'wind-fall' profits tax on the banks and the oil companies, and of an increase in petroleum revenue tax. The immediate response to the Budget was unfavourable and on 27 March the index fell by five points to 255. Thereafter there was an upturn in prices, influenced by the buoyant gilts market, and at the end of April the index stood at 265.

(1) In May, the issue was announced of £1,000 million of 13¼% Exchequer Stock 1992, £600 million of 3% Treasury Stock 1985 and £1,000 million of 13½% Exchequer Stock 1994.

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

New money raised by issues of equity capital during the period amounted to only £58 million, £36 million of which was by United Biscuits (Holdings) Limited.

There was little enthusiasm for unit trust units; gross sales continued to be low, while repurchases by the managers were larger than at any time during the past year. In all, there were net repurchases of £6 million.

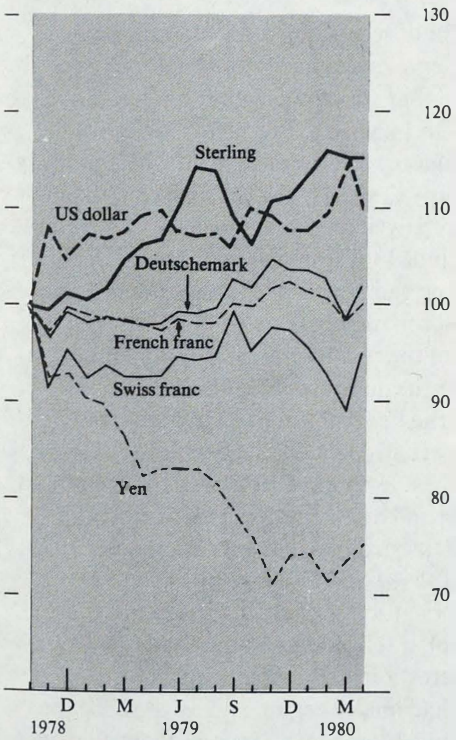
Foreign exchange and gold markets

Summary

US interest rates rose sharply after the restrictive monetary and fiscal measures of mid-March, but then fell swiftly in April. The corresponding rise and fall of the dollar, the latter exacerbated by renewed tension over Iran, dominated foreign exchange markets. The dollar's rise, unlike its fall, was resisted by substantial intervention. Sterling, insulated by North Sea oil and high nominal interest rates associated with a restrictive monetary policy, fluctuated less than other currencies, rising on balance by some 1% in effective terms. The European Monetary System (EMS) was under pressure only briefly, in early April; nevertheless, there was considerable intervention, chiefly by the Belgian authorities, to prevent the Belgian franc, the weakest currency for almost the whole period, from becoming excessively divergent. Belgium, and most other countries, also increased interest rates in response to the rises in US rates. As the dollar strengthened, there was a sharp fall in the price of gold, to below $500 per fine ounce, although it later recovered slightly as the dollar weakened.

Indices of effective exchange rates

Last working day in October 1978 = 100



Sterling

The persistence in February of the large shortages in the domestic money markets, with their effect on interest rates, gave support to sterling. So, too, did the publication of the January banking figures which indicated that, with the growth of the money supply still outside the target range, interest rates were unlikely to fall before the Budget. Sterling closed at $2.3133 on the 14th with the effective rate index (ERI) at 73.3, but fell back as the dollar advanced after the increase in the Federal Reserve discount rate in mid-month. Sterling ended the month at $2.2745, but with the ERI (73.1) little changed as the dollar gained more ground against the other European currencies.

UK economic indicators in March, though again generally unfavourable, were overshadowed by the recovery of the US dollar before and after President Carter's mid-month economic package. Indeed, although sterling fell by more than 5% against the dollar to close the month at $2.1640, other European currencies fell even further, despite substantial sales of dollars by European authorities; over the month, sterling rose against the deutschemark from DM 4.04 to DM 4.21½. As a result, the ERI fell only slightly, to 72.6. Sterling's fall against the dollar was interrrupted by short-lived demand ahead of the Budget, and the rate exceeded $2.20 on Budget day (26 March).

Shortly before Easter, sterling touched a low of $2.1397 when the dollar reached its peak. The settlement of the steel strike and news of the modest March wholesale price increase coincided with a sharply weaker dollar after the holiday; the UK money supply appeared to be coming under control, and expectations of lower domestic interest rates, coupled with outflows from the dollar, led to some overseas demand for the new £1,000 million government stock issued on the 17th, when sterling closed at $2.2290. Sharply lower US interest rates and the aftermath of the US attempt to rescue the hostages in Iran saw sterling briefly exceed $2.30 on the 28th, before falling to close the period at $2.2550 (ERI 72.6).

Between end-January and end-April, the UK reserves rose by $1,480 million after accruals of public sector borrowing under the exchange cover scheme of $320 million and repayments of $550 million. The United Kingdom repaid $80 million to the International Monetary Fund (IMF) in April under the oil facility and $255 million under the 1977 stand-by, although the latter repayment had no net effect on the UK reserves because the UK reserve position in the Fund, which is also included in the UK reserves, was correspondingly increased. The annual revaluation of the components of the reserves took place at end-March according to a formula modified so as to take account of actual market prices on 31 March when prudent to do so.(1) It resulted in an upward revision of some $3½ billion in the value of gold holdings—other than those swapped for European currency units (ECUs)—and a fall of $¾ billion in the other components, giving a revalued total at end-March of $27 billion. The quarterly renewal in April of the swap with the European Monetary Co-operation Fund(2) gave rise to a revaluation gain of $930 million. At end-April the reserves stood at $28 billion.

US dollar

In the absence of obvious signs of recession, and with inflation accelerating, the Federal Reserve raised its discount rate to a record 13% on 15 February.(3) The dollar subsequently strengthened by some 5% in effective terms. On 14 March, President Carter's economic package was announced. The fiscal elements, being mostly subject to Congressional approval, were regarded with reservation, but the monetary elements were well received. The latter were more severe than expected and included the imposition of special deposit requirements on increases in certain forms of consumer credit; more stringent reserve requirements on member banks' 'managed liabilities' and the extension of the requirements to non-member banks; a 3% surcharge(4) over the discount rate for large banks persistently borrowing from the Federal Reserve, and a restrictive voluntary target for loan growth in 1980. By the beginning of April, the dollar had risen to its highest level since 1978, as euro-dollar and US prime rates reached 20%; and on1 April it closed against the deutschemark at DM 1.9687, its strongest since 19 September 1978 and an increase of more than 15% over its low point at the start of 1980. Heavy world-wide intervention served only to restrict the rise. After Easter, however, the dollar fell as sharply as it had risen, following a rapid drop in interest rates. Economic indicators suggested that the recession had finally begun, and by the 23rd the dollar had fallen back to its mid-March level. Increased tension over Iran in the closing weeks of April was also a factor and, following the unsuccessful attempt to free the American hostages there on the 25th, the dollar fell below DM 1.80. It closed the period at DM 1.8008 with its effective index at 86.8, only some 2% higher, on balance, over the three-month period.

(1) With values at end-March lower than the average of the previous three months, gold (other than that swapped for ECUs) was valued in dollars at 75% of the London afternoon gold fixing price on 31 March, while ECUs and other non-dollar currencies were valued in dollars at exchange rates pertaining at noon on 31 March.

(2) See the additional notes to Table 17 in the statistical annex.

(3) Reduced to 12% on 29 May.

(4) Suspended on 7 May.

Other currencies

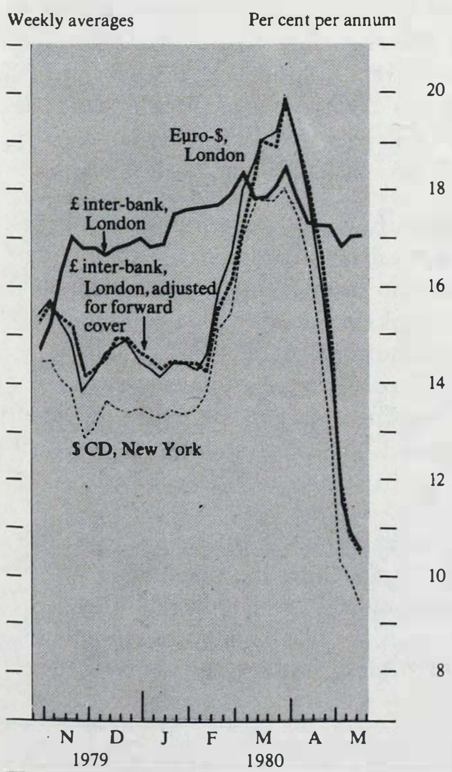
The Belgian franc was the weakest currency in the $2\frac{1}{4}\%$ band in the EMS for most of the period and was sometimes divergent.(1) A two-stage increase in administered interest rates did little to relieve the pressure until the deutschemark, the EMS currency most affected by the dollar's sharp rise in March, occasionally replaced the Belgian franc as the weakest currency towards the end of March and in early April. The West German authorities, fearing the effect on inflation of a depreciation of the deutschemark, intervened heavily and eased inflow controls further to attract private funding for the balance of payments deficit. Nevertheless, the rate fell to DM 1.9687 against the US dollar on 1 April, when the deutschemark reached its bilateral intervention point against the French franc, which was the strongest currency in the $2\frac{1}{4}\%$ band virtually throughout the period. Official interest rates in West Germany were increased in late February and in April. The Danish krone also came under some pressure and was occasionally the weakest currency in the system, after the proposals to improve the balance of payments met domestic opposition in late April. Rapidly accelerating inflation in Italy, and the fall of the Government, saw the lira move from being the strongest currency overall in the system to being the weakest (although always well within its 6% band).

Outside the EMS the Swiss franc was heavily supported. At its weakest it touched Sw. Fr. 1.8777, the lowest since June 1978. Controls on inflows were further eased, and official sources indicated that a rate of Sw. Fr. 0.95 to the deutschemark would be strongly defended. The rate was frequently around this level, but improved in April to around Sw. Fr. 0.93. The Swedish krona required steady support throughout the period. It fell by some 1% on balance against the US dollar, but its effective rate index rose very slightly. In contrast, the Norwegian krone was strong; but intervention by the authorities left the effective rate index also little changed. The discount of the Irish pound against sterling widened from 7% to 9%.

The Yen required further extensive support at first to keep it below ¥250, and the Japanese discount rate was raised to 9% in two stages. Thereafter, except in early April when it fell briefly to over ¥260, a narrowing trade deficit kept the Yen between ¥240 and ¥250, closing the period at ¥239.10. Bilateral swaps were arranged with the Swiss National Bank and the Deutsche Bundesbank. The performance of the Canadian dollar was mixed. Bank rate was tied to the Treasury bill rate in mid-March with the intention of reducing pressure on the exchange rate by narrowing the gap between Canadian and US interest rates.

UK and US three-month interest rates

Weekly averages

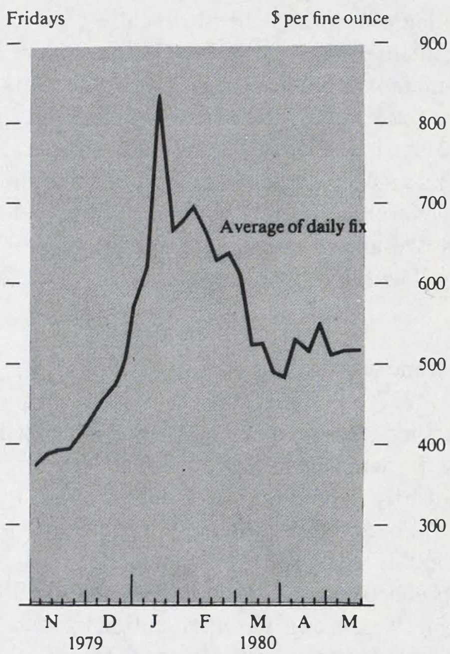


Interest rates and differentials

The three-month euro-dollar rate rose sharply in the period, in line with US domestic rates, moving from $14\frac{1}{4}\%$ in early February to just under 20% on 1 April. Prime rates rose similarly. With the US recession becoming more evident and loan demand slowing down, however, the euro-dollar rate fell by more than four percentage points to $15\frac{3}{4}\%$ on 23 April and later to 14% by the 30th. With the UK money market very tight virtually throughout the period, the three-month sterling inter-bank rate altered little, generally

(1) See the June 1979 *Bulletin*, page 190, for an explanation of the EMS.

London gold price



fluctuating between $17\frac{1}{2}\%$ and $18\frac{1}{2}\%$, although it touched $18\frac{3}{4}\%$ on 4 March and $17\frac{1}{8}\%$ on 30 April. Three-month forward sterling moved to a premium on 7 March, having opened the period at a discount of $3\frac{3}{8}\%$. The premium ranged as high as $1\frac{5}{8}\%$ before disappearing in the second half of April when forward sterling moved to a discount which reached $2\frac{5}{8}\%$by the end of the month. The covered differential moved against sterling in late February and early March to nearly 1% at one stage, with the corset reducing arbitrage possibilities by banks in the United Kingdom. Thereafter, it returned to interest-rate parity.

Gold

After the gyrations of December and January, the gold market was more stable in February, with the price falling by some $50 on balance to $637 per fine ounce, although it briefly exceeded $700 on the 11th. But in March, as the dollar advanced, the price fell very sharply in unsettled conditions; it dropped below $500 for the first time since Christmas after the announcement of the US measures, and was fixed at $474 on the morning of the 18th. A reminder from the South African Finance Minister that supplies could be withheld led to some short covering, and the price was fixed at $561 on the 20th; it later eased in more orderly conditions to close just above $485 on 27 March and again on 3 April after a disappointing IMF auction on the 2nd. With the dollar weakening, however, the price rose to over $550 on the 9th but thereafter fluctuated around $500, and closed the period at $518.

In each month of the period, the IMF auctioned 444,000 ounces of gold. The series of auctions ended in May. There were no auctions by the US Treasury.

International banking and euro-currency markets

In the fourth quarter of 1979, there was some easing in the rate of growth of international banking markets, according to the latest data published by the Bank for International Settlements (BIS);[1] this coincided with unsettled conditions and the start of a change of sentiment in favour of lenders towards the end of the period. Despite seasonal influences, which tended to inflate the growth rate, the total gross claims of banks within the reporting area increased by only $69 billion, to $1,111 billion, compared with a rise of $95 billion in the previous quarter. If inter-bank activity is excluded, the net size of the market is estimated to have grown by $30 billion, to $665 billion.

The slowdown in growth was entirely due to developments outside the European reporting area; the external positions of banks in the United States expanded much more slowly than in the preceding three months, while those of banks in Canada and Japan showed very little growth and those of the branches of US banks in the off-shore centres actually declined. These developments were influenced by the introduction of new marginal reserve requirements in the United States and informal official restraints on international lending by banks in Japan.

The claims and liabilities of banks within the BIS reporting area vis-à-vis the United States fell by $5 billion and $2 billion respectively. Whereas liabilities of banks within the reporting area to Japan also fell by $3 billion, claims on that country rose slightly, probably because of the need to finance the current account deficit;

(1) See Table 15 in the statistical annex. The figures cover the external business in domestic and foreign currencies of banks in the Group of Ten countries, Austria, Denmark, the Republic of Ireland and Switzerland, and of branches of US banks in certain off-shore centres.

UK banks' liabilities and assets by customer[a]

$ billions

	1979				1980
	30 Mar.	29 June	28 Sept.	31 Dec.	31 Mar.
Foreign currency liabilities of UK banks to:					
Other UK banks	65.0	70.3	78.0	87.5	96.1
Other UK residents	9.5	11.1	10.4	11.5	11.9
Overseas central monetary institutions	48.7	52.3	58.4	61.4	57.9
Other banks overseas	131.6	142.8	162.2	170.0	186.0
Other non-residents	36.2	39.6	46.6	51.0	55.2
Other liabilities(b)	2.6	2.8	2.7	3.3	3.1
Total liabilities	**293.6**	**318.9**	**358.3**	**384.7**	**410.2**
Foreign currency assets of UK banks with:					
Other UK banks	63.4	68.0	76.3	85.1	92.6
Other UK residents	22.1	22.9	22.1	22.1	22.6
Banks overseas	149.4	164.0	190.1	204.3	216.2
Other non-residents	55.8	59.2	64.3	68.1	73.2
Other assets(b)	4.2	5.0	5.5	5.8	5.9
Total assets	**294.9**	**319.7**	**358.3**	**385.4**	**410.5**

(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' net liabilities and claims by country or area[a]

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

	1979				1980
	30 Mar.	29 June	28 Sept.	31 Dec.	31 Mar.
BIS reporting area:					
European area	– 4.5	– 7.6	– 6.7	– 3.5	– 7.4
Canada	– 1.7	– 0.9	+ 0.4	+ 0.5	– 0.5
Japan	+ 9.8	+10.9	+11.8	+12.9	+13.5
United States	–12.0	–14.7	–18.9	–15.9	–13.9
Off-shore banking centres	+ 9.0	+11.5	+15.9	+14.8	+14.5
Other Western Europe	+ 0.7	+ 0.3	– 0.1	+ 1.4	+ 4.0
Australia, New Zealand and South Africa	+ 2.7	+ 2.3	+ 2.5	+ 2.3	+ 2.1
Eastern Europe	+ 8.0	+ 9.0	+ 9.2	+ 8.6	+10.1
Oil-exporting countries	–17.8	–18.3	–24.9	–27.6	–31.2
Non-oil developing countries	– 1.8	– 0.7	+ 0.6	+ 2.4	+ 7.2
Other(b)	– 5.2	– 4.7	– 3.6	– 7.9	–11.7
Total	**–12.8**	**–12.9**	**–13.8**	**–12.0**	**–13.3**

(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 liabilities as a percentage of total claims

	1979	1980
	Mid-Nov.	Mid-Feb.
Less than 8 days(a)	4.6	5.2
	3.3	*3.9*
8 days to less than 1 month	3.5	3.6
1 month to less than 3 months	5.1	5.4
3 months to less than 6 months	2.3	2.7
6 months to less than 1 year	0.5	0.4

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

Japan remains the largest single net user of international bank finance.

Deposits by the oil exporters increased by $13 billion. This figure was significantly lower than in the third quarter, which was inflated by the change in oil payment terms.

Despite the slower growth overall, the need to finance balance of payments deficits resulted in claims on non-oil developing countries again increasing quite heavily—by $12 billion—with Argentina accounting for about a quarter of this.

As in the third quarter, East European countries increased both their borrowing and lending by around $3 billion. There were, however, disparities between individual countries; the USSR remained by far the largest depositor of new funds, whereas Poland continued to be the major new borrower.

Provisional data for the first quarter of 1980 suggest that the rate of overall growth has recovered, with a major proportion of increased activity being centred on London. The gross foreign currency liabilities of banks in London increased by $33 billion, after adjustment for the estimated effects of currency valuation changes; this followed a rise of $26 billion in the previous quarter. More than one third of the growth in the first quarter of 1980 was attributable to increased activity with banks overseas.

After depositing only an additional net $3 billion in the fourth quarter of 1979 (all of which was in the first part of the period), the oil-exporting countries increased their deposits by $6 billion in the first seven weeks of 1980. Subsequently, however, some funds were withdrawn, and the net increase for the quarter as a whole was $4 billion.

Foreign currency claims by UK banks on the non-oil developing countries increased by $3 billion in the first quarter, and the banks' liabilities to these countries fell by nearly $2 billion. Most of this change was attributable to Latin America, on which net claims increased by almost $4 billion.

The maturity analysis of the foreign currency positions of UK banks at mid-February reveals a modest increase, compared with mid-November, in the net liability positions in all maturity bands up to six months; between six months and one year there was a slight fall in the mismatch. If the net positions are examined as a proportion of total claims, it is apparent that most bank groups shared in the deterioration in net liability positions for periods of up to one month; this was probably caused, to a certain extent, by the expectations of depositors that euro-dollar interest rates were set to rise.

The contribution of UK banks to the detailed half-yearly surveys of external positions, undertaken by all central banks in the BIS reporting area,(1) are set out, for end-December 1979, in Table 15 of the statistical annex in this issue. There have been two significant developments since the end-June 1979 analysis. First, there has been a further increase in the share of liabilities of UK banks attributable to the major oil-exporting countries; this is clearly related to increased oil revenues following the oil price rise earlier in the year.

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

Second, on the claims side, there was a noticeable lengthening in the maturities of UK banks vis-à-vis countries other than the off-shore centres as market conditions shifted in favour of borrowers. A decline in the proportion lent for less than six months was primarily offset by increased borrowing in excess of five years. West European countries outside the BIS area, being, in the main, prime-risk customers, were able to increase their borrowing at the longer end by some 42%, to around $5¾ billion. Borrowing by non-oil developing countries also lengthened, with Latin American and Caribbean countries prominent. As in the general maturity analysis above, 'roll-over' loans[1] are classified according to the remaining period to maturity rather than to the next roll-over date.

Medium-term euro-currency credit markets

The total volume of new medium-term credits announced in the first quarter[2] was $16 billion, compared with $17 billion in the previous three months and a quarterly average for 1979 of a little over $18 billion. Volume in January (less than $4 billion) was particularly low—partly reflecting uncertainties arising from the Iranian crisis—and was little higher in February ($5 billion). In March, however, there was a sharp recovery, to $7.3 billion. The prospective return to the market of Japanese banks, and the increase in size of several loans announced earlier, both suggested that this recovery might be sustained. In April, however, volume fell again.

The average size of loan rose sharply in March (to $120 million, compared with an average of $87 million last year, and only $70 million during the three months to February), but fell back again in April. The March figures are influenced by a number of large loans for prime borrowers; in general, the gradual tightening of conditions apparent towards the end of 1979 appears to have been maintained.The average maturity of loans in the first quarter was 8.2 years (compared with 9.2 years in the fourth quarter of 1979) and was declining through the quarter. In April, it fell to just 7.4 years. This apparent worsening of terms for borrowers was accompanied in some cases by higher spreads. For less-developed countries, funds are generally costing an extra ⅛% compared with 1979. Prime names—most OECD countries and the oil exporters—are paying similar spreads to last year but appear to be accepting shorter maturities.

An analysis of borrowers in the first quarter shows that major OECD and prime-name minor OECD countries maintained their volume of borrowing. Borrowing by less-developed countries, however, remains depressed, compared with the levels of earlier last year.

Foreign and international bond markets

In the first quarter, against a background of deteriorating prospects for inflation, sharp rises in short-term interest rates, and unusually high activity in precious metals, completed issues and placements in foreign and international bond markets totalled only $6,330 million; this was the second successive quarter in which volume had declined. The sharpest fall was in the dollar sector, where the

(1) 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.

(2) The Bank of England records medium-term euro-credits with maturities of three years or more on the date of the announcement. The size or terms of such loans may subsequently alter but the changes may not be announced. The BIS records euro-credits only when they are taken up.

total was $1,330 million, about half that of the previous three months; among international dollar issues, fixed-rate euro-issues were particularly affected. But in April there was a dramatic change in sentiment, encouraged by the precipitate falls in US domestic rates. The six-month euro-dollar rate dropped from $19\frac{11}{16}$% on 31 March to $11\frac{3}{8}$% on 8 May, while long bond yields fell from 13.55% to 11.85%; thus for the first time since August 1978, the yield on bonds exceeded the cost to market participants of financing their holdings. The new issue market reacted swiftly, and over the month a relatively large volume of $1,350 million of new dollar bonds was completed. Most of these ($1,220 million) were fixed-rate paper, compared with only $300 million in the whole of the first quarter.

The markets in non-dollar currencies improved only slightly in April, but here activity in the first quarter had been more normal. The recent growth in the deutschemark sector continued in the first quarter of 1980, with issues increasing by 13%, to $2,310 million, while the Swiss franc sector also expanded, to $1,690 million compared with $1,230 million in the fourth quarter. The sterling sector, inactive in the second half of 1979, recovered in the first quarter, with three issues totalling $200 million. The volume of yen issues fell slightly, to $350 million. There were no issues in either sterling or yen in April.

There was some change in the distribution of borrowers in the first quarter. The share of major OECD borrowers fell back from the 1979 average of 50% of the market to 43%, whilst that of minor OECD countries increased from 24% to 36%. There were no issues by Eastern bloc or oil-exporting countries, and the share of non-oil developing countries fell from 7% to 2%.

Deployment of oil money[1]

The total identified deployed cash surplus of the oil-exporting countries for the fourth quarter of 1979 is estimated to have been $19.8 billion, bringing the total for the second half of the year to $43.0 billion compared with only $10.8 billion in the first half (see table). The increase in the identified cash surplus for the year as a whole is less than the increase in the estimated current account surplus; part of the difference is explained by the greater amount of trade credit extended (notwithstanding some shortening of credit periods), but some is, as yet, unexplained.

Following the mid-year rise in oil prices, about three quarters of the identified cash surplus in the second half of 1979 was placed in bank deposits compared with just under half in the first six months. Euro-currency deposits in both the United Kingdom and other countries increased sharply. There was some diversification out of dollars in the fourth quarter.

Oil revenues of the oil-exporting countries are estimated to have been some 20% higher in the first quarter of 1980 than in the previous three months. Both sterling and other currency deposits with banks in the United Kingdom increased more sharply. Bank deposits and other placements in the United States rose by only $3 billion, compared with $7 billion in the previous quarter.

(1) See the article on page 154 for a description of the cash surpluses of the oil exporters over the 1974–79 period.

Identified deployment of oil exporters' surpluses[a]

$ billions

	1977	1978	1979			1980
			1st half	Q3	Q4	Q1(b)
United Kingdom						
British government stocks	—	−0.3	0.1	0.1	0.2	0.4
Treasury bills	−0.2	0.2	0.4	0.2	−0.6	0.6
Sterling deposits	0.3	0.2	0.3	0.4	0.7	0.8
Other sterling investments(c)	0.4	0.1	0.2	0.1	0.1	0.1
British government foreign currency bonds	0.2	—	—	—	—	—
Foreign currency deposits	3.1	−2.0	3.3	8.0	3.5	4.1
Other foreign currency borrowing	—	—	—	—	0.2	—
	3.8	−1.8	4.3	8.8	4.1	6.0
United States						
Treasury bonds and notes	4.3	−1.5	−1.9	0.3	0.5	2.1
Treasury bills	−0.9	−1.0	0.4	1.0	1.9	1.0
Bank deposits	0.4	0.8	0.5	0.7	3.7	−0.7
Other(c)	5.3	3.0	0.5	0.3	1.0	0.7
	9.1	1.3	−0.5	2.3	7.1	3.1
Other countries						
Bank deposits	7.5	5.0	1.1	9.2	6.1	..
Special bilateral facilities and other investments(c)(d)	12.8	8.8	6.2	3.3	2.2	..
	20.3	13.8	7.3	12.5	8.3	..
International organisations	0.3	0.1	−0.3	−0.4	0.3	..
Total	**33.5**	**13.4**	**10.8**	**23.2**	**19.8**	..

.. not available.

(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) Provisional.

(c) Includes holdings of equities, property, etc.

(d) Includes loans to developing countries.

Reconciliation of identified deployment of oil exporters' surpluses with current account data

$ billions

	1977	1978	1979(a)
Merchandise trade	64	44	120
Net invisibles, including official transfers	−37	−45	−46
Current balance	27	−1	74
Net external borrowing etc(b)	11	20	5
Surplus available for investment	**38**	**19**	**79**
Identified surplus from deployment table	33	13	54
Unidentified balance	5	6	25

(a) All figures for 1979 are provisional.

(b) For an explanation of this item see the article on page 154.

Commodity markets

For many commodities, speculative pressures, and the resultant price distortion, lessened during the February to April period, and genuine supply and demand factors accordingly had greater influence.

This trend was most marked in metals traded on the London Metal Exchange. With the exception of tin, prices fell, in varying degrees, over the period. To a large extent, this represented reaction to recessionary fears, notably in the United States, and to high interest rates which, even at the lower price levels, discouraged stock building by users. The most dramatic reduction came in silver, where the fall from peak prices in January was accelerated by the liquidity crises of large speculative operators in the United States; London markets proved to be adequately secured.

The rubber market was weak in line with the general industrial outlook.

In the terminal markets for trading foodstuffs, coffee and sugar maintained steady to firm prices, but for cocoa there was a markedly weaker tone on fears that producer countries would be unable to support prices in the face of the forecast of a substantial surplus.

The London terminal contract in Arabica coffees reopened on 14 April; early trading was only modest.