Operation of monetary policy

This article covers the three months from mid-November 1982 to mid-February 1983.

Review

During the three months under review the main monetary aggregates decelerated substantially; over the first twelve months of the target period they were all within the target range. Moreover the twelve-month rate of retail price inflation continued to fall. The main event in the market, however, was the depreciation of sterling, which totalled some $11\frac{1}{2}$ per cent in effective terms.

This depreciation occurred after a lengthy period of stability for sterling in terms of its effective exchange rate index. One of its main causes was the weakening of international oil markets and growing expectations that OPEC might lose control over the price of oil. Other factors affecting the change in sentiment towards the pound were forecasts that the UK current account balance of payments surplus would disappear, rumours of an early general election, less optimism about further falls in US interest rates, and sharp movements among other currencies.

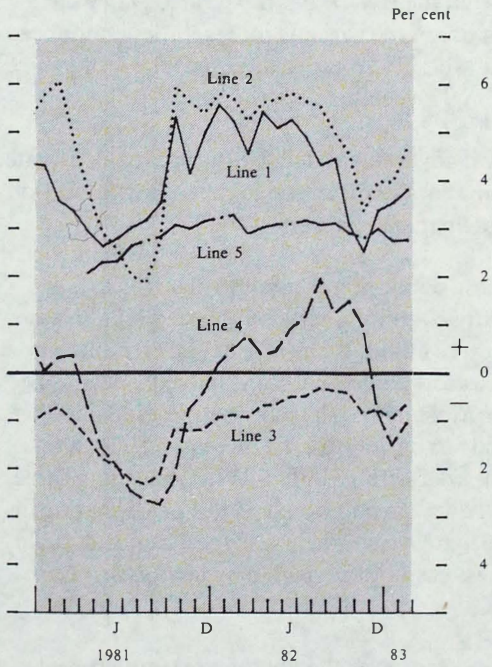
The authorities did not seek the depreciation of the exchange rate which occurred; but nor did they try to prevent the underlying market movement, although tactical intervention was undertaken on a larger than normal scale for a period in December to steady a thin and volatile market towards the end of the year. The fall in sterling clearly had implications for the assessment of monetary conditions, though there was a prospect that its inflationary consequences might be mitigated by lower dollar oil prices.

In the summer of 1982 the authorities had, partly in the light of sterling's strength, allowed the decline in interest rates to continue despite signs of an acceleration of monetary growth within the target range (see page 478 in the December 1982 *Bulletin*). In the most recent three months, with the exchange rate weak, the authorities did not ultimately stand against a rise in interest rates.

Inflationary expectations were being affected by the depreciation of the pound. The chart opposite shows that real interest rates, estimated in a number of different ways but all using data on inflationary expectations collected from private sector sources, rose only modestly over the period; this resulted from the combination of the fall in sterling and the accompanying increases in short-term interest rates (real building society share rates, which fell, were an exception, and reflected a reduction in nominal rates agreed on 12 November but not implemented until 1 December).

Taking all factors together, monetary conditions may not have changed much over the three months under review, with the overall stance of policy remaining moderately restrictive.
In his Budget speech the Chancellor of the Exchequer announced new monetary targets. As was suggested a year ago, these are 1% below last year's targets—that is, they are for annualised growth

Real interest rates



Line 1 One year inter-bank deposit rate *minus* the expected rate of retail price inflation over the following year.

Line 2 The London clearing bank base rate *plus* 1% *minus* the expected rate of inflation.

Line 3 As line 2, but with adjustments made in order to allow roughly for the deductibility of interest payments for corporation tax purposes, and for taxation of corporate income.

Line 4 The building society ordinary share rate, net of tax, *minus* the expected rate of inflation.

Line 5 The gross real redemption yield on 2% Index-Linked Treasury Stock 1996.

Measures of real interest rates are discussed in the December 1982 *Bulletin*, page 483. See also page 13 in this *Bulletin*.

rates of 7%–11% in sterling M_3, PSL_2 and M_1 over the period mid-February 1983 to mid-April 1984. Assuming that the relationship between monetary growth and nominal income growth remains broadly in its recent pattern, these targets will provide scope for a recovery in real activity while continuing to exert a restraining influence on inflation. Interpretation of monetary conditions will continue to take account of all the available evidence, including the exchange rate, structural changes in financial markets, saving behaviour, and the level and structure of interest rates.

Monetary aggregates and credit

The figures in this section are seasonally adjusted, unless otherwise stated.

The monetary aggregates decelerated during the three months under review (Table A). This meant that over the first twelve months of the 1982-83 target period, the target aggregates, while remaining inside the target range, were more evenly spread within the range than earlier in the period. Sterling M_3 was around the middle of the range, with M_1 somewhat above and PSL_2 somewhat below the middle of the range.

Among the counterparts to the change in sterling M_3 (Table B), the PSBR ran at much the same rate as in the preceding three months. Within the PSBR, however, the local authorities and public corporations borrowed less from central government and made smaller net repayments to other sources. Local authorities in particular took advantage of the trough in long-term interest rates last autumn to borrow from the Public Works Loans Board (PWLB) on fixed-rate terms; with the rise in rates since then, their fixed-rate borrowing from the PWLB has moderated. They have, however, made greater use of the variable rate facilities announced by the Chancellor on 25 June 1982, especially since the terms were made more attractive on 9 December.

Net purchases of central government debt by the non-bank private sector were £2.1 billion; they are discussed in the following section on official operations in financial markets.

The contribution of these public sector items to growth in sterling M_3 was modestly contractionary, but by £0.9 billion less than in the preceding three months. The rate of bank lending in sterling to the private sector, however, almost halved, and was no more than £2.6 billion. Most of this slowdown appears to have been accounted for by lending to businesses, the increase in which was about £1½ billion, compared with £3 billion in the preceding three months. Although there was an additional £¾ billion of lending in foreign currencies, the figures nevertheless suggest a considerable improvement in business cash-flow, which may have arisen from a run-down in stocks.

Lending to persons, too, was lower than in the preceding three months, and may have amounted to some £1¼ billion. The rate of lending by banks for house purchase fell back (Table C), as had been expected after the decisions by most London clearing banks to moderate their lending for this purpose; the rate of lending for consumption was somewhat lower as well.

The external and foreign currency counterparts to sterling M_3 were contractionary by £0.7 billion during the period. The implied

Table A
Growth of the monetary aggregates
Percentage increases (annual rates); *seasonally adjusted*

Banking months	Mar. 82– Feb. 83	June 82– Aug. 82	Sept. 82– Nov. 82	Dec. 82– Feb. 83
Wide monetary base (M_0)	3.5	0.7	14.9	7.2
Non-interest-bearing M_1	8.4	15.2	15.4	3.8
M_1	11.0	17.7	17.3	10.1
M_2(a)	5.1			
Sterling M_3	9.8	12.5	12.0	5.1
M_3	12.3	13.6	12.6	8.8
PSL_1	8.5	9.1	9.9	3.8
PSL_2	8.8	6.4	11.1	7.8

(a) On the new definition described in the note on page 78; not seasonally adjusted.

Table B
Sterling M_3 and its counterparts
£ billions; *seasonally adjusted*

Banking months	Mar. 82– May 82	June 82– Aug. 82	Sept. 82– Nov. 82	Dec. 82– Feb. 83
1 Central government borrowing requirement	−0.1	+3.2	+3.4	+2.0
2 Purchases(−) of central government debt by non-bank private sector	−2.4	−2.5	−3.2	−2.1
of which:				
Gilt-edged stocks	*−1.7*	*−1.8*	*−1.5*	*−0.9*
National savings	*−0.8*	*−0.5*	*−1.1*	*−1.1*
3 Other public sector	+0.9	−0.8	−1.5	−0.3
4 Sterling lending to UK private sector	+5.2	+3.9	+5.0	+2.6
5 External and foreign currency counterparts	−0.8	−1.1	−0.1	−0.7
6 Net non-deposit liabilities (increase−)	−0.8	−0.2	−1.1	−0.4
7 Sterling M_3	**+2.0**	**+2.6**	**+2.6**	**+1.2**

Note: The sum of rows 1 and 3 is the PSBR, *less* net purchases of local authority and public corporation debt by the non-bank private sector. The figures in rows 1 to 6 may not add to the figures in row 7 because of rounding.

Table C
House mortgage lending
£ billions
Net increase in lending

	1982				1983
	Q1	Q2	Q3	Q4	January and February
Building societies(a)	1.3	1.9	2.0	2.7	1.9
Monetary sector(a)	1.2	1.3	1.4	1.0	..
Other lenders(b)	0.3	0.3	0.2	0.2(c)	..
Total house mortgage lending	2.8	3.5	3.6	3.9	..

.. not available.
(a) Seasonally adjusted.
(b) Not seasonally adjusted.
(c) Rough estimate.

outflow was more than covered by an increase of £1.4 billion in external finance of the public sector (including among other things an increase of £0.5 billion in overseas holdings of gilt-edged stocks and a fall in the reserves). The inflow of sterling deposits from overseas non-banks dried up, however, while sterling lending to overseas non-banks rose by £0.6 billion. UK banks borrowed £0.4 billion net in sterling from banks overseas, but their net spot foreign currency liabilities fell by £0.3 billion.

Table D
Building societies
Seasonally adjusted

	Net receipts (including interest credited) *£ billions*	Net advances *£ billions*	Liquidity ratio (end-period) *percentages*
1982 1st quarter	2.3	1.3	19.0
2nd quarter	2.5	1.9	19.5
3rd quarter	2.6	2.0	20.0
4th quarter	2.8	2.7	20.1
1983 January and February	1.5	1.9	18.7

The rate of inflow of funds into building societies, which had been very high last autumn, fell sharply after 1 December when the societies cut their interest rates. The effect was most marked in liabilities outside PSL_2. But building society liquidity ratios had been high throughout last year, and increased during the autumn. This meant that the building societies were able to increase their rate of lending by more than enough to offset the slowdown in bank mortgage lending towards the end of the year. Accordingly, the rate of mortgage lending from all sources reached a new peak in the fourth quarter of last year. Building societies' share of total net lending may have recovered to about 70 per cent, compared with around 50 per cent early in 1982. Although their rate of net lending was higher still early in 1983 than in the fourth quarter of 1982, new mortgage commitments made by the societies were somewhat lower than in December.

The slowdown in M_1 involved two elements. The non-interest-bearing element—the sum of currency in circulation with the public and non-interest-bearing sight deposits—decelerated very sharply indeed, to an annualised growth rate of only 3.8 per cent. This may have been partly a result of the rise in interest rates. By contrast, interest-bearing sight deposits continued to grow rapidly, and by mid-February accounted for 24 per cent of M_1.

Table E
Analysis of bank deposits and bank borrowing by sector: 4th quarter 1982
£ billions; *seasonally adjusted*

	Personal sector(a)	Industrial and commercial companies	Non-monetary sector financial institutions	**Total**
Sterling:				
Deposits	+0.4	+1.3	+0.8	**+2.5**
Borrowing(b)	+2.3	+0.7	+0.3	+3.3
Foreign currency:(c)				
Deposits	+0.1	—	−0.5	−0.3
Borrowing	+0.2	−0.1	+0.8	**+0.8**

(a) Including unincorporated businesses.
(b) Including borrowing on commercial bills held by the Bank of England.
(c) Excluding estimated valuation changes arising from exchange rate fluctuations.

Calendar quarterly banking statistics provide a sectoral breakdown of bank deposits and borrowing for the fourth quarter of 1982 (Table E). The main feature is an improvement in the position of industrial and commercial companies, whose sterling deposits increased by more than their sterling borrowing for the first quarter since mid-1981 when the Civil Service strike delayed the collection of taxes. The rapid increase in financial institutions' holdings of sterling bank deposits continued; as in the two previous quarters this may have reflected the rise in building societies' liquidity. The personal sector (including unincorporated businesses) increased its sterling bank deposits only modestly, by £0.4 billion, but placed as much as £2.8 billion (net) in building societies (Table D). Sterling borrowing by the personal sector from the monetary sector was £2.3 billion, and a further £2.7 billion was borrowed from building societies.

Official operations in financial markets

The figures in this section are not seasonally adjusted, unless otherwise stated.

The development of lending to the private sector, and external influences on sterling M_3, were such that less government funding was needed in relation to the PSBR than in the previous three months to secure a satisfactory rate of monetary growth. Nevertheless, large cash shortages persisted in the money market. These arose partly from the maturing of earlier assistance to the market and partly from the seasonal strength of the Exchequer's finances; they formed the background to the Bank's operations in the money market, through which it also exerted an influence on short-term interest rates.

Sales of central government debt to the non-bank private sector totalled £2.1 billion, seasonally adjusted. This was £1.1 billion less than the exceptional level of the preceding three months, when relatively few certificates of tax deposit had been surrendered in payment of taxes. The inflow of funds into national savings was maintained, however, in line with the target of £3 billion for the financial year 1982/83.

Table F
Official transactions in gilt-edged securities[a]
£ billions; *not seasonally adjusted*

Banking months	Mar. 82– May 82	June 82– Aug. 82	Sept. 82– Nov. 82	Dec. 82– Feb. 83
Gross official sales(b)	+1.9	+3.6	+2.8	+2.3
less				
Redemptions and net official purchases of stock within a year of maturity	−0.7	−1.4	−0.9	−1.5
Equals net official sales(c)	+1.2	+2.2	+1.9	+0.8
of which, net purchases by:				
Monetary sector(c)	*−0.3*	*+0.3*	*+0.3*	*−0.6*
Overseas sector	*−0.1*	*+0.1*	*+0.1*	*+0.5*
Non-bank private sector	*+1.7*	*+1.8*	*+1.5*	*+0.9*

(a) Components may not add to totals because of rounding.
(b) Gross sales of gilt-edged stocks are defined as net official sales of stocks with over one year to maturity; apart from transactions under purchase and resale agreements.
(c) Apart from transactions under purchase and resale agreements.

Despite difficult market conditions, gross official sales of gilt-edged securities of £2.3 billion were achieved (Table F). There were, however, substantial stock maturities during and shortly after the period; redemptions and purchases of stocks near maturity amounted to £1.5 billion, so that net official sales were only £0.8 billion. The monetary sector sold £0.6 billion of stock (apart from stock sold to the Bank under repurchase agreements), most of which was accounted for by discount houses. The overseas sector, contrary to the general market perception, were consistent net purchasers of stock, buying a total of £0.5 billion. Net purchases by the non-bank private sector were therefore £0.9 billion.

Conditions in the money market were heavily influenced by the fluctuations in the CGBR which, over the three months as a whole, was some £1.4 billion. Most of this was accounted for by local authorities' and public corporations' borrowing from the central government—a substantial proportion of it under the new facilities announced by the Chancellor last June.

Up to around the turn of the year the CGBR was large, partly for seasonal reasons; and it was not fully matched by sales of government debt. This made it possible to unwind some earlier assistance to the money market. More Treasury bills were offered to the Bank in its daily operations, and the Bank's holdings of commercial bills fell by £1.1 billion between mid-November and the low point early in the New Year.

These flows were more than reversed with the onset of the tax paying season in January; in addition, central government debt sales picked up around this time. Over the three months as a whole, then, net new assistance to the money market totalling £1.3 billion was needed. Even though the Bank's holdings of commercial bills had fallen in the first half of the period, by the middle of January they amounted to almost £9 billion—about three-quarters of the total stock of bills in existence.

As usual at the beginning of the year, particularly heavy assistance to the money market was needed. Rather than relying on a further expansion in the total stock of bills at a time when the demand for credit seemed to be slackening, the authorities decided instead to reactivate, on a temporary basis, arrangements with the banks for the purchase and resale of gilt-edged securities and promissory notes related to guaranteed export credit and shipbuilding paper. This was announced on 14 January. As in 1980, when these arrangements were last used, the banks participating in the scheme were asked not to add significantly to their gilt-edged holdings while they had drawings outstanding.

Some £0.9 billion of assistance was provided under this arrangement, which ran from 21 January to 21 February (when the

Table G
Influences on the cash position of the money market[a]

£ billions; *not seasonally adjusted*
Increase in the market's cash +

Banking months	Mar. 82–Apr. 82	May 82–Nov. 82	Dec. 82–Feb. 83
Factors affecting the market's cash position			
CGBR(+)	−0.1	+7.4	+1.4
Net sales of central government debt(−)	−1.8	−7.0	−1.5
of which:			
Gilt-edged	*−0.9*	*−4.4*	*−0.8*
National savings	*−0.8*	*−1.6*	*−1.1*
Other	*−0.1*	*−1.0*	*+0.4*
Currency circulation (increase −)	−0.1	−0.2	−0.2
Other	−0.4	—	−0.9
Total(A)	**−2.4**	**+0.1**	**−1.3**
Official offsetting operations			
Net increase (+) in Bank's holdings of commercial bills(b)	+1.6	+1.5	−0.3
Net increase in Treasury bills in market (−)	+0.3	−0.8	+0.6
Securities(c) held under repurchase agreements with banks (+)	—	—	+0.9
Other	+0.5	−0.8	—
Total(B)	**+2.4**	**—**	**+1.3**
Change in bankers' balances at the Bank (=A+B)	—	+0.1	−0.1

(a) Components may not add to totals because of rounding.
(b) By the Issue and Banking Departments of the Bank.
(c) Gilt-edged stocks and promissory notes related to guaranteed export credit and shipbuilding paper.

Table H
Interest rates and exchange rates at selected dates

Percentages, except exchange rates

	12 Nov. *immediately before pressure on £*	26 Nov. *immediately before first base rate rise*	31 Dec. *end-year calm*	11 Jan. *immediately before second base rate rise*	16 Feb.
Exchange rate					
ERI	91.3	84.9	84.3	80.6	80.7
£/$	1.6512	1.5700	1.6175	1.5675	1.5465
Inter-bank rates					
1 week	$9\frac{3}{8}$	$9\frac{5}{8}$	$10\frac{5}{8}$	$10\frac{5}{8}$	$11\frac{1}{2}$
1 month	$9\frac{3}{8}$	$9\frac{5}{8}$	$10\frac{11}{16}$	$11\frac{1}{16}$	$11\frac{7}{16}$
3 months	$9\frac{1}{8}$	$9\frac{15}{16}$	$10\frac{1}{2}$	$11\frac{3}{16}$	$11\frac{3}{16}$
Base rates	**9**	**9**	**10–10¼**	**10–10¼**	**11**
Bank's bill dealing rates(a)					
Band 1	$9\frac{1}{8}$	$9\frac{1}{8}$	10	10	11
Band 2	9	9	10	10	11
Band 3	$8\frac{7}{8}$	$8\frac{7}{8}$–$8\frac{15}{16}$	10	10	11
Band 4	$8\frac{3}{4}$	$8\frac{3}{4}$–$8\frac{13}{16}$	10	10	11
3-month eurodollar rate	$9\frac{13}{16}$	$9\frac{5}{8}$	$9\frac{1}{4}$	$8\frac{3}{4}$	$9\frac{3}{16}$
Gilt-edged yields					
5-years	$9\frac{1}{2}$	$10\frac{5}{8}$	$10\frac{3}{4}$	$11\frac{1}{2}$	11
10-years	$10\frac{1}{2}$	$11\frac{3}{4}$	$11\frac{1}{4}$	$12\frac{1}{4}$	$11\frac{1}{2}$
20-years	$10\frac{1}{2}$	$11\frac{5}{8}$	$11\frac{1}{8}$	$11\frac{3}{4}$	$11\frac{1}{4}$
US 30-year bond yield	$10\frac{1}{2}$	$10\frac{1}{2}$	$10\frac{3}{8}$	$10\frac{1}{2}$	$10\frac{7}{8}$

(a) The Bank of England's latest bill dealing rates on a discount basis. The maturity bands are: band 1, 1–14 days; band 2, 15–33 days; band 3, 34–63 days; band 4, 64–91 days.

redemption of 3% Exchequer Stock 1983 provided cash to the market). This meant the Bank needed to hold fewer commercial bills, and its holdings fell on balance over the three months by some £0.3 billion (Table G).

Money market, interest rates and foreign exchange

The large cash shortages that persisted throughout the period in the money market meant that the Bank had to buy bills nearly every day. Interest rates during the period were affected particularly by conditions in the foreign exchange market, and an account of these[1] is an essential part of the domestic money-market story (Table H).

The period opened on 18 November after three days in which sterling had fallen by $3\frac{3}{4}\%$ in effective terms ($3\frac{1}{4}\%$ against the US dollar and 4% against the deutschemark). In the money market, the Bank responded to the movement on 17 November by confining its morning operations to purchases of bills in bands 1 and 2, leaving a substantial proportion of the day's cash shortage in the market. There had already been some upward movement in longer-term money rates, and during its afternoon operations the Bank received and accepted offers of bills in bands 3 and 4 at rates up to $\frac{1}{4}\%$ higher than previously, though it also accepted other offers in those bands at its earlier rates.

On 18 and 19 November sterling steadied, but the pressure re-emerged on Monday 22 November, following weekend press comment, despite the cut of $\frac{1}{2}\%$ in the Federal Reserve discount rate to 9% announced late on 19 November. The Bank repeated the pattern of money-market operations that it had adopted on 17 November. The pound fell further on 25 November, however, and that afternoon inter-bank money rates rose sharply—by $\frac{1}{4}\%$ to $9\frac{9}{16}\%$ at the three-month maturity.

The following morning, sterling opened weaker still: the effective index was down to 84.9. Inter-bank money rates moved up yet further, the three-month rate rising to $9\frac{15}{16}\%$. Against this background a clearing bank announced an increase of 1% in its base rate to 10%; and shortly afterwards the Bank in its morning operations in the money market accepted rates of 10% in its bill dealings for all maturity bands. The other clearing bank base rates were later raised to 10%–$10\frac{1}{4}\%$.

The pound traded more quietly in the foreign exchange market for a period, but there was further heavy selling early in the week beginning Monday 6 December, and the effective exchange rate had fallen by one percentage point by the close on 7 December. The three-month inter-bank rate, which had been 10% at the end of the previous week, rose to $10\frac{3}{4}\%$ by 8 December in response to this renewed weakness of sterling, thus putting upward pressure on the general level of short-term interest rates.

At this stage the authorities were concerned about the possibility that the movement in the exchange rate and associated movements in the domestic financial markets might become self-sustaining, especially in the often thin markets near the end of the year. There were also grounds for thinking that financial markets might become more settled in the New Year once the uncertainties

(1) A fuller account of exchange rate movements is given on page 34.

surrounding the OPEC meeting due to begin on 19 December were resolved and as end-year factors unwound. Accordingly, the Bank sought to steady the foreign exchange market during December and to restrain upward pressure on short-term interest rates by generous assistance to the money market.

In fact the pressure on sterling eased after a further cut in the Federal Reserve discount rate, to $8\frac{1}{2}\%$, was announced on 13 December, but sterling weakened on 17 December and fell further in the week before Christmas, with the effective exchange rate index closing at 84.1 on Christmas Eve. Inter-bank rates remained consistently very high in relation to base rates at 10%—the three-month rate was at times as high as 11%—but in this period base rates remained unchanged despite this pressure for them to be increased.

The position eased considerably immediately after Christmas. The dollar was generally soft, and although sterling's effective index recovered only modestly a rise in the sterling/dollar rate caused inter-bank rates to fall back and the three-month rate came down to $10\frac{1}{2}\%$; the gilt-edged market also improved. At this stage it seemed that consolidation in financial markets might have been achieved.

Early in the New Year, however, substantial selling of sterling re-emerged. The pound fell rapidly, from 83.8 in effective terms on 4 January to 80.6 on 11 January. At that stage there were no special factors to suggest that this renewed pressure might reverse itself, and the Bank continued its normal smoothing of exchange rate movements. In the short-term money markets, inter-bank rates at first responded only modestly to the renewed weakness of sterling—the three-month rate had risen only to $10\frac{5}{8}\%$ on 10 January; but on the following day it went up very sharply to $11\frac{3}{16}\%$. Late that afternoon rises in clearing bank base rates to 11% were announced, and the Bank confirmed the new higher level of rates by raising its bill dealing rates, also by 1%, on 12 January.

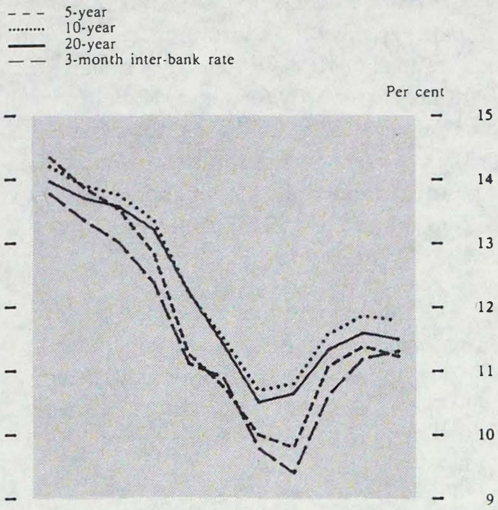
Sterling stabilised after this second rise in short-term interest rates. The effective index rose to 82.8 on 21 January, $2\frac{3}{4}\%$ above its low point, though because of the worldwide strength of the dollar, the sterling/dollar rate was down to \$1.5715.

Subsequently, sterling's effective exchange rate index fell back to around 81, and remained in the range 80.7 to 81.3 for the rest of the period. The three-month inter-bank rate reached a peak of $11\frac{11}{16}\%$ on 31 January, after a surge in the dollar led to a sharp drop in the sterling/dollar rate. There was, however, some general weakening of the dollar early in February, and the sterling/dollar rate recovered from its lowest levels. As a result, inter-bank rates fell back, and towards the end of the period expectations began to re-emerge that the general level of short-term interest rates would fall. The three-month inter-bank rate ended the period at $11\frac{3}{16}\%$.

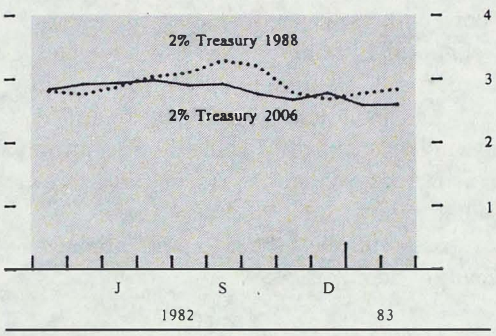
The funding programme

Conditions in the conventional (non-index-linked) gilt-edged market were difficult throughout the three months under review, as sentiment was affected by the recurring weakness of sterling. This did not, however, cause any serious interruption to the Government's funding programme, for three reasons. First, inflows into national savings continued on a substantial scale, totalling

Earlier falls in **gross redemption yields on British government stocks** *were checked...*



... but **index-linked yields** *were much less changed.*



£1.1 billion. Second, index-linked gilt-edged proved much more resilient than conventional stocks, and substantial official sales were possible at times, which, in addition to helping meet current funding needs, also secured receipts for banking March. Third, by mid-November the authorities had already secured £1.6 billion of future receipts in the conventional gilt-edged market through partly-paid issues. There were suggestions that the large volume of calls falling due accentuated the weakness of the conventional market. If the calls had not been in place, however, prices could have been depressed by the knowledge of a larger volume of unmet funding needs overhanging the market.

On the other hand, gilt-edged maturities during the period, and official purchases of stocks maturing shortly after the end of the period, meant that net official sales of stock were considerably lower than they otherwise would have been.

Gilt-edged market

For most of the period the conventional market followed the fortunes of sterling. This meant that in the second half of November and in most of December, prices were falling. Index-linked stocks, however, proved more resilient. In particular, there was a steady stream of demand for the 1988 maturity late in November and early in December, which took its real yield down to just over $2\frac{1}{2}\%$. To meet that demand a further £250 million tranche of this stock was created on 10 December and made available for sale by the Bank from 13 December (Table J).

In the few days before Christmas the market recovered, despite the continued softness of sterling, and the recovery persisted against the background of a stronger pound between Christmas and the New Year. With the forthcoming maturity of 3% Exchequer Stock 1983, a new low coupon stock, £500 million of $2\frac{1}{2}\%$ Exchequer Stock 1987, was announced on 30 December for sale by tender on 6 January.

The market in conventional stocks fell back once more early in the New Year following developments in the foreign exchange market. Demand switched to the index-linked market and official supplies of the index-linked stock maturing in 2003 were exhausted on 6 January. The demand for index-linked stocks continued, and the offer for sale of a new stock, maturing in 2016, was announced on 14 January. This issue was made in partly-paid form, with later instalments falling due in banking February and banking March, because there was no pressing need for immediate funding. The allotment price was £99, corresponding to a real yield of 2.55%.

Table J
Issues of gilt-edged stock

Stock	Amounts issued (£ millions)	Date announced	Date issued	Date exhausted	Price per £100 stock (£)	Payable per £100 stock: On issue (£)	Payable per £100 stock: Further instalments (£)	Redemption yield (per cent)
2% Index-Linked Treasury 1988	250(a)	10/12	10/12	1/2	—	—	—	—
$2\frac{1}{2}\%$ Exchequer 1987	500	30/12	6/1	—	84.00	84.00	—	7.02
$2\frac{1}{2}\%$ Index-Linked Treasury 2016	750	14/1	19/1	—	99.00	25.00	74.00	2.55(b)
$10\frac{1}{2}\%$ Exchequer 1987 'A'	750(c)	11/2	17/2	18/2	98.50	30.00	68.50	10.96

(a) Issued to the Issue Department of the Bank.
(b) Real yield.
(c) Of which £50 million was reserved for the National Debt Commissioners.

The time/yield curve of British government stocks.
Gilt-edged yields have risen by less at long than at short maturities.

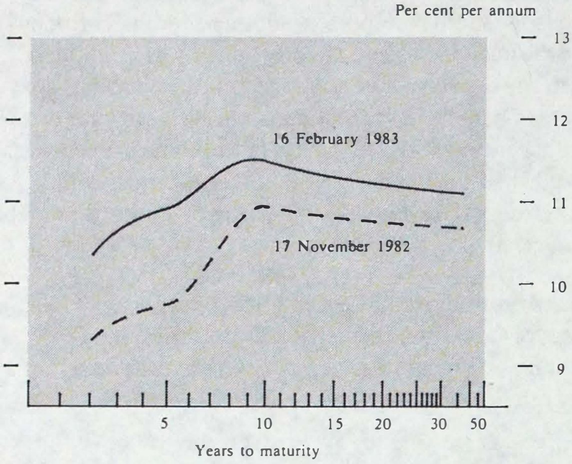


Table K
Number of holdings of index-linked stocks

Maturity	Nominal amount outstanding (£ million)	Number of holdings(a) Early Oct. 82	Mid-Nov. 82	Mid-Feb. 83
1988	750(b)	10,800 *8,800*	13,400 *10,700*	21,000 *15,800*
1996	1,000	2,100 *900*	2,300 *1,000*	3,600 *1,900*
2001	250	(c)	700 *500*	1,000 *700*
2003	250	—	(c)	800 *500*
2006	1,000	900 *300*	900 *300*	1,000 *400*
2009	400	—	200	400 *100*
2011	750	800 *200*	800 *200*	800 *200*

Note: No figures are available for the 2016 stock because it was still in allotment letter form at mid-February.

(a) The figures in italics show the number of holdings identified as holdings of private funds and private trusts. All figures are rounded to the nearest hundred.

(b) The amount of the 1988 stock outstanding was increased to £1,000 million in December 1982.

(c) Official holdings not exhausted.

There was steady demand for the new stock in the second half of January and early in February. Subsequently the conventional market began to improve, partly influenced by the stronger sterling/dollar exchange rate. To meet the continuing demand for stock, a new £700 million tranche of $10\frac{1}{2}\%$ Exchequer Stock 1987 was announced on 11 February for sale by tender on 17 February, the day after the period under review ended.[1] This stock was also issued in partly-paid form, in order to secure some future as well as present receipts. It met good demand at the tender and was priced at £98.50 so as to yield 10.96% gross to redemption. Remaining supplies were exhausted the day after issue.

Over the three months, yields on conventional gilt-edged stocks rose, but by less than short-term interest rates. Yields on five-year stocks rose by around $1\frac{1}{2}\%$ to about 11%, on ten-year stocks by 1% or more to around $11\frac{1}{2}\%$ and on twenty-year stocks by rather less than 1% to about $11\frac{3}{8}\%$. The real return offered by index-linked stocks rose by much less, however.

The evolution of the market in index-linked stocks which was noted in the December *Bulletin* (page 486) continued during the three months under review, with more personal investors being attracted. The number of holdings of the 1988 stock—of which the amount in issue was raised from £750 million to £1 billion—went up by over 50% to some 21,000 including some 15,800 identified as holdings of private funds and private trusts (Table K). In addition there were signs of increasing interest among personal investors in the longer-dated stocks, particularly the 1996 stock. These longer-dated stocks, however, continue to be held predominantly by pension funds and insurance companies.

Other capital markets

Three months to end-February
Pressure on sterling during the first week of December turned *equity* prices lower. But firmer conditions re-emerged in the middle of the month, and although trading conditions were quiet a reasonably firm undertone was maintained. Early in January hopes of further cuts in international interest rates triggered a new advance in equities in the wake of the US market until the further decline of sterling, and the further rise in clearing bank base rates, brought a sharp reverse. Sentiment recovered around the middle of the month but the market again turned easier on 21 January with renewed pressure on sterling. From around the end of January until the middle of February the market advanced strongly on hopes of tax cuts in the Budget and in line with the firm conditions on Wall Street. Successive all-time high levels were achieved in the major FT Indices, the All-Share Index reaching 413.08 on 11 February. Prices fell back on profit-taking in the middle of the month and, with a large volume of funds committed to new issues, the secondary market was rather subdued to the end of the month. Uncertainties about the future course of oil prices added to the uneasiness of the market. Over the three months the FT-Actuaries All-Share Index rose by 6% on balance to reach 399.35.

New equity issues were at a fairly low level for much of the period, but the sale by the Government of 48.5% of its share in Associated British Ports for £22 million on 9 February, followed a week later by an offer for sale of shares in Superdrug Stores, attracted very heavy oversubscriptions.

(1) A further £50 million was reserved for the National Debt Commissioners.

Table L
Debt issues announced on the London capital market: December 1982–February 1983

Date of announcement	Issuer	Nominal amount (£ millions)	Coupon	Maturity
Private domestic borrowers(a)				
2 Dec. 1982	Scottish Eastern Investment Trust	10	$12\frac{3}{8}$%	2012
15 Dec. 1982	London Shop Property Trust	10	$12\frac{1}{2}$%	2015/20
20 Dec. 1982	Bishopsgate Trust	4	7%–17% (rising coupon)	2023
18 Jan. 1983	S Pearson	25	13%	2007
Overseas borrower				
10 Jan. 1983	Kingdom of Sweden	50	$13\frac{1}{2}$%	2010

(a) All these issues were placings.

The number of new corporate *fixed-interest* issues was much lower than in the three preceding months—a consequence of the upturn in interest rates (Table L). There remains, nonetheless, an active interest among an increasing number of companies in coming to the market at lower interest rates. The market in *local authority* new issues was dormant with neither new stock issued nor droplocks triggered during the period.

There has been only one issue by an *overseas borrower* in the domestic market in this period compared with four such issues, raising some £230 million, in the previous three months. The latest borrower was the Kingdom of Sweden for £50 million, with a twenty-seven year maturity and a $13\frac{1}{2}$% coupon. Similarly, only two *eurosterling issues* were made—£30 million for Norsk Hydro and £50 million for the European Community with coupons of 12% and $11\frac{7}{8}$% respectively—compared with six issues totalling £220 million in the earlier period.