Financial review

Introduction

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

Conditions were unusually tight in both the money markets and banking system. In the money market, short-term interest rates rose sharply in the middle of June and remained high thereafter.

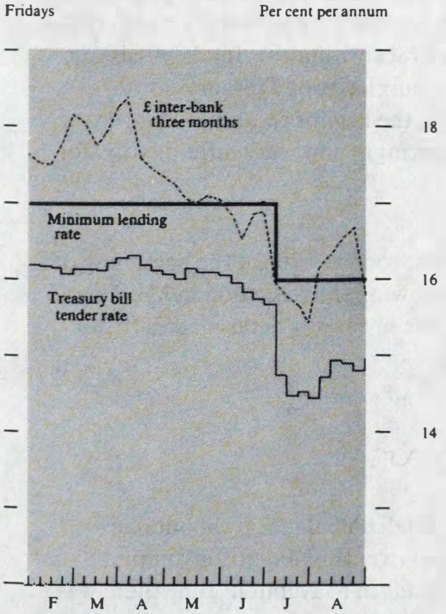
In the gilt-edged market, turnover was lower in May but subsequently recovered. Yields on most stocks fell by about one percentage point. There were large net official sales of stock.

The foreign exchange markets were much quieter than in the previous three months. The value of the US dollar declined as US interest rates eased. In spite of the cut in minimum lending rate (MLR) sterling rose by some 5% against the dollar to reach a five-year peak.

Money markets

There was unusual stringency in the money markets and persistent pressure on banks' liquidity during May to July because of continuing heavy tax payments and large official sales of gilt-edged stocks. The tightness was reflected in short-term inter-bank rates: those of one month and less rose sharply in the middle of June and remained high to the end of the period, despite the decline in longer rates which followed the reduction from 17% to 16% in MLR on 3 July.

Short-term interest rates in London



In response to these pressures the Bank made increasingly frequent use of special measures of assistance. The two facilities with the clearing banks for the purchase and resale of gilt-edged stocks, which were due to expire on 12 and 19 May, were extended on 8 May to 12 and 17 June, and at the same time the recall of special deposits equal to 1% of eligible liabilities, due on 14 May, was cancelled. Partly as a result of this substantial assistance, pressure on the reserve asset position of the banking system slackened in the latter part of May, and inter-bank rates of up to three months were generally easier until the beginning of June. By 4 June the seven-day rate had fallen to $16\frac{3}{8}$%.

Further assistance was given by the Bank on 5 June, when the second 1% recall of special deposits, due on 16 June, was cancelled. At the same time, however, a temporary easing of pressure on banks' liquidity was recognised in the decision not to offer a further extension of the purchase and resale agreements with the clearing banks.

Following the unwinding of these facilities, renewed pressure began to develop in mid-June. Short-term rates moved up again and by 25 June the gap between three-month and one-year inter-bank rates had widened to $2\frac{5}{8}$% compared with about 2% at the beginning of May. The seven-day rate reached a peak of 18½% on 1 July.

On 27 June the Bank took further steps to ease these pressures on short rates by offering to all listed banks and to deposit-taking finance houses a facility for the purchase and resale of gilt-edged stocks similar to that previously offered only to the clearing banks. This facility, which was to run from 4 July to 11 August, was for 1½% of each institution's mid-May eligible liabilities and totalled some £700 million.

At the beginning of July, as a result of further large official sales of stock, money-market pressures intensified again, and a second similar facility (for 2% of each institution's mid-May eligible liabilities) was announced on 4 July. This new facility, for the sale and repurchase of gilt-edged stocks, was supplemented by a facility relating to over two-year government-guaranteed export credit and shipbuilding paper. The combined facilities, for a maximum of £900 million, were to run from 11 July to 18 August. By the end of July, rates of up to one month were standing above MLR, and longer rates were moving upwards.

The Bank announced on 7 August a further facility for the purchase and resale of gilt-edged stocks and government-guaranteed export credit and shipbuilding paper to cover the period 11 August (the date of termination of the £700 million facility) to 8 September. The new facility amounted to some £500 million. On 14 August, the Bank announced another facility (of up to £750 million) for the purchase and resale of gilt-edged stocks to cover the four weeks from 18 August to 15 September.

In addition to these special facilities, regular assistance to the market by the Bank was necessary on most days during this period; only occasionally, in late May and early June, were the authorities required to sell Treasury bills to absorb surplus funds. Assistance to the market took the form of purchases of Treasury, local authority and commercial bills, the last for resale at future dates. The Bank also lent at MLR overnight and, very infrequently, for longer periods.

Clearing bank base rates, which stood at 17% at the beginning of May, were lowered to 16% following the reduction in MLR on 3 July. Most banks lowered their seven-day deposit rates (from 15% to 14%) at the same time.

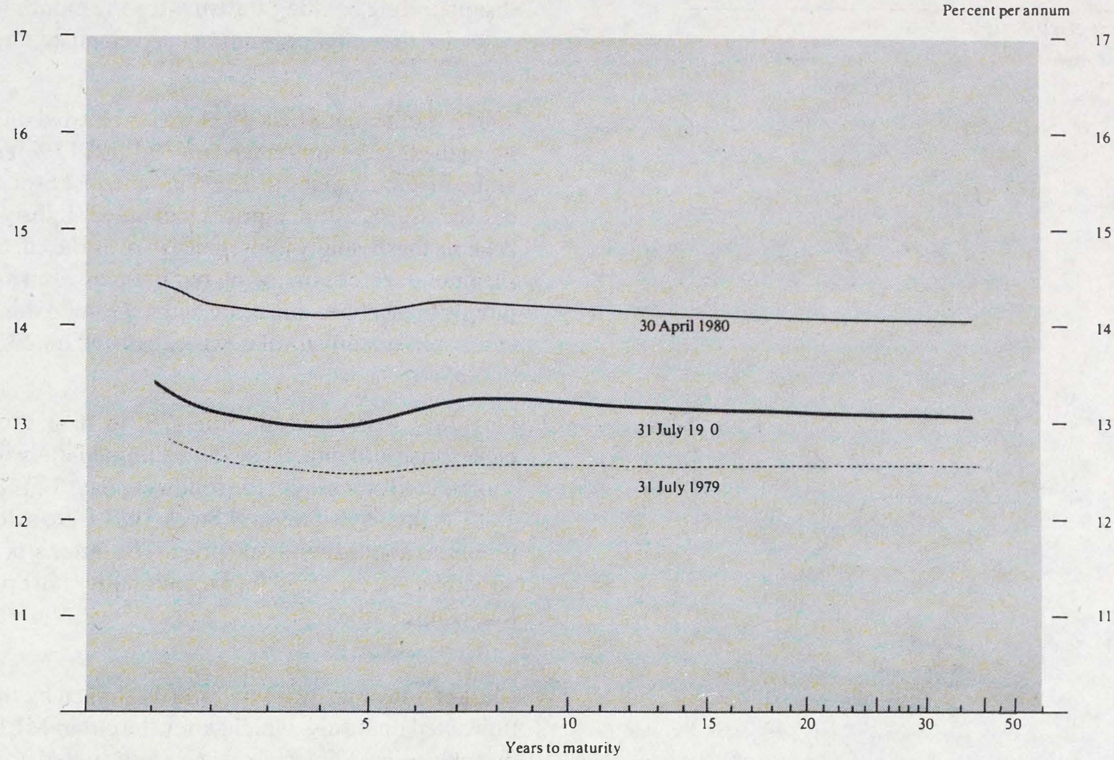
Capital markets

The gilt-edged market

In the gilt-edged market, yields fell on balance by about one percentage point on most stocks over the May to July period. Turnover fell in all maturity bands in May, but in June there was a marked increase, particularly in stocks with more than five years to maturity, and turnover remained high in July.

At the beginning of May, the gilt-edged market was strong. The continuing decline in US interest rates, coupled with expectations of a further set of favourable banking statistics (to be released on 7 May), gave rise to hopes that MLR would be reduced shortly.

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.

However, the statistics (for the month to mid-April) showed a sharp increase in bank lending to the private sector; these disappointing figures, together with the Chancellor's indications (on the evening of 7 May) that expectations of an early cut in MLR were unwarranted, led to a sharp set-back in prices. On the same day, £1,000 million of $13\frac{1}{2}\%$ Exchequer Stock 1992 was issued and initial applications were small.[1] Nevertheless, the Government Broker was soon able to operate the stock as a tap at a premium which was initially £$\frac{1}{16}$ per cent, but which rose quickly to £$\frac{3}{16}$ per cent.

The market improved towards the end of May. The strength of sterling, coupled with increasingly persistent rumours of substantial overseas interest in gilt-edged stocks, attracted UK buyers: on 27 May, $13\frac{1}{2}\%$ Exchequer Stock 1992 was exhausted at a £$\frac{3}{8}$ per cent premium. Two days later, a special low-coupon short-dated stock (£600 million of 3% Treasury Stock 1985) was issued,[2] specifically to meet demand for this type of stock as and when it arose. Initial applications were small.

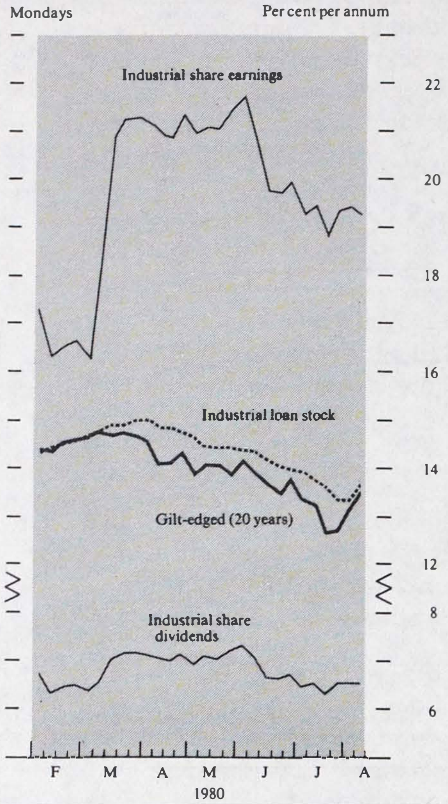
Immediately afterwards, prices weakened as concern mounted over the continuing high level of inflation. Later in the week, on 30 May, a new issue, £1,000 million of $13\frac{1}{2}\%$ Exchequer Stock 1994, was announced.[3] Again, applications were only minimal. This proved to be only a temporary setback, however, as the market responded strongly to the implications of the European Community budget settlement. Prices rose sharply, and

(1) Allotments were made at the minimum tender price of £96 per cent (to give a gross redemption yield of 14.20%) with £20 per cent payable on tender, £30 on 13 June and £46 on 11 July.

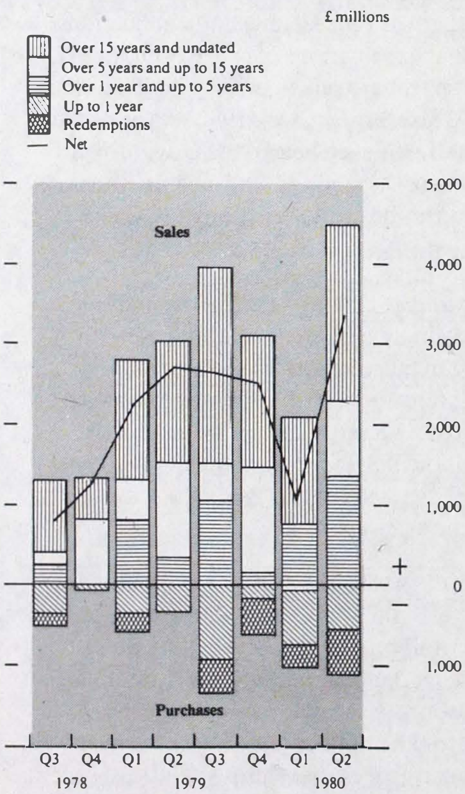
(2) Issued at a minimum tender price of £69 per cent (to give a yield of 11.33%).

(3) Issued on 4 June at a minimum tender price of £96 per cent (to give a yield of 14.17%) with £40 per cent payable on tender, £30 on 4 July and £26 on 25 July.

Security yields



Official transactions in gilt-edged stocks by maturity(a)



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

were little affected either by the publication on 10 June of disappointing banking statistics for the month to mid-May, or by evidence that public spending had remained unexpectedly buoyant.

13½% Exchequer Stock 1994 was exhausted on 16 June, and two new stocks were announced on 20 June: 13% Treasury Stock 2000, and a further tranche of 12¼% Exchequer Stock 1985.(1) By the date of issue (25 June), prices had eased slightly as investors became increasingly apprehensive over the effects of a recession on the public sector borrowing requirement, and as shortages in the money market became more acute. Despite this, the long-dated stock sold steadily until it was exhausted on 2 July.

On 3 July, MLR was cut from 17% to 16%; this took the market by surprise and interest switched immediately from long to short-dated stocks. On the following day, 12¼% Exchequer Stock 1985 'A' and 3% Treasury Stock 1985 were sold out, both at a premium above their issue price. The latter stock was sold out in only thirty-seven days, an exceptionally short period for a low-coupon stock.

Market buoyancy was temporarily shaken by the banking statistics published on 8 July, which, after the cut in MLR, were regarded as disappointing. (The figures were interpreted as indicating that there would be no rapid reduction in interest rates.) Consequently, a new issue, 12% Treasury Stock 1987,(2) received only modest interest on application; however, the market quickly recovered and, following the tender, some stock was sold at £⅛ per cent premium in £20 per cent paid form. The stock was exhausted on 16 July at a price of £20⅜ per cent.

In view of the strength of demand for low-coupon issues, a further £400 million tranche of 3% Exchequer Stock 1983 was issued on 17 July, at a minimum tender price of £83.25 per cent.(3)

On 18 July, an issue of an additional tranche of 11¾% Treasury Stock 1991 was announced.(4) The stock attracted a good response on issue and was quickly established as a tap. Towards the end of July, however, prices declined in the face of severe shortages in the money markets and in the expectation that banking statistics due to be released on 5 August would be poor. Turnover thereafter declined and the market remained subdued through to mid-August.

In the second quarter of 1980, cash raised from official sales of stocks and from instalments paid on stocks issued in the previous quarter amounted to £3,375 million, net of buying in and

(1) £1,000 million of the 2000 stock was issued with a further £50 million reserved for the National Debt Commissioners. Allotments were made at the minimum tender price of £96 per cent (to give a yield of 13.59%) with £30 per cent payable on application, £45 on 8 August and £21 on 29 August. £600 million of the 1985 stock was issued on the same day, with £40 per cent payable on issue and the balance of £58.25 on 1 August (to give a yield of 12.72%). £700 million of this stock had been issued in 1978.

(2) £800 million of this stock was issued on 9 July, with a further £200 million reserved for the National Debt Commissioners. It was allotted at the minimum tender price of £96 per cent (to give a yield of 12.87%) with £20 per cent payable on 9 July, £30 on 15 August and £46 on 12 September.

(3) £600 million of this stock had been issued in 1977.

(4) £1,000 million of this stock was issued on 23 July with a further £200 million reserved for the National Debt Commissioners. It was allotted at the minimum tender price of £94 per cent (to give a yield of 12.81%) with £20 per cent payable on tender, £30 on 22 August and £44 on 26 September.

redemptions. The non-bank private sector (£2,010 million) and overseas sector (£785 million) were the main purchasers. Sales of long-dated stocks amounted to £2,195 million, of medium-dated to £945 million and of stocks with one to five years to maturity to £1,355 million. Purchases of stocks within one year of maturity totalled £575 million. Three stocks matured in the period: $9\frac{1}{2}\%$ Treasury Stock 1980, $5\frac{1}{4}\%$ Funding Stock 1978/80 and $3\frac{1}{2}\%$ Treasury Stock 1977/1980, with just over £545 million in total in market hands.

National savings

After rising for three consecutive quarters, net receipts from national savings fell back to £265 million as a result of sharply lower sales of both index-linked retirement and ordinary certificates. Sales of the latter declined as hopes of a rapid reduction in interest rates faded.

Other markets

There was only moderate activity in the local authority market during the period May to July. There were no new issues of stock (the last was in March 1979) and issues of negotiable bonds (£207 million) exceeded redemptions by only £4 million.

In the market for company fixed-interest securities, turnover increased; yields, which had fallen back in late April, continued to decline throughout the three-month period, and lost just over one and a quarter percentage points overall. Both issues and redemptions of loan capital and preference shares, at £47 million and £56 million respectively, were much in line with the average of the previous twelve months, although over half of the total amount of stock issued was accounted for by one company's issue of convertible loan stock. There were no debenture issues, and gross issues of preference shares totalled £8 million.

Prices in the equity market, which had risen in late April, continued to advance somewhat uncertainly in early May, and the FT-Actuaries industrial (500) share price index reached 270 on 14 May. During the second half of the month the market retreated in the face of profit-taking and renewed awareness of the bleak economic position following the latest high inflation and low industrial output figures, and by the end of the month the price index had fallen to 258. In early June, however, investment interest was stimulated by news of the agreement on future UK contributions to the European Community, and hopes of an early cut in MLR. Turnover increased, and the index rose to 287 on 18 June, its highest point for over a year. Subsequently, the market hesitated but there was a further advance after the reduction in MLR on 3 July which aroused speculation about a rapid fall in interest rates later in the year. News of a UK current account surplus for the second consecutive month gave the advance further impetus, and the share index advanced to 300 on 16 July.

Thereafter disappointing news caused prices to slip back and by the end of the month the share index stood at 296. Over the period as a whole, prices rose by 10.7%.

New money raised by issues of equity capital during the three months totalled £298 million (the largest amount since the same quarter last year), £241 million of which was raised during July, including £108 million by Land Securities Investment Trust. Net sales of unit trust units during the three-month period, including the conversion of two investment trusts into unit trusts in June, were £26.5 million, with gross sales of £134.1 million and gross repurchases by the managers of £107.6 million.

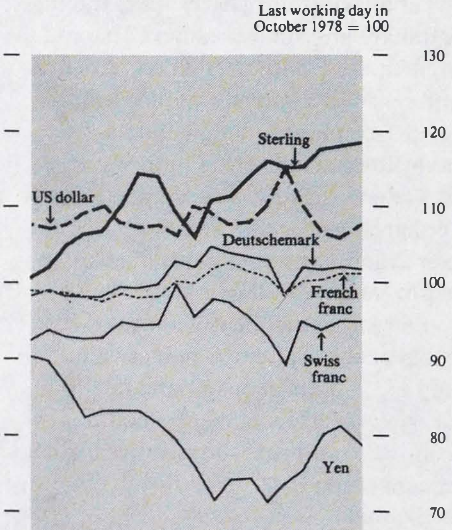
On 29 July the Kingdom of Denmark announced the issue of a 25-year sterling bond on the London market to raise £75 million in August. This was the first such issue by a borrower from outside the former Scheduled Territories since the abolition of exchange control regulations.

Foreign exchange and gold markets

Summary

In the period May to July, foreign exchange markets were much quieter than in earlier months. In the face of the continuing decline in US interest rates, the dollar fell some 10% in effective terms from its early April peak and required some support. Sterling rose by some 5% against the US dollar to reach its highest level for five years, in spite of the cut in MLR. In effective terms, however, it rose by only $2\frac{1}{2}$%, and by even less in terms of the basket of currencies in the European Monetary System (EMS). The system itself, with the deutschemark for most of the period the weakest of the currencies observing the $2\frac{1}{4}$% margin, was under no pressure, although the lira required substantial support in the face of devaluation rumours. The Yen strengthened sharply at first, and then remained stable, in spite of the uncertainties engendered by the death of the Japanese Prime Minister and the election. The Canadian dollar strengthened on the result of the Quebec referendum. Gold, although quiet at first, moved up sharply in June and early July to nearly $700 per fine ounce, before finishing the period at about $615.

Indices of effective exchange rates



Sterling

Sterling opened the period at $2.2620, depressed by the unwinding at the end of April of a large position taken up earlier in the year. Further falls in US interest rates, however, led to a general weakening of the dollar and sterling exceeded $2.30 on 15 May, helped by the Prime Minister's statement rejecting an early cut in MLR. The continued decline in US interest rates, some relaxations in the US credit restraint programme, and unco-ordinated oil price rises, subsequently led to aggressive buying of sterling, and the rate reached $2.3785 on 27 May, with the effective rate index (ERI) at 74.9.[1] The rate against the deutschemark neared DM 4.19, having opened the month at DM 4.06, but it remained below its late-March peak of DM $4.21\frac{1}{2}$. Higher UK Continental Shelf oil prices set by the British National Oil Corporation (reflecting developments in official OPEC prices) and news of a sharp fall in the US index of leading indicators at the end of May kept sterling firm, and it closed the month at $2.3450 (ERI 74.3).

On 3 June, the Prime Minister's remarks that the settlement of the European Community budget issue should lead to lower UK interest rates were taken by the market to imply that a reduction was imminent. Under pressure of heavy selling, sterling fell rapidly to $2.29 and to DM 4.08, before turning. Although the rate had recovered to $2.35 by 9 June, for a period thereafter sterling traded somewhat uneasily, with a tendency to soften in advance of the weekly MLR announcement. In the second half of June, the market was very quiet and sterling traded narrowly in the range of $2.32–2.35, breaking through the $2.35 barrier only

(1) The accompanying chart shows the effective rate index rebased at October 1978.

at the end of June following the news of the large US May trade deficit, to close the month at $2.3570 (ERI 74.4).

After the reduction of MLR to 16% on 3 July the rate was initially marked down, but a good two-way market soon developed and sterling closed the day at $2.3455 (ERI 73.9) and at DM 4.12½. Some encouraging statistics on prices and wages, renewed buying interest in British government stocks, and a further weakening of the US dollar, took sterling to $2.3995 on 24 July, the highest against the dollar since March 1975. It closed the period lower, at 2.3440, on the strengthening of the dollar, though little changed, at 74.7, in effective terms, or against the European currencies.

Between end-April and end-July, the UK reserves rose by $264 million, to $28,272 million. There were various factors at play. First, public sector borrowing under the exchange cover scheme brought in $425 million. Second, there were repayments of public sector borrowing of $580 million and to the International Monetary Fund (IMF) of $82 million of the oil facility. Third, the quarterly renewal in July of the swap with the European Monetary Co-operation Fund(1) gave rise to a revaluation gain of $58 million. The repayment of $263 million to the IMF under the 1977 stand-by left the level of the UK reserves unchanged because the UK reserve position with the IMF, also included in the reserves, was correspondingly increased. After allowing for these factors, the underlying rise in the reserves was $443 million.

US dollar

As in the previous three months, movements in the US dollar were largely dictated by interest-rate considerations. The Federal Reserve discount rate was reduced in three stages to 10% by the end of July; and prime rates, which stood at around 18½% at the start of the period, were cut to around 11% by the end. After opening the period at 86.8 in effective terms, the US dollar fell to 83.4 on 27 May following the announcement on 23 May of relaxations in the mid-March credit restraint programme. Against the deutschemark, the rate fell to DM 1.7642, the level at the end of February. A series of gloomy indicators in the first half of June, including a record fall in the index of leading indicators for April, were accompanied by a sharp fall in interest rates, and the dollar came under further pressure, falling to DM 1.7537 on 13 June (ERI 83.0) in spite of official support. The stabilising of the Federal funds rate at around 9% brought some respite; but the unexpectedly large May trade deficit and the announcement on 3 July that the credit restraint programme was to be phased out entirely gave rise to further selling, and on 8 July the dollar closed in London at DM 1.7367, with the effective index at 82.8, the lowest since the beginning of 1979. Prime rates were further reduced in the second half of July, a few to 10¾%, and the dollar continued weak. However, the cut in discount rate to 10% announced on 25 July was quickly followed by a rise in short-term interest rates as a number of economic indicators implied that the recession might be short-lived, and the dollar rose sharply to close the period at DM 1.7815 (ERI 84.8).

Other currencies

Concern over the course of the West German balance of payments kept the deutschemark generally the weakest of the currencies observing a 2¼% margin within the EMS. The system was never

(1) See the additional notes to Table 17.1 in the statistical annex.

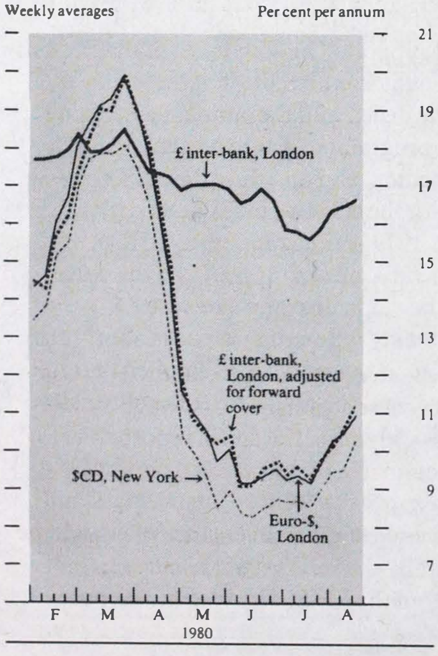
under pressure, however, and no currency was particularly divergent, with the spread between the weakest and the strongest currency—the latter being almost without exception the French franc—for the most part between 1% and $1\frac{1}{2}$%. The deutschemark's weakness relieved the pressure on the Belgian franc in particular, enabling the Belgian authorities to reduce Bank and Lombard rates to 13% on 26 June and to 12% at the end of the period. The guilder strengthened within the system after an increase of one half of a percentage point in administered interest rates in early May, and intervention to maintain the cross rate against the deutschemark at D fl. 1.10. Later, interest rates were lowered in two stages, by one percentage point. Both the Danish krone and the Irish pound also strengthened, and on occasions the latter was the strongest in the system; its discount against sterling, however, remained virtually unchanged at 9%. Between early June and the middle of July, the lira was subject to severe pressure as rumours of devaluation abounded. On 2 July, the day the authorities announced an economic package, it moved to over 4% from the strongest EMS currency (though well within its 6% margin) in spite of substantial intervention. Thereafter, the pressure eased and some previous sales of exchange were recouped.

The Swiss franc was very firm against both the US dollar and the deutschemark, and strengthened to around Sw. Fr. 0.92 against the latter. The Swedish krona needed almost continual support, although it strengthened against the dollar.

The Yen, which started the period at ¥240, appreciated to ¥226 by the third week of May, thereafter strengthening more slowly in the face of substantial intervention by the authorities, until it reached ¥220 in the first week of June. The rate remained between ¥215 and ¥220 until the third week of July, and subsequently weakened to ¥228 by the end of the month. During the period, the Yen benefited from the decline in US interest rates while, unlike earlier occasions, further rises in oil prices had little effect, mainly because of the strength of Japanese exports. The Canadian dollar appreciated by some $1\frac{1}{2}$% on the defeat of the separatist resolution in the referendum on 20 May. Thereafter, it remained firm against the US dollar, supported by continuing rumours of discoveries of substantial oil and gas reserves.

UK and US three-month interest rates

Weekly averages Per cent per annum



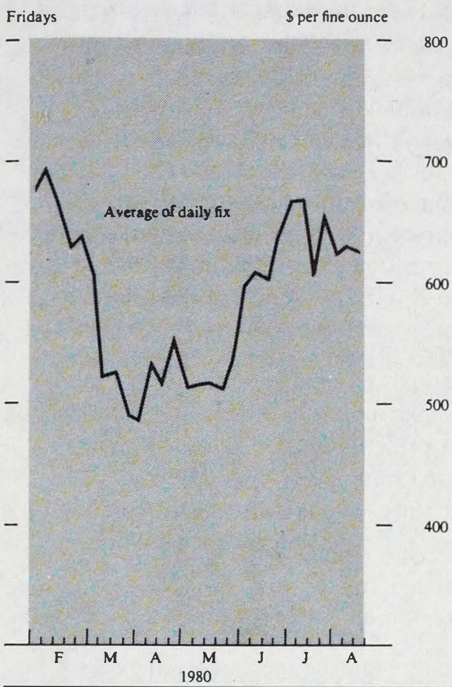
Interest rates and differentials

The decline in the three-month euro-dollar rate, which opened the period at 14%, continued almost uninterrupted to the middle of June, when it touched $8\frac{3}{4}$%. Thereafter, the rate firmed slightly to nearly $9\frac{3}{4}$% at the start of July, before easing to around $9\frac{1}{2}$% and finishing the month at almost 10%. The three-month sterling inter-bank rate fluctuated either side of 17% throughout May and June touching, at its lowest, $16\frac{1}{2}$% in mid-June. Following the reduction in MLR in July, the rate declined to $15\frac{3}{4}$%. The three-month forward discount on sterling, which opened at $2\frac{1}{2}$%, went above 7% on 10 June, and reached a peak of just under 8% on 13 June. It fell back to less than 7% following the fall in MLR, and closed the period at $6\frac{1}{16}$%. The covered differential kept close to interest-rate parity throughout the period.

Gold

Gold opened the period quietly, fluctuating between $500 and $525 per fine ounce for most of May, though it closed the month at

London gold price



$535.50 as the price of silver started to rise. The sabotage of oil plants in South Africa and reports of Russian troop movements in Afghanistan pushed the price up sharply to $627.50 on 9 June, 17% higher than at end-May. It fell as sharply to below $590 on 12 June, before settling down around $600. Investment and speculative activity increased towards the end of June as the dollar weakened and the bull market in US bonds came to an end, and the price was fixed at $688.75 on the morning of 8 July. Rumours, subsequently denied, that the US Treasury intended to recommence gold auctions, led to profit-taking and the price fell to $650 on 14 July and then, in some disarray, to $606 on 18 July, a level at which firm buying interest was apparent. The price closed the period at $614.25, a net increase of $96.25.

In May, at the last auction in the present series, the IMF sold 444,000 ounces of gold. There were no auctions by the US Treasury.

International banking and euro-currency markets

International developments (first quarter of 1980)

Despite the unwinding of end-year window dressing, international bank lending continued to grow fairly strongly during the first quarter of 1980, according to the latest data published by the Bank for International Settlements (BIS).[(1)] After allowing for the statistical effects of exchange rate fluctuations (the dollar appreciated during the period), the growth of the market was even more marked; the following paragraphs, therefore, are based on adjusted data.

Overall, the gross claims of banks within the BIS reporting area increased by some $44 billion, or by some $30 billion if inter-bank redepositing is excluded. Some $40 billion represented an increase in claims on the reporting area itself, in particular to the West German non-bank sector which increased its borrowing by $6 billion, predominantly in deutschemarks. Outside the reporting area, the smaller OECD countries, which absorbed $2 billion, were the only group to maintain their rate of borrowing. Non-oil developing countries borrowed only $4 billion, probably deterred by high euro-dollar interest rates, while drawings by East European countries were negligible. Both these groups appear to have met part of their financing requirements by running down deposits, by $1 billion and $2 billion respectively.

Although new deposits by oil-exporting countries were lower than in the previous quarter, their repayments of borrowing resulted in an increase of $3½ billion compared with the last quarter of 1979 in their net supply of funds to the market. The US non-bank sector, which provided $7 billion, was the largest single net supplier of new funds, the flow resulting primarily from interest-rate differentials between the domestic and external markets.

High US interest rates and the strengthening of the dollar brought about a shift to borrowing in other currencies: of the $35 billion increase in lending by banks within the European reporting area, less than one third was denominated in dollars, and particularly large increases were recorded in Swiss franc, deutschemark and French franc lending. On the sources side of the balance sheet, the

(1) See Table 15 in the statistical annex. The figures cover 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 offshore centres.

UK banks' liabilities and assets by customer[a]
$ billions

	1979			1980	
	29 June	28 Sept.	31 Dec.	31 Mar.	30 June
Foreign currency liabilities of UK banks to:					
Other UK banks	70.3	78.0	87.5	96.1	103.7
Other UK residents	11.1	10.4	11.5	11.9	13.5
Overseas central monetary institutions	52.3	58.4	61.4	57.9	61.4
Other banks overseas	142.8	162.2	170.0	186.0	198.6
Other non-residents	39.6	46.6	51.0	55.2	57.4
Other liabilities(b)	2.8	2.7	3.3	3.1	3.5
Total liabilities	**318.9**	**358.3**	**384.7**	**410.2**	**438.1**
Foreign currency assets of UK banks with:					
Other UK banks	68.0	76.3	85.1	92.6	99.4
Other UK residents	22.9	22.1	22.1	22.6	25.6
Banks overseas	164.0	190.1	204.3	216.2	227.1
Other non-residents	59.2	64.3	68.1	73.2	80.6
Other assets(b)	5.0	5.5	5.8	5.9	7.1
Total assets	**319.7**	**358.3**	**385.4**	**410.5**	**439.8**

(a) Figures differ from those in Table 6 in the statistical annex (see additional notes to Tables 13 and 14).
(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	
	29 June	28 Sept.	31 Dec.	31 Mar.	30 June
BIS reporting area:					
European area	– 7.6	– 6.7	– 3.5	– 7.4	– 3.7
Canada	– 0.9	+ 0.4	+ 0.5	– 0.5	– 0.5
Japan	+10.9	+11.8	+12.9	+13.5	+16.0
United States	–14.7	–18.9	–15.9	–13.9	–18.7
Offshore banking centres	+11.5	+15.9	+14.8	+14.5	+12.5
Other Western Europe	+ 0.3	– 0.1	+ 1.4	+ 4.0	+ 4.7
Australia, New Zealand and South Africa	+ 2.3	+ 2.5	+ 2.3	+ 2.1	+ 2.7
Eastern Europe	+ 9.0	+ 9.2	+ 8.6	+10.1	+10.7
Oil-exporting countries	–18.3	–24.9	–27.6	–31.2	–33.1
Non-oil developing countries	– 0.7	+ 0.6	+ 2.4	+ 7.2	+ 8.4
Other(b)	– 4.7	– 3.6	– 7.9	–11.7	–13.8
Total	**–12.9**	**–13.8**	**–12.0**	**–13.3**	**–14.0**

(a) The breakdown corresponds to that in Table 13 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.	Mid-May
Less than 8 days(a)	4.6 *3.3*	5.2 *3.9*	5.1 *3.9*
8 days to less than 1 month	3.5	3.6	3.3
1 month to less than 3 months	5.1	5.4	4.7
3 months to less than 6 months	2.3	2.7	3.5
6 months to less than 1 year	0.5	0.4	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.

main features were increases of $6½ billion in euro-Swiss franc liabilities and $4½ billion in euro-sterling liabilities. Of the latter, $1½ 1·2 billion came from UK bank and non-bank residents and just under $1 billion from oil-exporting countries; nonetheless, the euro-sterling market remains small in comparison with the euro-currency markets in dollars, deutschemarks and Swiss francs.

Incomplete data for the second quarter suggest that the growth in international lending may have lost some of the impetus evident in previous quarters.

London market (second quarter of 1980)
There was a considerable slowdown in the growth of the London euro-currency market in the quarter to end-June. After adjustment for the effects of exchange rate fluctuations, the gross foreign currency liabilities of banks in London rose by $18 billion, compared with $33 billion in the previous quarter. Increased activity with banks overseas was responsible for over half this growth.

Liabilities to the oil exporters increased by only $3 billion in the quarter, despite a rise of $5 billion during the first seven weeks. The position of UK banks *vis-à-vis* the non-oil developing countries showed little change. However, net claims on Latin America rose by $2 billion.

The maturity analysis of the foreign currency positions of UK banks[1] at mid-May shows a considerable improvement in the short-term net liability position of the British banks which at sight to six months moved from 29.1% of total claims in November to 26.9% in May. The positions of other bank groups was virtually unchanged.

BIS half-yearly maturity analysis of country data (second half of 1979)
The analysis for end-December 1979[2] shows an increase in external claims of 14% over the level at end-June—a significantly larger rise than in the first half of 1979—with nearly half of the increase going to Latin America. There was a marked shortening in the maturity profile of claims on Latin America—59% were for periods of up to one year compared with 45% in the first half-year.

The data also reveal a fall of $ 12 billion, to $90 billion, in the level of undisbursed commitments; two thirds of the fall was accounted for by the position *vis-à-vis* Latin America. Brazil's undrawn facilities declined by $4 billion, to $7 billion, while its deposits with banks fell by $1 billion.

Medium-term euro-currency credit markets
Almost $18 billion of new medium-term credits were announced in the second quarter.[3] In nominal terms this was virtually the same as the quarterly average for 1979 and represented some recovery from the first quarter figure of $16 billion. In real terms, however, new credits in the first half of 1980 were some 23% lower than in the first half of 1979, and there was a further fall in July. The table

(1) See Table 14 in the annex.
(2) The UK contribution to the half-yearly analysis, which sets out by maturity the claims of banks in the Group of Ten countries, Austria, Denmark, the Republic of Ireland and Switzerland on countries outside this area, appeared as Table 14 in the annex to the June *Bulletin*.
(3) The Bank of England records medium-term euro-credits with maturities of three years or more on the date of the announcement. The BIS records euro-credits only when they are taken up.

Announced new medium-term credits
$ billions

	1979 1st half	1980 1st half	1980 1st half adjusted(a)
Larger OECD countries	5.0	6.7	5.7
Other OECD countries	6.1	10.9	9.4
Non-oil developing countries	15.8	10.5	9.0
Oil-exporting countries	4.2	4.6	4.0
Eastern bloc	2.2	1.2	1.0
Other (mainly China)	3.0	—	—
Total	**36.3**	**33.9**	**29.1**

(a) Deflated by the dollar index of world manufactured export prices based on 1979 first half = 1.0.

Identified deployment of oil exporters' surpluses[a]
$ billions

	1977 Year	1978 Year	1979 Year	1979 Q4	1980 Q1	1980 Q2(b)
United Kingdom						
British government stocks	—	−0.3	0.4	0.2	0.4	0.7
Treasury bills	−0.2	0.2	—	−0.6	0.6	−0.4
Sterling bank deposits	0.3	0.2	1.4	0.7	0.8	0.6
Other sterling investments(c)	0.4	0.1	0.4	0.1	0.1	—
British government foreign currency bonds	0.2	—	—	—	—	—
Foreign currency bank deposits	3.1	−2.0	14.8	3.5	4.1	1.9
Other foreign currency borrowing	—	—	0.2	0.2	—	—
	3.8	−1.8	17.2	4.1	6.0	2.8
United States						
Treasury bonds and notes	4.3	−1.5	−1.1	0.4	2.1	2.4
Treasury bills	−0.9	−0.9	3.3	1.9	1.3	−0.4
Bank deposits	0.4	0.8	5.0	3.7	−0.8	2.6
Other(c)	3.5	2.5	−0.4	0.4	0.7	1.0
	7.3	0.9	6.8	6.4	3.3	5.6
Other countries						
Bank deposits	7.5	5.0	16.4	6.1	8.3	..
Special bilateral facilities and other investments(c)(d)	12.8	10.4	18.3	4.6	5.0	..
	20.3	15.4	34.7	10.7	13.2	..
International organisations	0.3	0.1	−0.4	0.3	0.7	..
Total	**31.7**	**14.6**	**58.3**	**21.5**	**23.3**	..

.. 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.

shows that there were significant changes in the amounts borrowed by different groups of countries: borrowing by the OECD group increased, while borrowing by the non-oil developing countries and the Eastern bloc fell quite sharply.

The average maturity of loans continued to decline: for the second quarter it was 8 years, compared with 8.3 years in the first quarter and 9.1 years for 1979 as a whole. In July, the average fell to 7.8 years. The decline in maturities has not always been accompanied by a rise in spreads.[1] During the second quarter the range of spreads widened appreciably. Those for some non-oil developing countries and, to a lesser extent, for some borrowers from smaller OECD countries increased, while those for borrowers from major OECD countries remained very fine. For certain borrowers the rise in spread was quite marked.

Foreign and international bond and note markets

The bond markets were buoyant in the second quarter of 1980 as yields followed the downward trend of interest rates in the domestic markets for the major currencies. Publicised foreign and international bond issues and placements totalled $11.5 billion, the largest quarterly figure recorded, and a significant break in the generally downward trend of new issues over the previous five quarters. There was also a high level of activity in July.

The recovery in the second quarter was largely the result of an improvement in the dollar sector. A precipitous fall in interest rates in the second quarter (when the three-month euro-dollar rate fell from around 20% to almost 9%) and a more modest decline in bond yields (from 14% to 11%) made it profitable for the first time since August 1978 to finance a bond portofolio with short-term borrowing. New issues rose by $5.2 billion, to $6.5 billion. By the end of the period there were signs of a glut which was aggravated by some over-optimistic pricing as managers expected a more pronounced fall in yields than that which occurred. Interest rates showed a slight upward trend in July and, coinciding with the start of the holiday period, new issue volume fell back to $0.8 billion. This decline in activity in the dollar sector during July, however, was partly offset by high levels of deutschemark and Swiss franc issues.

Following the relaxation of exchange controls, the sterling sector expanded significantly. Nine issues, totalling $0.6 billion, were completed between end-March and early August, bringing the amount raised since the turn of the year to $0.8 billion. These included the first euro-sterling floating-rate note and convertible issues[2] and the first foreign sterling bond issue for many years.

Deployment of oil money

The identified deployed cash surplus of the oil exporters in the first quarter was $23 billion—some $2 billion higher than in the previous quarter. The proportion of funds placed in bank deposits reverted to 50% after reaching 75% following last year's rise in oil prices. About $11 billion of the increase in bank deposits was in the form of euro-currency deposits in the United Kingdom and other countries, and $6 billion of this was in currencies other than US dollars. Deposits with banks in the United States fell. As a result,

(1) See the article on page 311.

(2) The floating-rate note issues were £20 million for Scandinavian Bank and £50 million for Lloyds Euro-Finance N.V. The convertible issues were £20 million for The Daiei Inc. (Japan), £15 million for Orient Finance (Japan), and £75 million for Kollmorgen International Finance N.V. (USA).

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

	1977	1978	1979
Merchandise trade	64	44	121
Net invisibles, including official transfers	−37	−45	−47
Current balance	27	−1	74
Net external borrowing etc.	11	20	5
Surplus available for investment	**38**	**19**	**79**
Identified surplus from deployment table	32	15	58
Unidentified balance	6	4	21

the proportion of dollar-denominated bank deposits declined from 68% at end-December 1979 to 65% at end-March, and the proportion of oil-exporting countries' total foreign assets denominated in dollars is estimated to have fallen from 75% to 72%. The proportion of total foreign assets identified as short-term remained high in the first quarter, at just over 50%.

In the second quarter, the oil exporters' identified cash surplus deployed in the United Kingdom and the United States together was again smaller. A little over half of the second quarter inflow was placed in dollar-denominated bank deposits.

Forecasts of oil exporters' current account surpluses in 1980 range between $115 billion and $150 billion.

Commodity markets

The reduced level of speculative interest in markets noted in the previous quarter continued.

In the metals markets, recessionary influences kept prices of base metals relatively low, and the limited upward movements seen from time to time were principally in reaction to short-term factors—such as the copper workers' strike in the United States—and reflected no underlying strength. Silver prices made a modest recovery, but there was no evidence of any significant renewed speculative interest.

In the coffee and cocoa terminal markets there were substantial and steady falls in price against a background of ample supplies and the absence or withdrawal of support from producing countries. The sugar market, however, recorded a net rise in price over a period of marked volatility, the peak being reached in late May. A new terminal market trading main crop potatoes opened in June; steady business was reported.