Financial review

Introduction

The review describes developments in various markets, mainly during the four months to end-February,[1] and in the first two sections seeks to relate the impact of official policy to the environment in which it operates. Money-market conditions and the reserve asset position of the banking system were easier in the first half of the period but, with the advent of the peak tax collection period in January, there were renewed pressures which were offset by a reduction in the minimum reserve asset ratio requirement on banks and by developments in the Bank's money-market techniques. A reduction in minimum lending rate (MLR) from 14% to 12% was announced on 10 March.

The authorities were able to sustain the momentum of the funding programme of the public sector borrowing requirement (PSBR) with substantial net official sales of stock and a large increase in receipts from national savings. An issue of index-linked government stock was announced in the Budget.

In the foreign exchange market, the dollar continued to strengthen with interest rates a major factor throughout the period. Sterling was generally weak against the dollar, but rose against European currencies in December and January before falling back sharply in the second half of February.

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

Money markets

Pressure on the liquidity and reserve asset position of the banking system eased during November and December, but increased again in the New Year with the start of the main tax collection season. Tax payments reached a peak towards the end of January and money-market conditions thereafter were again somewhat easier until late February. Developments in the Bank's money-market techniques, explained below, together with a reduction in the minimum reserve asset ratio requirement on banks, enabled the authorities to offset the pressure in January. A further temporary reduction in the reserve asset ratio was announced late in February, to help the authorities deal with severe cash shortages resulting from the payment on 2 March of petroleum revenue tax.

Developments in techniques

The changes in the Bank's methods of operation, which began in August 1980, also helped to lay the basis for the proposed money-market changes described in the Bank's background note of 24 November on methods of monetary control.[2] They were designed to allow the authorities to put greater emphasis on open market operations than on discount window lending when

(1) A longer period is covered in this issue as the *Bulletin* is being published later than usual.
(2) Reproduced in the December 1980 *Bulletin*, page 428.

relieving cash shortages. They were also intended to permit more flexibility in short-term interest rates and to allow market forces an increasing role in determining the structure of these rates.

One necessary step towards reducing the frequency with which discount houses borrowed 'through the discount window' was for the Bank to make it clear that any such assistance would generally be offered on less advantageous terms than hitherto.

A second necessary step was to increase the flexibility of the Bank's own dealing operations so that, when faced with the need to relieve a cash shortage, the Bank could buy sufficient bills at market-related rates. Changes in this respect had begun as early as August, when the Bank began progressively to modify the conventional structure of its dealing rates in Treasury bills in order to encourage discount houses to sell bills to the Bank in circumstances when previously they might have preferred to borrow from the Bank.

To give greater weight to market factors in the determination of the structure of short-term interest rates, the Bank abandoned the practice of quoting prices at which it would buy bills with over one month to maturity—first in October for eligible bank bills, and then in January for Treasury bills. A house which wished to offer such bills to the Bank thus had to formulate a price itself, and the Bank was free to choose which, if any, offers it accepted. The Bank also made it clear that the price at which it first bought bills on any day would not necessarily be maintained throughout that day.

There was a further change of emphasis in that the Bank increased the proportion of its total open market purchases that was in the form of eligible bank bills. This was necessary because the banking system began the period short of both cash and reserve assets—and purchases of Treasury and local authority bills by the Bank increase only the supply of cash. In contrast, eligible bank bills (which can be counted by a bank as reserve assets up to 2% of its eligible liabilities) can be generated within the banking system. Consequently, when the Bank buys such bills, the banking system receives cash and, if relative interest rates encourage borrowers to issue bills rather than take up overdrafts, the system can also augment the supply of reserve assets. To ease liquidity pressures the Bank therefore frequently bought large amounts of eligible bills(1) in the period under review, although at times—particularly after the reduction in the minimum reserve asset ratio early in January (see below)—the Bank also bought significant quantities of Treasury and local authority bills.(2)

Management of the market

As already noted, there was a considerable shortage of liquidity in the money market at the beginning of the period under review, and the official facilities for the purchase and resale of gilt-edged stocks were rolled over at only a slightly reduced level into November.(3)

(1) Throughout the period, the Bank usually bought bills outright rather than on a purchase and resale basis as had been the case earlier in 1980. This change of approach followed in part from the form of the monetary controls on discount houses (see the additional notes to Table 2 in the statistical annex) which effectively limit the amount of eligible bills and other private sector assets which any house can hold. The houses were reluctant to replace bills sold to the Bank on a resale basis by buying more bills in the market, because they did not know whether the Bank would roll the agreements forward when they matured. This indirectly constrained the creation of additional reserve assets by the banking system.

(2) On 9 January, the Bank also reduced the amount of Treasury bills on offer each week from £200 million to £100 million. This step—which followed a similar reduction of £100 million last August—reflected the fact that, with cash so short, issues of Treasury bills generally had to be offset by additional open market purchases by the Bank. At the same time, the Bank suspended its requirement that at least 15% of the security lodged against a loan from the Bank should be in the form of Treasury bills.

(3) See the December 1980 *Bulletin*, pages 411–2.

But by 24 November, largely because of a persistent and heavy flow of net government payments, conditions had eased sufficiently to allow half of the facilities for the purchase and resale of gilt-edged stocks to lapse, and the other half lapsed on 3 December. On days when there were cash shortages, the Bank was generally able to buy enough bills to offset the pressure. With banks monitoring their reserve asset positions more carefully each day (as they had been asked to do),(1) 'make-up' day in both November and December passed without the temporary upward pressure on very short-term interest rates which gives scope for arbitrage.

The market's cash position tightened somewhat in the two weeks before Christmas, partly under the pressure of the seasonal rise in the note issue (which drained cash from the banks), and partly because of substantial government stock sales (see below). Conditions were particularly tight on Christmas Eve when, for the first time in several months, there was some discount window lending.

On 2 January, the Bank announced that the banks' minimum reserve asset ratio requirement would be reduced from 12½% to 10% of eligible liabilities with effect from 5 January.(2) In the light of the announcement on 24 November that the reserve asset ratio requirement would be abolished as soon as appropriate liquidity provisions had been introduced, this reduction in the minimum ratio seemed to the authorities to be a suitable response to the prospective drain of cash from the banking system during the peak tax collection period. The reduction potentially released £1,700 million of reserve assets.

Cash shortages did begin to appear shortly afterwards, partly because of a large call on a gilt-edged stock and partly because of the first heavy tax payments. The market subsequently became extremely short of cash, and in one week (19–23 January) the Bank bought over £1,500 million of Treasury, local authority and eligible bank bills. Thereafter, a more normal pattern of government receipts and payments re-emerged. Although a significant amount of gilt-edged stock was sold in late January and in early February, and cash was also withdrawn from the market on 6 and 13 February to meet calls on stocks sold earlier, the Bank was able to offset occasional shortages without difficulty. There was a further significant call at the end of February on stock sold earlier. In anticipation of this and of the massive government receipts expected on 2 March from payments of petroleum revenue tax, the Bank announced on 24 February that the banks' minimum reserve asset ratio requirement would be reduced from 10% to 8% of eligible liabilities between 2 and 10 March.

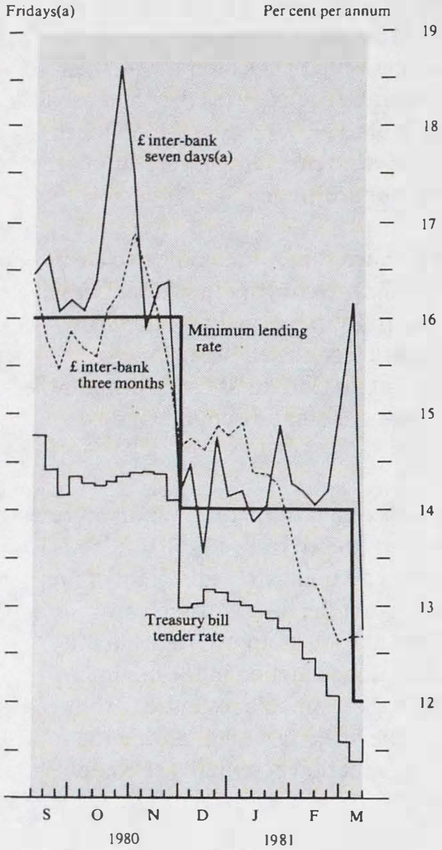
Interest rates

The cut in MLR from 16% to 14% on 24 November had already been partly discounted in longer-term interest rates, but short-term rates reflected the fall more fully. Thereafter, inter-bank rates were generally steady through December, though rates for periods of one week and less reflected shortages as they occurred and rates for periods below three months rose by up to three quarters of a point in the second half of the month. All rates, but particularly those at the very short end, eased after the announcement of the cut in the reserve ratio requirements on 2 January, and longer rates declined

(1) See the December 1980 *Bulletin*, page 413.

(2) The minimum required ratio had been 12½% since it was first introduced in September 1971.

Short-term interest rates in London



(a) The seven-day LIBOR observations are for Wednesdays

further towards the end of the month as expectations of an imminent reduction in MLR strengthened. Rates of one month and less, however, were kept up first by the cash shortages noted above,[1] and then by the growing desire of borrowers to maintain their holdings of longer-term assets ahead of a possible cut in MLR. When MLR was not reduced early in February, longer rates firmed a little, but the pattern within each week still tended to reflect some expectations of an early cut. Speculation that a cut in MLR might be larger than hitherto expected led to further significant falls in longer rates in the last week of February, to a point where rates of three months and over fully discounted a 2% decline in MLR.

The Bank's change of emphasis towards dealing in eligible bills encouraged a reduction in the rates on these bills relative to rates on securities such as certificates of deposit and ineligible bills in which the Bank does not deal. The rate on eligible bank bills also fell a little compared with that on Treasury bills.

Following the announcement on 24 November of the reduction in MLR, clearing bank base rates moved down from 16% to 14%, and their seven-day deposit rates from 14% to $11\frac{1}{2}$% or 12%. By January, all banks' deposit rates were at $11\frac{1}{2}$%. After the cut in MLR to 12%, banks' base rates were reduced to 12% and deposit rates to 9%.

Summary

Overall, the market has adapted readily to the changes made so far by the Bank in its money-market operations. Discount window lending in the period was very limited, and both the Bank and the main market-makers in bills have become able to respond more quickly in their bill dealings to emerging cash shortages or surpluses. Further changes will be required before the proposals set out by the Bank in its November background note can be implemented fully; but the speed and ease with which it has been possible to move so far have been encouraging (see also page 38).

Capital markets

The gilt-edged market

With sterling M_3 and the PSBR both running above target, it was necessary to maintain the momentum of the programme of sales of government stocks throughout the period covered by the review. Despite several setbacks to market sentiment, substantial sales were in fact achieved.

At the beginning of November, the authorities had two tap stocks in operation—$11\frac{3}{4}$% Exchequer Stock 1986 and 3% Treasury Stock 1985 'A'—and the market was reasonably firm, despite rapidly rising US interest rates and official statements which had been taken as implying that there was only limited scope for early falls in UK short-term interest rates. The effects of the announcement on 4 November of a worse-than-expected set of banking statistics for October and of further increases in US prime rates were only temporary. A growing expectation of an imminent cut in MLR, good trade figures for October and acceptance of a moderate pay deal at BL Ltd caused prices to rise, particularly among long-dated stocks. The authorities moved to take advantage of this recovery

(1) The January make-up day came in the middle of the heaviest pressure; late on that day very short-term inter-bank rates rose sharply and unexpectedly.

by announcing a long-dated stock—$11\frac{3}{4}$% Treasury Stock 2003–07 'A'—on 14 November (see the table for details of this and subsequent stock issues). This was the first stock with a maturity of over twenty years to have been issued since June. £40 per cent was payable on application (the first day of banking December), and the balance in banking January.

Issues of gilt-edged stock (four months to end-February)

Stock	Amount issued (£ millions): Total	Amount issued (£ millions): *of which to NDC*(a)	Date announced	Date issued	Date exhausted	Minimum price per £100 stock (£)	Payable per £100 stock: On tender (£)	Payable per £100 stock: Second instalment (£)	Payable per £100 stock: Third instalment (£)	Redemption yield (per cent)
$11\frac{3}{4}$% Treasury Stock 2003–07 'A'	1,000	—	14/11	20/11	20/11	92.50	40.00	52.50 on 9/1	—	12.73
$11\frac{1}{2}$% Treasury Stock 1989 'A'	1,350	*350*	21/11	26/11	19/12	92.00	30.00	30.00 on 16/1	32.00 on 13/2	13.10
$12\frac{1}{4}$% Exchequer Stock 1992(b)	100	—	22/12	22/12	—	—	—	—	—	—
$12\frac{1}{2}$% Exchequer Stock 1994(b)	100	—	22/12	22/12	—	—	—	—	—	—
$10\frac{1}{2}$% Exchequer Stock 1997(b)	100	—	22/12	22/12	—	—	—	—	—	—
$12\frac{1}{4}$% Exchequer Stock 1999 'B'	1,100	*100*	2/1	7/1		89.75	20.00	50.00 on 6/2	19.75 on 6/3	13.79
12% Exchequer Convertible Stock 1985(c)	1,000	—	23/1	28/1	2/2	97.00	40.00	57.00 on 27/2	—	12.96
12% Treasury Stock 1986	1,150	*150*	6/2	11/2	24/2	96.00	20.00	30.00 on 13/3	46.00 on 10/4	13.08
3% Treasury Stock 1986	500	—	27/2	4/3		69.50(d)	69.50	—	—	10.80

(a) National Debt Commissioners.
(b) See text for explanation.
(c) Convertible into $13\frac{1}{2}$% Exchequer Stock 1992.
(d) Payable in full on application.

Several factors, particularly the widespread expectations of an early cut in MLR, brought buyers into the market and a large amount of the 1986 tap was sold on 19 November; on the following day the new long-dated issue was so nearly subscribed in full that it could not be operated as a tap stock. After further sales the 1986 stock was withdrawn as a tap stock on 21 November and, with the market still firm, another stock—$11\frac{1}{2}$% Treasury Stock 1989 'A'—was announced on the same day. This time, the payments were arranged to fall roughly equally in banking December and in the subsequent two banking months to avoid an excessive drain of cash from institutional funds and from the money market during the main tax season beginning in January.

After the Chancellor's statement on 24 November,[1] short-dated stocks remained quite firm in response to the cut in MLR, but longer-dated stocks subsequently weakened and there were minimal subscriptions for the new stock. Sizable official sales of non-tap stocks were possible as the market rallied, notably when the miners accepted their pay offer on 1 December, but rapidly rising US prime rates helped to leave the market weak ahead of the announcement of the November banking statistics and central government borrowing requirement. Both of these were much worse than had been expected and, with US prime rates reaching 20%, prices fell sharply for several days. Following this abrupt price adjustment, the market established a new trading level, and on 16 December the Bank was able to activate for the first time the tap stock, $11\frac{1}{2}$% Treasury Stock 1989 'A', and made large sales, albeit at a discount of £$4\frac{7}{8}$ per cent. The stock was exhausted on 19 December.

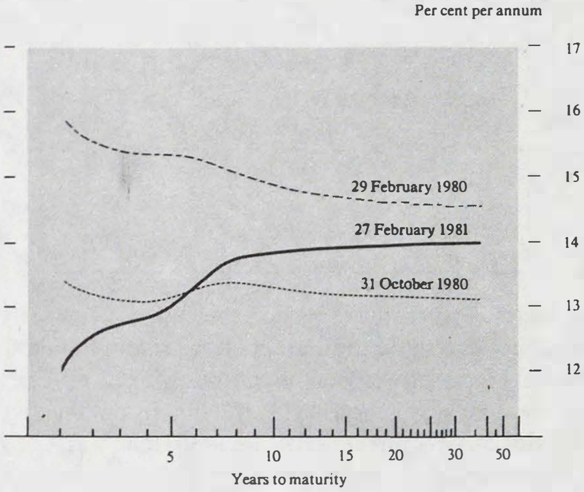
With only the low-coupon stock then available as a tap, the authorities needed additional stock to be in a position to exercise influence in the market if that became necessary during the Christmas period; but a conventional issue could have meant offering the stock for sale on Christmas Eve when large money-market shortages were already likely (see above) and when

(1) See the December 1980 *Bulletin*, page 393.

applications by the general public would be subject to seasonal postal delays. Instead, the authorities issued an additional £100 million of each of three existing stocks to the Issue Department of the Bank, for sale through the market when appropriate. In the event, the market was quiet over the holiday period.

On 2 January, a new conventional stock was announced, 12¼% Exchequer Stock 1999 'B'. Only a small payment was required on application because significant sales of other stocks were already assured for banking January; the balance was to be paid in February and March. Applications, on 7 January, were very modest; and for much of the next two weeks prices generally drifted lower, with sentiment affected particularly by concern over the size of the PSBR.

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.

Against this background, and despite widespread market expectations of a significant fall in yields later in the year, it seemed possible that the market might remain subdued ahead of the Budget on 10 March. With only limited funding secured for banking February by way of calls on stocks previously sold, it was decided to seek to maintain the momentum of debt sales by offering a different type of stock, 12% Exchequer Convertible Stock 1985. This was a conventional short-dated stock which gave the right to convert into a longer-dated (1992) stock on any one of five dates over two years, beginning in September 1981. The stock was announced on 23 January. The minimum tender price was set broadly in line with prices on comparable short-dated stocks, leaving the market to determine the value of the conversion option; the conversion terms gave a yield on the 1992 stock below that then ruling on this stock, the yield difference increasing from about ½% per annum to 1¾% per annum the longer conversion was delayed. In effect, a holder was being offered a series of options to convert into a medium-dated stock in the future at prices increasingly above the current price, or to retain a conventional short-dated stock offering a fully competitive rate of return.

This novel approach[1] was well received; applications at the tender, on 28 January, were substantial, and further sales were possible at rapidly increasing prices until the stock was exhausted at three quarters of a point premium on 2 February. The market as a whole was encouraged by evidence that the funding momentum was being sustained and by re-emerging expectations of an early cut in MLR. The low-coupon stock, 3% Treasury Stock 1985 'A', which had been reactivated briefly in mid-January, was also exhausted on 2 February when there were, in addition, significant sales of the long-dated tap stock.

Against the possibility of further demand at the short end of the market, a conventional short-dated stock—12% Treasury Stock 1986—was announced on 6 February; but with MLR unchanged and with the publication on 10 February of banking statistics for January that were much as expected, subscriptions for the new stock were only modest. Demand for short-dated stock picked up in the middle of the month on renewed hopes of a large cut in MLR in the Budget, and the tap stock was exhausted following heavy sales on 23 and 24 February. A new low-coupon stock—3% Treasury Stock 1986—was announced on 27 February, and in the Budget the Chancellor announced the issue of the first index-linked government stock—2% Index-Linked Treasury Stock 1996.

(1) A convertible stock was issued in 1973, but it offered only one conversion date and that after seven years.

During the three banking months to mid-February, total cash issues of gilt-edged stocks (the aggregate over which the authorities have most influence) totalled some £3.8 billion (see table). Of this, some £1.7 billion effectively offset the cost of redemptions and of official buying-in of stocks within a short period to maturity. Net sales to UK non-bank residents—the figure most immediately relevant to the control of sterling M_3—also amounted to £1.7 billion. Over the year to mid-February, total cash issues amounted to nearly £15 billion. Redemptions and buying-in absorbed £4.4 billion; while non-bank UK residents bought an additional £7.4 billion (net).

Sales of gilt-edged stocks

£ billions

	Total cash issues	Redemptions and buying-in of next maturities	Net sales to UK non-bank residents
Banking months			
Mar. 79–May 79	2.4	0.3	2.1
June 79–Aug. 79	4.5	1.5	2.5
Sept. 79–Nov. 79	3.2	1.5	1.6
Dec. 79–Feb. 80	4.9	1.3	3.1
Mar. 80–May 80	1.8	0.4	1.3
June 80–Aug. 80	5.0	1.1	2.0
Sept. 80–Nov. 80	4.2	1.2	2.4
Dec. 80–Feb. 81	3.8	1.7	1.7

During the four months to end-February, yields on the shortest maturity stocks fell by between ½% and 1%, while yields on stocks with more than five years to maturity rose by 1% or more. As a result, the time yield curve exhibited a more normal profile, with yields on long-dated stocks about 1% to 1½% above those of short-dated maturities.

National savings

Net receipts from national savings picked up sharply in the three months to end-January (see table). This improvement, largely the result of the introduction on 17 November of a new index-linked certificate for persons aged sixty and over,[1] continued into 1981. It was helped by the increase to £5,000 in the limit on holdings of the nineteenth issue of ordinary certificates and also by the maintenance of an attractive interest rate on National Savings Bank investment accounts (included in the definition of national savings from 1 January). The Government have made it clear that they intend to continue to attract a significant share of personal savings into national savings in order to facilitate monetary control, thereby avoiding undue pressure on the gilt-edged market.

Other markets (three months to end-January)

In the private sector, net issues of equity capital by UK-listed public companies were the highest in any such period since 1976.[2] These included two particularly large issues—by Consolidated Gold Fields (£188 million) and by Royal Insurance (£121 million); in contrast, manufacturing industry raised only £55 million (net) over the three months.

Other capital markets (including national savings)

£ millions; *not seasonally adjusted*
Net cash raised +

Calendar months	Feb. 80– Apr. 80	May 80– July 80	Aug. 80– Oct. 80	Nov. 80– Jan. 81
A **National savings**(a)				
Inflow	+381	+208	+194(b)	+965(b)
of which, index-linked certificates	*+227*	*+204*	*+126*(b)	*+767*(b)
B **Local authorities**				
Stocks	− 44	− 22	− 90	− 79
Negotiable bonds	+ 34	+ 4	+ 4	+ 16
C **Private sector**				
Loan capital and preference shares(c)	− 29	− 16	+ 57	− 75
Equity capital(c)	+ 58	+301	+289	+439
Unit trusts	− 6	+ 26	+ 42	+ 44

(a) Includes National Savings Bank investment accounts from January 1981. Inflows in January amounted to £156 million.
(b) Provisional.
(c) Net issues by listed UK public companies.

In the equity market, the FT-Actuaries industrial (500) share price index reached a new peak, of 329.58, on 21 November, but it fell back after the Chancellor's statement on 24 November, and again in the following week under the influence of concern over rising interest rates in the United States and over prospects for profits in the United Kingdom following poor results from Courtaulds. Prices then moved fairly narrowly until early in January when the market was depressed by a wave of selling of American stocks in New York and then by generally gloomy domestic news, including the start of the seamen's strike on 12 January. There was a modest recovery towards the end of the month, boosted by hopes of lower interest rates, but the 500 share index on 30 January was still some 8% below its November peak. Over half of this loss was recovered in February, largely on hopes of an easing in the financial pressures on companies—notably, through a decline in interest rates. Demand

(1) The certificate was more attractive than the one it replaced in two respects: for the first time men aged between 60 and 65 were eligible to buy certificates, and the maximum individual holding was £3,000, against £1,200 for the previous certificate.
(2) All rights issues made by BL Ltd and taken up by the National Enterprise Board are excluded in making this comparison.

was sufficiently strong for prices to fall back only temporarily when, late in the month, ICI cut its dividend.

Redemptions of loan capital and preference shares exceeded new issues, as had been the pattern for much of 1980. Yields on existing issues in this market rose by just over $\frac{1}{2}\%$ in the three months, fractionally less than the rise in comparable gilt-edged stocks.

Net sales by unit trusts totalled £80 million, substantially more than earlier in 1980.

The local authority market remained fairly quiet. Redemptions of stock totalled £84 million (there has not been a new issue of stock since 1978), while in the negotiable bond market there were net new issues of £16 million.

In January, Iceland became the second foreign sovereign borrower (following Denmark in July 1980) to make a stock issue in the sterling domestic market since the ending of exchange control.(1) The issue, for £15 million, was in partly-paid form and had a thirty-five year maturity. The bonds were issued to give a gross yield to redemption of a little over 15% per annum, just over 1% above a gilt-edged stock of comparable maturity.

The Bank welcomes the prospect of a resumption of foreign issues—whether by sovereign or corporate borrowers—in the United Kingdom and has been in close touch both with market intermediaries and with prospective borrowers to establish an efficient and orderly framework for such issues. The market is open to foreign borrowers without restriction, although they, like domestic borrowers, are required to obtain the Bank's prior agreement to the timing of an issue. This requirement is administered by maintaining a queue of prospective new issues whose sole purpose is to sustain a regular flow of issues by preserving orderly conditions. To end-February, a number of prospective borrowers other than Denmark and Iceland had joined the queue, but deferred their issues in the hope that long-term interest rates would fall. As gaps thus opened up in the queue, the Bank invited other potential borrowers—of whom there are a number—to bring their issues forward and sought by this means to accelerate the flow of foreign issues. In mid-March, Sweden announced a £50 million issue.

Foreign exchange and gold markets

Summary

The foreign exchange markets were quiet in November and December as dealers closed their positions towards the end of the year, but thereafter activity increased markedly. Interest rate considerations dominated throughout the period, although tensions in the Middle East and Poland also continued to affect the exchange markets. The dollar was underpinned by the Federal Reserve's continuing tight monetary policy in the face of the unexpected strength in the economy and the reappearance of inflationary pressures. Sterling weakened against the dollar, and after strengthening considerably against European currencies in December and January, it fell back sharply in the second half of

(1) In addition, in the four months to end-February, five foreign companies floated capital issues in sterling, totalling £77 million. Four of these issues were syndicated internationally; the fifth was placed mainly with domestic investors.

February to lose most of its earlier gains. Relatively high domestic interest rates, together with a persistent and large current account surplus and the United Kingdom's strong energy position, were the main factors behind the initial strength of sterling, while further falls in the annual rate of increase in retail prices gave additional encouragement; but these factors were later offset as interest rates fell in anticipation of a substantial cut in MLR. Both sterling and the dollar reached their highest levels in Europe for between three and seven years. The exchange rate mechanism of the European Monetary System (EMS) came under pressure: the Belgian franc weakened to remain at the bottom of the EMS, while the deutschemark was also heavily sold for much of the period. The yen, supported by investment demand, remained very firm. Gold fell steeply to below $500 an ounce as the level of US interest rates greatly increased the cost of financing holdings.

Sterling

Sterling began November very firm on substantial commercial demand and was given a further stimulus by the October banking figures which dispelled market fears of a cut in MLR. The effective index (ERI) rose to a record 103.4[1] in the first week, and sterling reached its highest levels for several years against the French franc, deutschemark and Swiss franc.

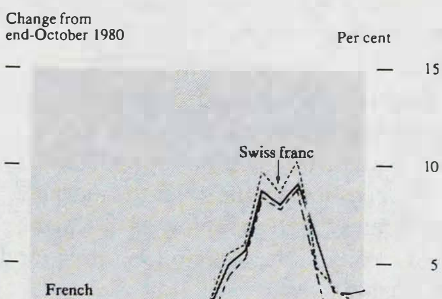
As US interest rates began to rise, the uncovered interest rate differential turned against London, and sterling fell back. The announcement on 17 November of a large trade surplus in October was offset by growing anticipation of a cut in MLR, and in the event the reduction in MLR on 24 November had already been largely discounted by the market. Sterling dipped briefly to 99.0 in effective terms after the announcement, but finished the month steady at 99.9.

In December, sterling initially held firm against a steadily strengthening dollar, but fell back sharply on 11 December on reports of a major oil producer diversifying out of sterling. However, the November trade figures, published on 15 December, underlined the strength of the balance of payments, and sterling settled to trade quietly in the $2.31–2.33 range. As dollar interest rates eased in the week before Christmas, sterling began to recover, and continued to strengthen in thin markets between Christmas and the New Year on commercial and investment demand. It finished the year at $2.3920, up 4 cents on the month, and at 101.4 in effective terms.

The combined effect of a continued fall in US interest rates and a large buying order from the Middle East gave sterling a firm start to the New Year. Later, while continuing to strengthen against European currencies, it fell back against the dollar as the Federal Reserve appeared to tighten domestic monetary conditions. There was a brief rally to $2.4330, as US interest rates fell sharply in the wake of the release of the US hostages, but thereafter US rates began to move upward again and sterling eased. Advances against European currencies continued unabated, however, and the ERI closed the month at 105.2, having reached 105.6 shortly before.

Sterling began February weaker on expectations of an imminent and possibly substantial cut in MLR but, in the absence of any reduction, the rate quickly recovered, helped later in the month by announcements of a further fall in the rate of increase in retail prices and another very large trade surplus in January. Although

Sterling against selected foreign currencies



(1) The effective exchange rate indices for the major currencies have been revised to take account of 1977 trade flows and have also been rebased so that 1975 average rates = 100. The changes are explained in more detail in the technical note on page 69.

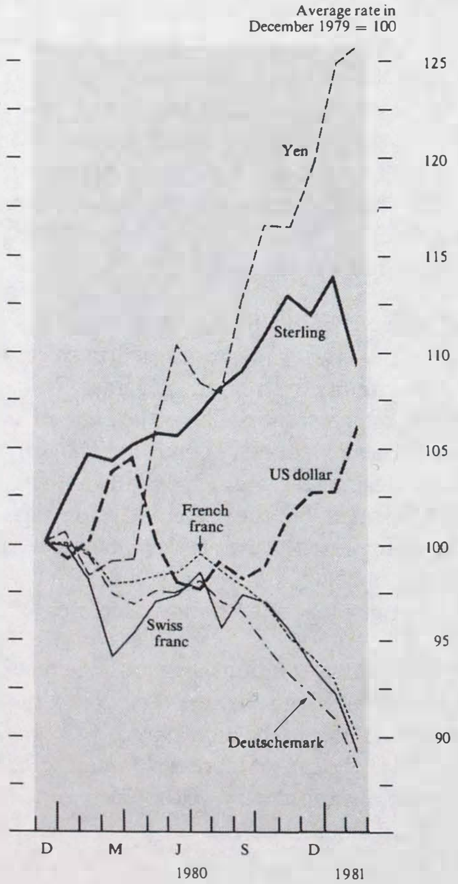
continuing to ease against a very strong dollar, sterling made further advances in Europe, and on 16 February touched DM 5.07 and Sw. Fcs. 4.62, levels not recorded for nearly five years, and Fr. Fcs. 11.71, the highest for over six and a half years. These peaks were short lived, however, as sterling was depressed by concern about a possible miners' strike and then fell further on expectations that a substantial reduction in MLR would be announced in the Budget. It closed February at $2.2032, with the ERI at 98.9, a fall of 6% over the month in effective terms.

Changes in UK official reserves
$ millions

	1980		1981	
	Nov.	Dec.	Jan.	Feb.
Change in reserves	**+163**	**−713**	**+918**	**+ 40**
IMF oil facility repayment	—	—	− 78	—
Other HMG capital repayments	−100	−374	—	—
SDR allocation	—	—	+373	—
EMCF swap valuation gain	—	—	+266	—
Exchange cover scheme:				
Borrowing	+159	+ 70	+213	+100
Repayments	− 17	−447	−164	− 56
Underlying change in reserves	**+121**	**+ 38**	**+308**	**− 4**

The UK reserves rose by $408 million to $28,434 million in the four months to end-February (see table). The oustanding portion of the $1½ billion HMG euro-dollar loan raised in February 1977 and renegotiated in August 1978 was repaid and a capital repayment of $124 million was also made on the long-term North American loans in December. In January the UK received an allocation of SDR298 million ($373 million) from the International Monetary Fund, the final instalment of the three-year disbursement programme. The underlying increase in the reserves over the four-months was $463 million.

Indices of effective exchange rates



US dollar

The dollar continued to strengthen in November as US interest rates rose and the market reacted favourably to the result of the Presidential election. The upward trend was temporarily interrupted by heavy selling from the Middle East and concern that interest rates might have peaked, but it resumed after the Federal Reserve on 17 November increased the discount rate to 12% and introduced a surcharge of 2% on larger banks that borrow frequently at the discount window; meanwhile indicators showed continued buoyancy in the economy. With monetary aggregates continuing to exceed targets, the Federal Reserve maintained its tight credit stance, increasing the discount rate to 13% and the surcharge to 3% on 5 December. Supported by rising interest rates the dollar then strengthened further and reached 97.4 in effective terms (1) in the middle of December. Prime rates rose to a peak of 21½% on 19 December, but thereafter rates began to ease; these fell further after the announcement on 5 January of a sharp drop in the monetary aggregates, and the dollar weakened. However, the Federal Reserve made it clear both through testimony by Chairman Volcker to Congress and in its operations in the domestic market that it would not allow interest rates to fall as rapidly as in April 1980. Federal funds were held mostly in the 17% to 19% range and the dollar began to strengthen again.

The resolution of the Iranian hostage crisis, and positive reactions to policy statements by the new Administration, gave the dollar further impetus, and it reached new three-year peaks against European currencies in the middle of February (DM 2.25, Sw. Fcs. 2.06, and Fr. Fcs. 5.20). Thereafter, however, the dollar reacted as interest rates eased, falling further when the West German and Swiss authorities took measures to support their currencies, but it subsequently recovered as the Federal Reserve tightened domestic monetary conditions and later announced lower monetary targets for 1981; it closed the month at DM 2.1250, and 100.6 in effective terms.

Other currencies

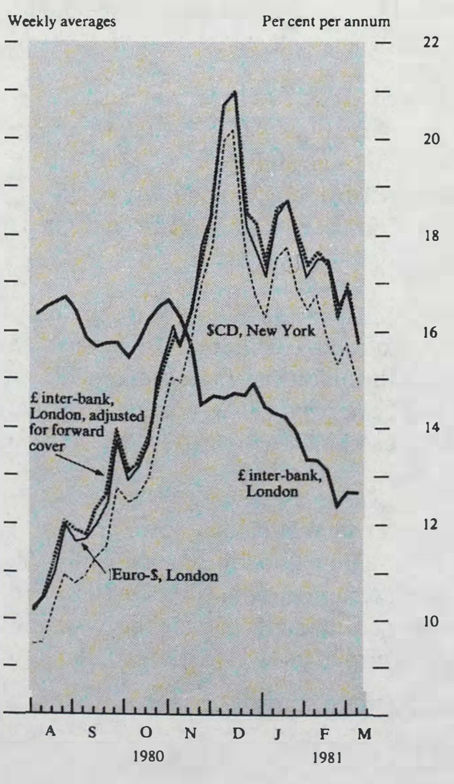
Pressures within the EMS continued as all European currencies weakened against the dollar. The margin between the weakest and

(1) 1975 average = 100.

strongest currencies observing $2\frac{1}{4}\%$ limits rarely fell below 2% and reached the permitted maximum frequently. A package of measures introduced in France on 7 November (which included reserve requirements on non-resident deposits) helped to ease pressure between the deutschemark and the French franc; the Belgian franc and Dutch guilder took over as the weakest and the strongest currencies, respectively. But in mid-December the French franc, buoyed up by high interest rates and overseas borrowing, rose to the top of the grid again. The Belgian franc, depressed by a poor balance of payments position, remained at the bottom for most of the period, and its divergence indicator reached 86 towards the end of February, despite substantial intervention. It was occasionally replaced at the bottom of the EMS by the deutschemark, which was under considerable pressure because of a weak balance of payments, increasing tension in Poland and capital outflows into the dollar. In February, the West German authorities took measures to stem the sharp fall in the deutschemark, including the removal of restrictions on non-resident purchases of short-term domestic paper, and a change in Lombard arrangements. West German domestic interest rates rose sharply and the deutschemark recovered some of its earlier losses to move to the top of the EMS by the end of the month.

The Dutch guilder, the second strongest currency in the EMS, was helped by the sustained fall in inflation, while the Danish krone remained comfortably around the middle of the band. The Irish pound remained near the bottom, seemingly unaffected by the strength of sterling; its discount on sterling widened from 19% to 22%. The lira grew weaker, burdened by a large balance of payments deficit and high inflation. Its margin against the strongest currency widened to reach over 4% at times in both January and February, and despite official intervention it fell as low as Lira 1061.50 against the dollar. To combat this weakness, the authorities introduced further credit restrictions at the end of January.

UK and US three-month interest rates



The Swedish krona required support for most of the period, but came under particularly heavy pressure in January. The downward pressure was reversed, following a 2% increase in the discount rate, to a record 12%, measures to reduce the government deficit and a new wage agreement. The Norwegian krone continued to be sustained by North Sea oil revenues and fell less against the dollar than did most other European currencies. In Switzerland, despite increases in discount rate (to 4%) and Lombard rate (to $5\frac{1}{2}\%$) the Swiss franc weakened to Sw. Fcs. 0.92 against the deutschemark.

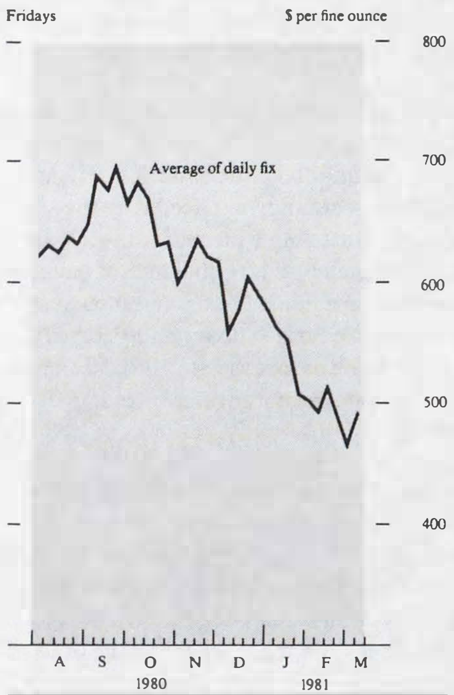
The yen continued to be supported by strong investment demand, which more than offset any concern about oil supplies. The rate weakened only slightly when the discount rate was cut by 1% on 5 November, but fell quite sharply to ¥218.25 against the dollar when exchange controls were lifted in early December. However, it quickly recovered to touch ¥198.70 in early January, and thereafter traded between ¥200–210.

The Canadian dollar weakened against the US dollar as interest rates fell below those in the United States, but partially recovered following a record trade surplus in November and a reversal in interest-rate differentials.

Interest rates and differentials

The three-month eurodollar rate, which began November at $15\frac{1}{2}\%$, rose steadily to reach a peak of $22\frac{5}{16}\%$ on 12 December. It then eased, apart from a small rally over the year end, and fell to a

London gold price



low point of $16\frac{1}{2}\%$ on 6 January before firming again to remain around 18%–19% for most of the month. In February, it fell again to close at $16\frac{1}{16}\%$. The three-month inter-bank sterling rate began November at $16\frac{7}{8}\%$, but eased gradually, fluctuating between 14% and 15% from 24 November until 29 January; subsequently it fell further to reach $12\frac{3}{16}\%$ at the end of February as expectations of a reduction in MLR grew stronger. From 17 November, three-month sterling traded consistently at a premium in forward markets, reaching a peak of $7\frac{1}{16}\%$ on 11 December. It closed the period at 4%, having fallen to a low of $2\frac{5}{16}\%$ on 7 January. The covered differential fluctuated throughout the period, generally in the range of plus or minus $\frac{1}{4}\%$, but reached nearly $\frac{3}{4}\%$ against sterling on 25 November, and almost 1% in favour of sterling on 5 January, as markets took time to adjust to the cut in MLR in November and the sharp fall in US interest rates at the beginning of January.

Gold

At the beginning of November, the gold price still seemed to be sustained by tensions in Poland and the Middle East. But as dollar interest rates continued to rise these political considerations were largely offset by the high costs of running a position, and the price fell steadily. The release of the US hostages in Iran added further impetus to the decline, and the price broke through the $500 level to touch $482 on 3 February as positions continued to be liquidated both from the Middle East and by commission houses. After a small recovery the price fell again to close February at $489, a fall of $140 over the four months.

International banking and euro-currency markets

International developments (third quarter of 1980)

According to data published by the Bank for International Settlements (BIS),[1] the gross external claims of banks within the BIS reporting area grew by some $42 billion in the third quarter of 1980. After allowing for the statistical distortions caused by exchange rate fluctuations, and for redepositing between reporting banks, the underlying growth of the market was about $35 billion, some $10 billion less than in the second quarter.

US banks (both within the United States and in certain offshore centres) were again very large net suppliers of funds to the market; their external claims rose by $12 billion, after an increase of $19 billion in the second quarter. The increased liquidity of US banks and the depressed level of domestic loan demand continued to influence lending behaviour.

The net contribution of the oil exporters ($8 billion) was smaller than earlier in the year ($15 billion and $10 billion). There was also a change in the supply pattern of the funds, the 'low absorbers'[2] re-emerging as the predominant category. Outstanding borrowing by oil exporters increased by over $3 billion in the third quarter after falling in the first half of the year.

The less developed countries again increased their borrowing from the market, by $2 billion, to $12 billion; two thirds of the new borrowings were taken by Latin American countries. On the other hand, new borrowing by developed countries outside the reporting area ($2.7 billion) was barely a third of its level in the second quarter.

(1) See Table 13 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.

(2) See Table 13 in the statistical annex for countries falling in the 'low absorbers' group.

Euro-sterling market[a]
£ billions

	1979			1980		
	June	Sept.	Dec.	Mar.	June	Sept.
Deposits by:						
UK banks	0.6	0.6	0.7	1.0	1.7	2.1
UK non-banks	0.4	0.4	0.6	0.9	1.0	0.8
Other Western Europe	4.1	4.5	4.4	5.4	5.6	5.6
Oil-exporting countries	0.5	0.6	0.7	1.1	1.1	0.9
Other	1.3	1.6	1.4	1.6	1.6	1.6
Total	**6.9**	**7.7**	**7.8**	**10.0**	**11.0**	**11.0**
Claims on:						
UK banks	1.0	1.1	1.7	1.6	2.2	2.2
UK non-banks	0.3	0.3	0.9	0.8	0.8	0.6
Other Western Europe	3.2	3.4	3.2	3.8	3.8	4.0
Other	0.5	0.7	0.5	0.6	0.8	0.7
Total	**5.0**	**5.5**	**6.3**	**6.8**	**7.6**	**7.5**

Source: Bank for International Settlements

(a) The table shows sterling liabilities and claims of banks in the Group of Ten countries (except the United States and—by definition—the United Kingdom), Austria, Denmark, the Republic of Ireland and Switzerland. Loans to, and deposits from, residents of the countries in which the reporting banks are situated are not available for all countries: the table therefore understates the size of the market.

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

	1979	1980			
	31 Dec.	31 Mar.	30 June	30 Sept.	31 Dec.
Foreign currency liabilities of UK banks to:					
Other UK banks	87.5	96.1	103.7	109.1	118.5
Other UK residents	11.5	11.9	13.5	13.5	13.9
Overseas central monetary institutions	61.4	57.9	61.4	62.8	62.1
Other banks overseas	170.0	186.0	198.6	201.0	219.3
Other non-residents	51.0	55.2	57.4	60.6	67.8
Other liabilities(b)	3.3	3.1	3.5	3.7	3.8
Total liabilities	**384.7**	**410.2**	**438.1**	**450.7**	**485.4**
Foreign currency assets of UK banks with:					
Other UK banks	85.1	92.6	99.4	106.4	116.4
Other UK residents	22.1	22.6	25.6	24.1	22.9
Banks overseas	204.3	216.2	227.1	228.9	249.1
Other non-residents	68.1	73.2	80.6	84.8	88.2
Other assets(b)	5.8	5.9	7.1	7.5	8.4
Total assets	**385.4**	**410.5**	**439.8**	**451.7**	**485.0**

(a) Figures differ from those in Table 6 in the statistical annex (see additional notes to Table 14.1.)

(b) Mainly capital and other internal funds denominated in foreign currency.

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			
	31 Dec.	31 Mar.	30 June	30 Sept.	31 Dec.
BIS reporting area:					
European area	– 3.5	– 7.4	– 3.7	– 1.4	– 7.2
Canada	+ 0.5	– 0.5	– 0.5	– 0.3	+ 0.5
Japan	+12.9	+13.5	+16.0	+17.3	+17.9
United States	–15.9	–13.9	–18.7	–17.0	–20.3
Offshore banking centres	+14.8	+14.5	+12.5	+ 9.3	+ 7.6
Other Western Europe	+ 1.4	+ 4.0	+ 4.7	+ 5.3	+ 6.7
Australia, New Zealand and South Africa	+ 2.3	+ 2.1	+ 2.7	+ 3.0	+ 3.3
Eastern Europe	+ 8.6	+10.1	+10.7	+10.4	+10.6
Oil-exporting countries	–27.6	–31.2	–33.1	–37.4	–38.6
Non-oil developing countries	+ 2.4	+ 7.2	+ 8.4	+10.8	+13.5
Others(b)	– 7.9	–11.7	–13.8	–13.1	– 6.9
Total	**–12.0**	**–13.3**	**–14.0**	**–13.1**	**–13.1**

(a) The breakdown corresponds to that in Table 14.1 in the statistical annex.

(b) Includes international organisations and certain unallocated items.

Borrowing by Eastern European nations also slowed, and this, coupled with a build up of their deposits, resulted in a very small increase in their net indebtedness to the international banking system.

Countries within the reporting area continued to be large net takers of funds, absorbing about $15 billion.

Euro-sterling

After the growth earlier in the year, which was probably associated with the removal of UK exchange controls in October 1979 and the continued operation of the 'corset' until June 1980, the euro-sterling market showed very little overall change in the third quarter, with UK banks the only major suppliers of funds. Deposits by central monetary institutions fell by £100 million, to £800 million. UK non-banks' deposits and borrowing both contracted during the quarter and remain low in comparison with domestic sterling money and credit aggregates. (Similarly, there has been no major rise over the period since the end of exchange control in UK non-banks' non-sterling banking business abroad as recorded in the BIS data, and this, like their euro-sterling business, remains low in comparison with domestic money and credit aggregates).

BIS half-yearly maturity analysis of country data (first half of 1980)

The analysis for end-June 1980[1] shows an increase in external claims of just over 6% during the first half of the year. Almost two thirds of this increase was for periods in excess of one year, although the maturity profiles on new lending to individual groups of countries were markedly dissimilar. In the case of Eastern Europe, the increase in lending ($1½ billion) was entirely in the over-one-year category, while of the increase in claims on Latin America ($10¾ billion) nearly 60% was for less than one year.

Undisbursed credit commitments, which declined by some $12 billion in the second half of 1979, expanded by $11 billion in the first half of 1980. This increase was concentrated in three groups of countries: developed countries outside the BIS reporting area (+$4½ billion), Latin America (+$4 billion) and countries in the 'other Asia' group (+$2 billion).

London market (fourth quarter of 1980)

After adjustment for the effects of exchange rate fluctuations, the London euro-currency market—as measured by gross foreign currency liabilities of UK banks—grew by $39 billion ($35 billion unadjusted), against only $13 billion during the third quarter. In unadjusted terms, $9½ billion of the growth was accounted for by Japanese banks, outstripping the $4½ billion increase of the American banks. The liabilities of British banks increased by $8 billion.

Deposits from oil-exporting countries rose by $2½ billion. There was little change in the aggregate deposits of non-oil developing countries, although within the total Latin American countries increased their deposits by nearly $1 billion while Asian countries drew down theirs by $1¼ billion.

Lending to non-oil developing countries rose by $3 billion, of which $1½ billion was to Latin America. Lending to Western European countries outside the BIS reporting area rose by $1¼ billion.

(1) 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, is contained in Table 14.3 in the statistical annex.

Announced new medium-term euro-currency credits[(a)]
$ billions

	Quarterly rate 1979	Quarterly rate 1980 Q1–Q3	1980 Q4	1981 Jan.	1981 Feb.
OECD countries	6.8	7.9	14.4	5.1	2.3
Oil-exporting countries	1.9	1.8	1.9	0.6	0.5
Developing countries	7.5	5.4	8.4	2.3	2.5
of which, countries with some degree of oil self-sufficiency	*2.3*	*1.6*	*1.8*	*0.8*	*0.8*
Eastern Europe	1.0	0.6	0.7	0.3	0.2
Other	0.9	—	—	—	—
Total	**18.1**	**15.9**	**25.5**	**8.3**	**5.6**

(a) Maturities of three years and over.

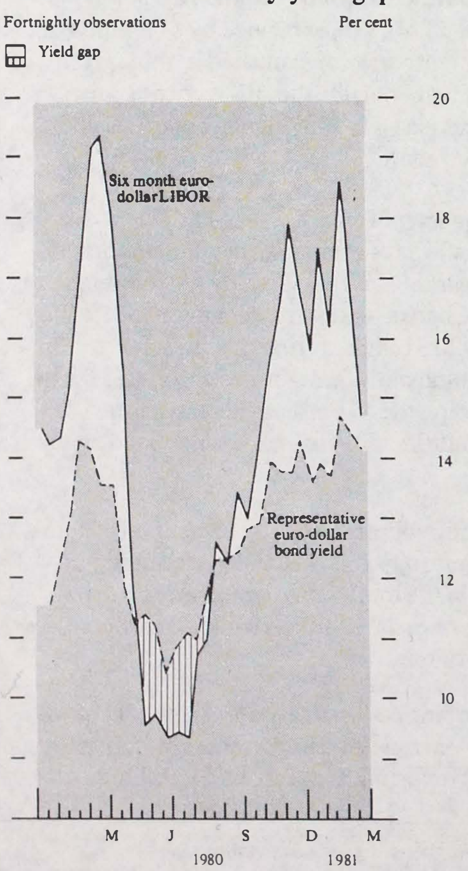
Completed international bond issues[(a)]
$ billions

	Quarterly rate 1979	Quarterly rate 1980 Q1–Q3	1980 Q4	1981 Jan.	1981 Feb.
Total	**8.4**	**8.7**	**9.3**	**3.0**	**2.1**
By currency:					
Dollars	3.2	3.6	4.1	1.6	0.9
Deutschemarks	1.8	2.1	1.6	—	0.1
Swiss francs	2.3	1.7	2.1	0.8	0.7
Sterling	0.1	0.3	0.2	—	—
Other	1.1	1.1	1.2	0.6	0.5
By type of issue:					
Non-convertible fixed rate	6.5	7.1	6.0	2.6	1.7
Convertible into equity	0.8	0.6	1.6	0.2	0.2
Floating rate	1.1	1.0	1.7	0.2	0.3
By borrower:					
OECD countries	6.2	6.4	7.2	2.7	1.8
International institutions	1.5	1.7	1.7	0.3	0.3
Developing countries(b)	0.6	0.4	0.3	—	—
Other	0.2	0.1	0.2	0.1	—

(a) Euro-market and foreign issues, both fixed and floating rate, with maturities of three years and over. Includes private placements if publicised, but excludes Canadian borrowing in New York.

(b) Excluding oil-exporting countries.

Eurobond-eurocurrency yield gap



The maturity analysis of the foreign currency positions of British banks at mid-November[(1)] shows that their short-term net liability positions, viewed as a percentage of total claims, stabilised after large improvements in the maturity mismatch over the previous two quarters. For British banks, both the sight to three-month and sight to six-month bands showed changes of less than 1%, remaining at 17% and 24% respectively. The same stability was apparent in the maturity profiles of other bank groups.

Medium-term euro-currency credit markets (fourth quarter of 1980)
Medium-term credits amounting to $25½ billion were announced in the final quarter of 1980, twice as much as in the third quarter and the highest quarterly total yet recorded. For 1980 as a whole, aggregate medium-term credits were $73 billion, only slightly higher than for 1979, which implies some fall in real terms. Borrowing by OECD countries rose markedly but all other country groups borrowed less than during 1979. The decline for the developing countries was especially sharp, particularly since nine countries that are net oil exporters—but not within the recognised group of major oil exporters—accounted for just over a quarter of total borrowing. Instead, as described above, the developing countries increased their borrowing from international banks, which suggests that medium-term euro-currency credits are now a less significant source of finance for these countries than they have been in the past. In the first two months of 1981, borrowers raised $13¾ billion, in contrast to only $8¾ billion over the same period last year.

The divergence in spreads noted earlier in the year continued through the final quarter and into 1981. Many OECD public sector borrowers have obtained spreads starting at ⅜% over London inter-bank offered rate (LIBOR), and some as low as ¼%, while the average spread for borrowers in the developing countries rose again, to almost 1%. However, infrequent borrowers from developing countries have also secured some fine margins, reflecting the scarcity of their paper in banks' portfolios. There was a marked increase in deals priced over the higher of LIBOR or US interest rates. The trend towards lending for shorter periods which, particularly for the developing countries, has been evident since the end of 1979, appears to have ended but there is no sign yet of any general lengthening of maturities. In January, Sweden announced that it was seeking the first credit denominated in SDRs, based on the simplified five-currency basket.[(2)]

International bond markets
Although interest rates were generally rising in the fourth quarter of 1980, $9¼ billion was raised in the bond and floating rate note-markets, slightly more than in the third quarter. Most of the activity took place in early October when dollar interest rates temporarily stabilised. When interest rates began to rise again activity in straight dollar issues fell back and, as equity prices slipped, many convertible issues weakened. The secondary markets also suffered from the re-emergence of a negative yield gap (see chart), making it once again unprofitable to fund bond holdings with short-term deposits. The moratorium by the German Capital Markets Sub-Committee on new issues (announced in November) had a marked effect and the total of deutschemark bonds in the fourth quarter was the lowest for the year. In the sterling sector, the November reduction in MLR had already been discounted by the

(1) See Table 14.2 in the statistical annex.
(2) See the technical note on page 66.

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

	1979 Year	1980 Q1	Q2	Q3	Q4
United Kingdom:					
Sterling bank deposits	1.4	0.6	0.7	0.2	−0.1
Euro-currency bank deposits	14.8	4.1	1.9	5.3	3.5
British government stocks	0.4	0.3	0.9	0.7	—
Treasury bills	—	0.6	−0.4	−0.2	−0.1
Other sterling placements	0.4	0.1	—	—	—
Other foreign currency placements	0.2	—	—	—	—
	17.2	5.7	3.1	6.0	3.3
United States:					
Bank deposits	5.0	−0.8	2.6	−2.0	−1.0
Treasury bonds and notes	−1.1	2.1	2.4	1.6	2.2
Treasury bills	3.3	1.3	−0.4	0.7	−0.2
Other portfolio investment	1.0	0.7	1.0	1.9	1.0
Other	−1.4	−0.4	0.9	..	..
	6.8	2.9	6.5	2.2	2.0
Bank deposits in other industrialised countries	18.7	8.3	8.2	6.9	..
Other investment in other industrialised countries(b)	8.7	3.4	4.7	4.5	3.9
IMF and IBRD(c)	−0.4	0.9	2.5	0.3	1.2
Loans to developing countries	9.6	1.9	1.4	1.5	0.3
Total identified deployed net cash surplus	**60.6**	**23.1**	**26.4**	**21.4**	..
Residual of unidentified items(d)	10.4	3.9	3.6	..	..
Total net cash surplus derived from current account (as shown in the following table)	**71.0**	**27.0**	**30.0**	**20.0**	..

.. 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. These items are shown as net external borrowing etc. in the following table.

(b) Mainly loans and holdings of equities.

(c) Includes holdings of gold.

(d) The residual may reflect errors in either the current or capital account.

Oil exporters' current account balance and cash surplus available for investment
$ billions

	1979 Year	1980 Year	1980 Q1	Q2	Q3	Q4
Merchandise trade	112	160	46	43	39	32
Net invisibles	− 46	− 55	−13	−14	−14	−14
of which, official transfers	*− 3*	*− 4*	*− 1*	*− 1*	*− 1*	*− 1*
Current balance	**66**	**105**	**33**	**29**	**25**	**18**
Net external borrowing etc.(a)	5	..	− 6	1	− 5	..
Surplus available for investment	**71**	..	**27**	**30**	**20**	..

(a) For definitions see footnote (a) to previous table.

market, and there was no increase in new issues. Even the Swiss franc sector, relatively stable in October and November, weakened at the end of the year.

Market conditions improved at the start of 1981, and, despite the German moratorium (other than for supra-national borrowers), there were initially many new issues. Helped both by the absence of deutschemark issues and by realistic pricing, an increase in the amounts of Swiss franc issues was sustained in February even in the face of a significant upturn in interest rates. But the dollar sector was again less stable and falling interest rates in the last weeks of 1980 resulted in an over supply of new issues in early January. Two reactivated techniques—the 'bought deal' and warrant-attached issues[1]—were used in a number of deals to encourage borrowers and lenders respectively, but market weakness caused by the ensuing oversupply of issues was exacerbated when interest rates began to rise again during the month, and there was little new dollar issue activity in February.

Deployment of oil money

In the third quarter of 1980, the identified cash surplus of the oil exporters was $21 billion, $5 billion less than in the previous quarter. Some $10 billion was deposited with banks, the net increase in new deposits being entirely in euro-currencies, with domestic currencies actually showing a small fall as increases in domestic holdings in some European countries were more than offset by a fall of $2 billion in dollar deposits with banks in the United States. Nevertheless, the overall share of bank deposits denominated in US dollars continued to rise.

In the first three quarters of 1980, the proportion of new funds placed in the United Kingdom and the United States fell to some 37% of total identified investments, as more funds were placed in other industrial centres, notably West Germany and Japan.

The aggregate current account surpluses of the oil exporters are estimated to have totalled some $87 billion in the first three quarters of the year. The disposable cash surplus for the same period is estimated at about $77 billion, still somewhat greater than the deployed surplus of $71 billion identified so far.

In the fourth quarter, oil exporters' placements in the United Kingdom rose by $3 billion, with dollar-denominated bank deposits rising by nearly $3½ billion. Sterling bank deposits and Treasury bill holdings both fell by a small amount. Oil exporters' investments in the United States rose by $2 billion during the quarter, with falls in bank deposits and Treasury bills being more than offset by rises in other assets.

Commodity markets

Activity in the markets continued to be modest with speculative interest again being very limited.

Weakness in precious metals and globally depressed industrial activity contributed to a further easing of prices for base metals; a modest reversal of the trend at the end of the period was largely attributable to weakness of sterling.

Coffee and cocoa markets were little changed; sugar prices were again volatile but declined substantially over the period from the high levels reached in October 1980.

(1) Bought deals are where the managers effectively buy the bonds from the issuer at pre-arranged terms, rather than the more normal open-pricing where terms are finalised only at the last moment. Warrants entitle the holder to purchase, within a given time, a further bond at a specified price.