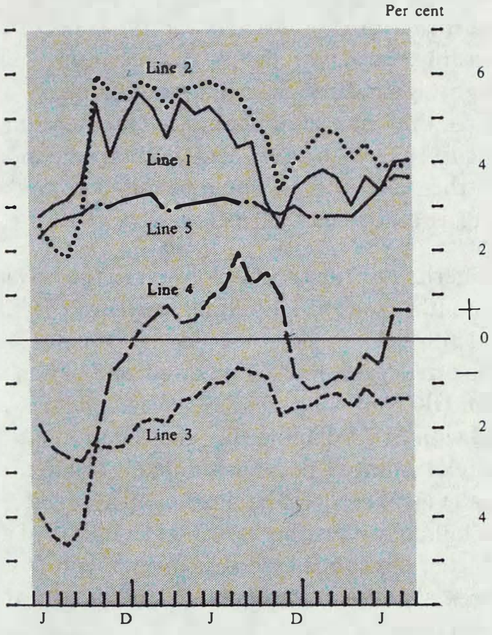
Operation of monetary policy

This account covers the three months from mid-May to mid-August.

Monetary growth moderated during the three months, but the target aggregates remained above the target range. The exchange rate was steady in effective terms, while the development of the retail price index and the prospects for inflation remained satisfactory. The recovery of output on the other hand continued to be somewhat hesitant.

Real interest rates



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

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

Line 3 The London clearing banks' base rate *plus* 1% divided by two to allow for the deductibility of interest payments for corporation tax purpose *minus* the expected rate of inflation.

Line 4 The building society ordinary share rate, net of basic-rate income 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.

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

Banking months	Sept. 82– Nov. 82	Dec. 82– Feb. 83	Mar. 83– May 83	June 83– Aug. 83
Wide monetary base	6.2	5.4	4.7	3.6
Non-interest-bearing M_1	15.6	4.9	10.6	10.5
M_1	15.9	11.3	16.5	12.1
M_2				8.8(a)
Sterling M_3	12.4	8.6	13.8	11.1
PSL_1	9.3	8.0	17.2	8.6
PSL_2	10.0	11.9	18.4	11.7
M_3	13.3	13.4	11.4	11.4

(a) Change over twelve months to mid-August 1983 (not seasonally adjusted), on the new definition described in the note on page 78 of the March *Bulletin*.

The main counterparts to the growth of the monetary aggregates were the persistence of a large PSBR, some revival in bank lending to the private sector, and, in the case of PSL_2, the continuing strength of building society mortgage lending. Official policy aimed as far as possible to offset these expansionary influences through government funding, mainly in the gilt-edged market. A very high rate of gilt-edged sales was maintained; and in addition the incidence of maturing stocks was abnormally low.

The foreign exchange markets were dominated by the strength of the dollar (foreign exchange developments are described on pages 355–7). This strength arose from expectations that the pace of monetary growth in the United States, the large Federal budget deficit, and the development of the US economy more generally would lead to higher US interest rates; and it took place in spite of the widening deficit in the current account of the US balance of payments. Indeed, the three-month eurodollar rate rose from 9% to $10\frac{1}{8}$% over the period under review. Bond yields also rose—on thirty-year US government bonds from $10\frac{5}{8}$% to $11\frac{9}{16}$%. Sterling fell against the dollar, but it appreciated against other currencies and its effective exchange rate index was on balance little affected by these US developments.

Immediately after the general election, there was a limited fall in short-term interest rates, the background to which is described on page 339. The prospect that the PSBR might overshoot the forecast of £8.2 billion which had been made at the time of the Budget led early in July to anxieties in the financial markets that the general level of short-term interest rates might move upwards, and these persisted for a time even after the Chancellor had announced fiscal measures on 7 July. Further concern about interest rates emerged early in August, when US interest rates and bond yields reached their peak. But in both these episodes the authorities judged that the case for higher short-term interest rates was not made and accordingly conducted their market operations in such a way as to dampen the market pressure for a rise. These tactics proved successful and the general level of short-term interest rates remained steady. Nevertheless, real interest rates may have risen modestly as inflationary expectations moderated.

Monetary aggregates

Figures in this section are seasonally adjusted, unless otherwise stated.

Monetary growth on all measures decelerated during the three months under review (Table A), but the annualised growth rates of the target aggregates over the first six months of the 1983–84 target

Table B
Composition of changes in the money stock[a]
£ billions; *seasonally adjusted*

	Banking months	Dec. 82– Feb. 83	Mar. 83– May 83	June 83– Aug. 83	Level outstanding at mid-Aug. 83
1	Non-interest-bearing M_1	+0.3	+0.7	+0.7	30.3
2	Interest-bearing sight deposits	+0.7	+0.8	+0.4	11.1
3	**M_1 (1 + 2)**	**+1.0**	**+1.5**	**+1.2**	**41.3**
4	Other private sector sterling deposits	+0.9	+1.8	+1.2	54.8
5	Private sector holdings of sterling M_3 (3 + 4)	+1.9	+3.3	+2.4	96.1
6	Public sector sterling deposits	—	−0.2	+0.2	2.3
7	**Sterling M_3 (5 + 6)**	**+1.9**	**+3.1**	**+2.6**	**98.4**
	Non-bank private sector holdings of:				
8	Sterling deposits with maturity of over two years (increase −)	—	—	—	1.5
9	Treasury and commercial bills	—	+0.1	+0.6	1.3
10	Local authority debt	−0.2	+0.3	−0.5	1.9
11	CTDs and certain national savings instruments	+0.5	+0.2	−0.2	9.6
12	Building society shares and deposits(b)	+1.2	+1.8	+2.1	56.1
13	Building society CDs	—	—	+0.3	0.3
14	Building society liquid asset holdings (increase −)	+0.6	+0.8	−0.2	3.5
15	**PSL_2** (5 + sum of items 8 to 14)	**+4.1**	**+6.5**	**+4.4**	**160.3**

(a) Components may not add to totals because of rounding.
(b) Other than term shares; including interest credited.

Table C
Sterling M_3 and its counterparts[a]
£ billions; *seasonally adjusted*

	Banking months	Sept. 82– Nov. 82	Dec. 82– Feb. 83	Mar. 83– May 83	June 83– Aug. 83
1	Central government borrowing requirement(b)	+3.4	+1.7	+5.3	+3.9
2	Purchases (−) of central government debt by the non-bank private sector	−3.0	−1.9	−1.6	−3.1
	of which:				
	Gilt-edged stocks	*−1.5*	*−0.8*	*−0.9*	*−2.8*
	National savings	*−1.1*	*−1.1*	*−0.5*	*−0.5*
3	Other public sector(b)	−1.3	−0.4	−1.4	−1.0
4	Sterling lending by the banking system to the UK private sector	+4.7	+3.3	+1.9	+3.1
5	External and foreign currency counterparts	+0.2	−0.3	+0.3	−0.6
6	Net non-deposit liabilities (increase−)	−1.3	−0.5	−1.5	+0.3
7	**Sterling M_3**	**+2.6**	**+1.9**	**+3.1**	**+2.6**

(a) Components may not add up to totals because of rounding.
(b) 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.

period nevertheless remained outside the target range of 7%–11%; the rates were reduced to 14.3%, 12.4% and 15% for M_1, sterling M_3 and PSL_2 respectively.

The growth rate of non-interest-bearing forms of money was little changed from the preceding three months (Table B); the slowdown in the private sector's holdings of bank deposits was concentrated in interest-bearing accounts, including both sight and time deposits. PSL_2 decelerated much more sharply than sterling M_3, mainly because the building societies began to rebuild their liquidity (partly bank deposits which increase sterling M_3 but not PSL_2) and because the local authorities made net repayments of short-term debt to the non-bank private sector.

Among the counterparts to the growth in sterling M_3(Table C), the PSBR[1] was £2.9 billion; this was £1 billion less than in the preceding three months when the PSBR had been inflated by the surge in public sector expenditure at the end of the 1982/83 financial year. Early in July, faced with the prospect that the PSBR for 1983/84 might significantly overshoot the Budget projection of £8.2 billion, the Chancellor announced measures to reduce public spending in 1983/84 by over £500 million, and in addition said that a further £500 million would be raised in this financial year by selling assets owned by the Government.

The rate of lending in sterling by the banking system to the private sector over the three months rose to £3.1 billion. Furthermore, the amount of commercial bills held outside the banking system rose by £0.5 billion, and the private sector also borrowed £0.8 billion in foreign currencies from UK banks. The total of all these items was £4.4 billion, compared with £1.7 billion in the preceding three months. The rate of bank lending to persons is unlikely to have changed very much—the increase over the three months might have been around £1½ billion, with rather less than £1 billion of it for house purchase. Part of the implied increase in lending to businesses will have been a natural consequence of the effect of the lower PSBR on business finances.

The rate of building society lending (a counterpart of PSL_2 rather than sterling M_3), which had been nearly £1 billion a month between January and May, moderated somewhat in June as the societies increasingly rationed mortgages to protect their falling liquidity ratios. After the societies issued their first certificates of deposit in June, and more especially after their share rates went up on 1 July, their inflows recovered sharply. But the societies made it their first priority to reconstitute their depleted liquidity, and their rate of mortgage lending fell back further in July, to some £0.8 billion.

External and foreign currency counterparts to sterling M_3 were contractionary, by £0.6 billion, in the latest three months, having been expansionary in the previous three—this turnround perhaps associated with a lower balance of payments current account surplus.

Net non-deposit liabilities fell by £0.3 billion over the three months under review, having risen by £1.5 billion in the previous three months. Part of the reason for this large change was that net capital issues in the United Kingdom by monetary sector institutions fell from £0.4 billion to £0.1 billion.

(1) Strictly, the PSBR minus net purchase of local authorities' and public corporations' debt by the non-bank private sector.

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

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

Banking months	Sept. 82– Nov. 82	Dec. 82– Feb. 83	Mar. 83– May 83	June 83– Aug. 83
Factors affecting the market's cash position				
CGBR(+)	+2.9	+1.4	+6.0	+5.0
Net sales of central government debt(b)(−)	−3.5	−1.6	+2.5	−3.7
of which:				
Gilt-edged	*−1.9*	*−0.8*	*−1.7*	*−3.5*
National savings	*−1.0*	*−1.1*	*−0.5*	*−0.5*
Other	*−0.5*	*+0.3*	*−0.2*	*+0.3*
Currency circulation (increase −)	+0.1	−0.2	−0.3	−0.3
Other	—	−1.0	−0.2	+0.2
Total(A)	**−0.5**	**−1.4**	**+2.9**	**+1.3**
Official offsetting operations				
Net increase(+) in Bank's holdings of commercial bills(c)	+1.5	−0.3	−1.6	−1.2
Securities(d) held under repurchase agreements with banks(+)	—	+0.9	−0.9	—
Net increase(−) in Treasury bills in market	−0.5	+0.6	−0.3	−0.3
Other	−0.4	—	−0.1	+0.3
Total(B)	**+0.6**	**+1.3**	**−2.9**	**−1.1**
Change in bankers' balances at the Bank (A+B)	+0.1	−0.1	—	+0.1

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

Official operations in financial markets

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

The primary objective of the Bank's official operations was to achieve a sufficient rate of sales of government debt to the non-bank private sector to offset the impact of other influences, notably the PSBR, on monetary growth. But the CGBR was very large (substantially larger than the PSBR) so that the volume of official assistance to the money market decreased and the daily cash shortages became smaller.

The main burden of the funding effort during the period fell on the gilt-edged market. National savings inflows were subdued, totalling £0.5 billion, and there were net surrenders of certificates of tax deposit amounting to £0.3 billion (both figures seasonally adjusted). Gross official sales of gilt-edged securities, however, were as high as £4.1 billion, and, with redemptions and purchases of stock within a year of maturity lighter than normal, net official sales to all sectors were £3.5 billion. The monetary sector bought £0.3 billion net, and the overseas sector a similar amount, so that the net take-up by the non-bank private sector was £2.8 billion. Net sales of central government debt in all forms to the non-bank private sector were £3.1 billion (seasonally adjusted).

Heavy though gilt-edged sales were, with the CGBR as high as £5 billion, and with other forms of funding subdued, the effect of official operations in the money market was to withdraw £1.1 billion (net) of assistance from the banking system (Table D). At the end of the period total assistance outstanding to the market (excluding assistance extended by Treasury bill operations) was down to about £7 billion.

The money market

At the start of the three months under review, on 19 May, clearing bank base rates stood at 10% and interbank deposit rates for maturities from a week out to a year stood at $10\frac{5}{16}$%–$10\frac{3}{8}$%. The yield curve was thus virtually flat. This pattern was maintained for much of the period up to the election, partly reflecting an assumption on the part of the market that there would be official resistance to a change in the general level of short-term interest rates during this period.

Interbank deposit rates fell sharply during election week, however, and by the following Monday morning (13 June), the three-month rate was down to $9\frac{7}{8}$% and the twelve-month rate to $10\frac{1}{16}$%; on 10 and 13 June the discount houses offered bills to the Bank at rates below the rates at which it had been buying them earlier.

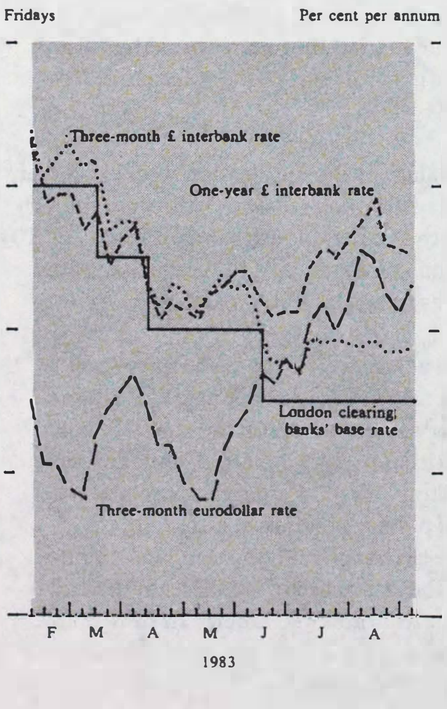
This market pressure posed a question to the authorities about interest-rate policy. At that stage the monetary aggregates were above the target range. This was, however, on the basis of figures for only the first three months of the target period; and moreover it seemed that the overshooting might be a purely temporary consequence of the surge of public spending at the end of the financial year 1982/83. The exchange rate was firm, and could have become firmer still in the aftermath of the election (indeed it remained firm even after interest rates had fallen). In sum, on the basis of the underlying monetary situation, the case for lower interest rates was fairly evenly balanced.

The market pressure for lower rates was heavy enough, however, that the authorities could have had to take strong action in the money market to resist it. To do that would inevitably have created the impression, both in the real economy, where the recovery did not yet seem to be firmly established, and in the financial markets, that the authorities were not prepared to contemplate even a modest fall in short-term interest rates, which was a harsher attitude than the overall situation appeared to justify. Accordingly, the Bank accepted offers of bills at lower rates on 13 June; on that and the following day, the Bank's lowest accepted rates fell by a total of $\frac{1}{2}$%. On 14 June the clearing banks announced cuts of $\frac{1}{2}$% in their base rates to $9\frac{1}{2}$%.

Even after this fall in the general level of short-term interest rates, building society interest rates, which had been set in November 1982 when bank base rates stood at 9%, were still out of alignment with the general level of short-term interest rates. Moreover the societies' appetite for funds had been greatly increased by the strength of demand for their mortgages. Accordingly, they decided at their meeting on 22 June to raise the recommended mortgage rate by $1\frac{1}{4}$% to $11\frac{1}{4}$% and the ordinary share rate by 1% to $7\frac{1}{4}$% (net of basic-rate income tax).

After the cut in base rates, interbank rates fell a little further —the one-month rate to around $9\frac{3}{4}$% and the one-year rate to 10%. The upward slope in the money-market yield curve became steeper on 21 June when the one-year rate rose to about $10\frac{1}{8}$% on growing concern about the monetary situation in both the United Kingdom and the United States, while the three-month rate remained unchanged. Concern about the domestic monetary situation became more acute early in July, and persisted despite the measures to reduce the PSBR announced by the Chancellor on 7 July; the one-year rate rose as high as $10\frac{9}{16}$% on 13 July. Shorter-term money-market rates fell, however, as operators financed their positions more by borrowing long or selling longer-term assets. The Bank's purchases of bills during this period were concentrated in the longer maturity bands, and were mainly at unchanged rates, so that the principal effect of this change in the market's maturity preferences was seen in slacker demand for shorter-term funds. The one-week interbank rate fell from $9\frac{9}{16}$% on 4 July to as low as $8\frac{5}{8}$% on 11 July.

Short-term interest rates: *the money-market yield curve became steeper during the summer.*



The consequent lengthening of the average maturity of the Bank's bill portfolio, combined with the continuing high CGBR, which was not fully matched by central government funding, led to a reduction in the average size of the daily cash shortages in the money market, from £340 million in banking June and £330 million in banking July to £210 million in banking August.

Around mid-July, fears of higher interest rates receded, particularly after the heavy gilt-edged funding on 12 July, and the slope of the yield curve became less pronounced. These fears re-emerged for a time early in August when concern about US monetary developments was particularly strong, and the one-year interbank rate, which had fallen back to $10\frac{1}{2}$% on 21 July, rose as high as $10\frac{7}{8}$% on 10 August. Notwithstanding the smaller shortages, the Bank continued to invite the discount houses to offer bills in all four maturity bands on days of cash shortage, and during this period received offers concentrated in the longer bands. This tended to stabilise the three-month interbank rate and there was little pressure for a rise in the general level of short-term interest rates. The money market was reassured by the publication of more encouraging US money supply figures on 12 August and by the end of the period the yield curve from a month out to a year had become less steeply sloped, the one-year interbank rate having fallen back to $10\frac{9}{16}$%.

Over the three months as a whole, interbank rates fell at shorter maturities—at one month from $10\frac{11}{32}$% to $9\frac{7}{16}$% and at three months from $10\frac{11}{32}$% to $9\frac{7}{8}$%, but the one-year rate rose on balance from $10\frac{3}{8}$% to $10\frac{9}{16}$%. Bank base rates fell by $\frac{1}{2}$% to $9\frac{1}{2}$%, but building societies' ordinary share rates rose by 1% to $7\frac{1}{4}$% (post basic-rate tax) and their mortgage rates by $1\frac{1}{4}$% to $11\frac{1}{4}$%.

Technical arrangements in the money market

On 19 July the Bank announced a number of modifications, to take effect from 18 August, to the arrangements relating to official operations in the money market which were introduced in August 1981. The notice sent to all banks and licensed deposit-takers is reproduced on page 346.

There were four main changes. First, the Bank proposed that eligible banks should in future agree to keep an average of 5% (previously 6%) of their eligible liabilities (ELs) in the form of secured money with discount houses and secured call money with gilt-edged jobbers and money brokers. This change was made possible by the rapid growth over the last two years in both the number of eligible banks and in their total ELs. Second, the period on which the average is calculated was changed, to give eligible banks additional flexibility in managing their liquid assets. For a similar reason, the daily minimum of secured funds with discount houses was reduced from 4% to $2\frac{1}{2}$% of their ELs. Finally, the Bank announced that it would publish some additional information on its daily operations.[1]

These changes are not expected to have any significant implications for the monetary aggregates.

The gilt-edged market

The authorities began the period with £1.1 billion of receipts secured through calls on earlier sales of partly-paid stock; on the other hand Variable Rate Treasury Stock 1983 and $9\frac{1}{4}$% Treasury Stock 1983 were due to be redeemed on 24 May and 18 July respectively, with some £0.6 billion of these stocks still then in market hands.

The gilt-edged market strengthened during the last full week of May on electoral speculation, and the authorities announced the issue by tender of a new stock, £1,000 million of $10\frac{1}{4}$% Treasury Convertible Stock 1987, convertible into $9\frac{3}{4}$% Conversion Stock 2001.[2] At the minimum tender price (at which the stock was allotted) the yield assuming conversion at the first possible date was 9.99%, roughly $\frac{1}{4}$% below the market yield on a comparable conventional long-dated stock. The stock was issued on 2 June in partly-paid form to provide funds for banking July and August as well as June. There was significant demand for it at the tender and, with the market remaining buoyant, official supplies were exhausted on 9 June.

(1) The change was introduced, in the event, on 12 August.

(2) The conversion terms are shown in Table F.

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

Banking months	Sept. 82– Nov. 82	Dec. 82– Feb. 83	Mar. 83– May 83	June 83– Aug. 83
Gross official sales(b)	+2.8	+2.3	+3.1	+4.1
less				
Redemptions and net official purchases of stock within a year of maturity	−0.9	−1.5	−1.4	−0.7
Equals net official sales(c)	+1.9	+0.8	+1.7	+3.5
of which, net purchases by:				
Monetary sector(c)	*+0.3*	*−0.6*	*+0.5*	*+0.3*
Overseas sector	*+0.2*	*+0.6*	*+0.3*	*+0.3*
Non-bank private sector	*+1.5*	*+0.8*	*+0.9*	*+2.8*

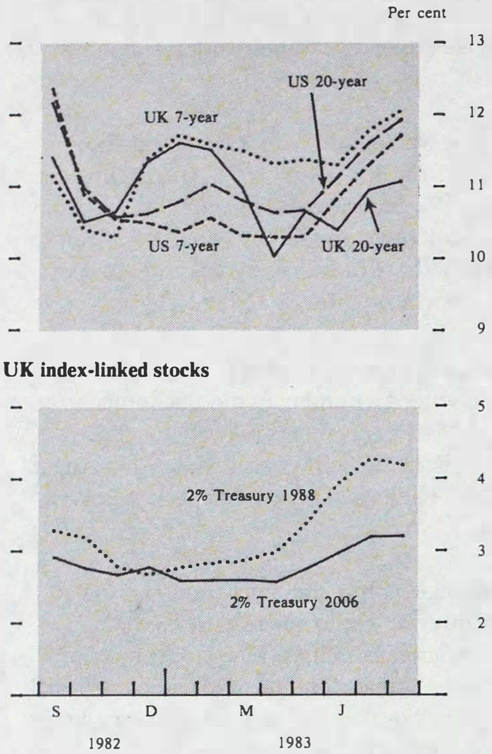
Note: Sales are recorded in this table on a payments basis, so that payments on partly-paid stocks are entered when they are made rather than at the time of commitment to make the payment.

(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.

Gross redemption yields on UK and US government stocks ***turned up during the summer.***



In order to be in a position to take advantage of favourable market conditions, if they should persist, the authorities announced a new tranche of £800 million of 9½% Treasury Stock 1988 on 10 June, for issue by tender on 16 June. In the event, however, though prices rose further on 13 June, they fell back subsequently despite the fall in short-term interest rates, and very little of the stock was sold at the tender.

Increasingly thereafter the main influence on the market was uncertainty about the UK monetary situation, as a series of published statistics indicated rapid monetary growth fuelled by a large government borrowing requirement. In addition, financial developments in the United States were a depressing influence on the market. The CGBR figure for calendar May, published on 9 June, was larger than expected, and the full money and banking figures for May, published on 16 June, showed that monetary growth had been restrained by heavy funding. During this period the authorities were able at times to make significant sales, but the uncertainty was heightened on 5 July when figures were published showing rapid monetary growth in banking June.

Around this time, suggestions began to appear in the press that the Bank should attempt to re-stimulate demand for gilt-edged by cutting the prices of tap stocks. To have attempted to do so at that stage, before the market adjustment was complete, and while uncertainty about the appropriate level of yields persisted, would have been likely simply to have heightened market uncertainty and pushed prices further down, below the newly-established tap level. The fact that the market's adjustment was not by then complete was reflected in a further fall in prices—by a total of up to £1¾ for long-dated conventional stocks—on Tuesday 5 and Wednesday

Table F
Issues of gilt-edged stock

Stock	Amounts issued (£ millions)	Date announced	Method of issue	Date issued	Price per £100 stock (£)	Payable per £100 stock: Initial payment (£)	Payable per £100 stock: Further instalments (£)	Redemption yield (per cent)	Date exhausted
10¼% Treasury Convertible 1987	1,000	27/5	Minimum price tender	2/6	98.25	20	50 (18/7) 28.25 (15/8)	10.84(a)	9/6
9½% Treasury 1988 'A'	800	10/6	Minimum price tender	16/6	95.00	40	30 (25/7) 25 (22/8)	10.77	8/9
10½% Exchequer 1997	300	13/7	Direct to Bank	13/7	—	—	Fully paid	—	12/8
11½% Treasury 2001/04	200	13/7	Direct to Bank	13/7	—	—	Fully paid	—	19/7
10% Treasury Convertible 1986	1,000(b)	12/8	Minimum price tender	17/8	97.25	40	57.25 (19/9)	11.24(c)	17/8
12% Treasury 1995	300	22/8	Direct to Bank	22/8	—	—	Fully paid	—	12/9
11¾% Treasury 2003/07	200	22/8	Direct to Bank	22/8	—	—	Fully paid	—	6/9

(a) Yield to 1987. Holdings may, at the option of the holder, be converted in whole or in part into 9¾% Conversion Stock 2001, as on the following dates:

Date of conversion	Nominal amount of 9¾% Conversion 2001 per £100 nominal of 10¼% Treasury Convertible 1987	Implied redemption yield (%)
10 February 1984	£100	9.99
10 August 1984	£97	9.69
10 February 1985	£94	9.41
10 August 1985	£91	9.16
10 February 1986	£88	8.92

(b) Of which £200 million was reserved for the National Debt Commissioners.

(c) Yield to 1986. Holdings may, at the option of the holder, be converted in whole or in part into 10% Conversion Stock 2002, as on the following dates:

Date of conversion	Nominal amount of 10% Conversion 2002 per £100 nominal of 10% Treasury Convertible 1986	Implied redemption yield (%)
11 April 1984	£102	10.56
11 October 1984	£100	10.33
11 April 1985	£98	10.13
11 October 1985	£96	9.94

6 July. The Bank accordingly did not take any immediate funding initiative.

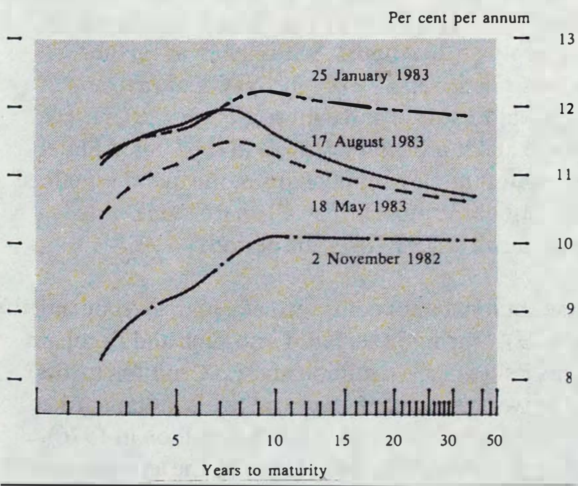
The Government responded more quickly than was widely expected to the fiscal situation by announcing on 7 July measures to reduce the PSBR in 1983/84 by about £1 billion. The initial market reaction, however, was adverse, partly because of press reports that the prospective overshoot in the PSBR from the total envisaged at the time of the Budget was much larger than £1 billion.

There was an expectation in the market that the Bank would announce a new gilt-edged stock issue on Friday, 8 July. But the authorities still did not consider the moment opportune. In the event prices fell further on Friday 8 and Monday 11 July, partly in response to the June CGBR figures.

On Tuesday 12 July there were indications that market prices had reached a level which could provide a firm basis for trading, and, in an attempt to consolidate the improvement in sentiment, the Bank accepted bids for $2\frac{1}{2}$% Index-Linked Treasury Convertible Stock 1999 at a price of £91$\frac{7}{8}$, £5$\frac{7}{8}$ below the price at which the stock had last been supplied; these were sufficient to exhaust official supplies.

The market remained firm on 13 July, and the authorities sought to further the consolidation by announcing on that day the issue of a total of £500 million of stock in the form of 'tranchettes'—£300 million of $10\frac{1}{2}$% Exchequer Stock 1997 and £200 million of $11\frac{1}{2}$% Treasury Stock 2001/2004—to be available for sale in the market from Friday 15 July. This was the first issue of long-dated conventional stock for about a year.

Time/yield curve of British government stocks
has risen lately, particularly at the short end.



The market fell back on concern about possible US developments on 15 July, but substantial quantities of the tranchettes were sold the following week. The Bank's supplies of the longer stock were exhausted on 19 July, and sales of $9\frac{1}{2}$% Treasury Stock 1988 'A' were re-started on 21 July at a price of £37$\frac{3}{4}$ (£40 paid).

Bond yields in the United States rose sharply late in July and early in August, and trading in the gilt-edged market was generally quiet, though prices remained steady. On 12 August the authorities announced the issue by tender of £800 million of 10% Treasury Convertible Stock 1986(1) in partly-paid form. The stock is convertible into 10% Conversion Stock 2002.(2)

Following the encouraging US money supply figures published on the evening of 12 August gilt-edged prices opened higher on 15 August enabling further official sales to be made to the market. Moreover, at the tender on 17 August, the new convertible issue was over-subscribed and allotted at a price of £97.25, that is, £0.50 above the minimum tender price. At the allotment price, its yield to 2002 (assuming conversion at the earliest possible date) was 10.56%, roughly $\frac{1}{2}$% below the yield on comparable straight long-dated stocks.

Over the three months gilt-edged yields rose on balance: on five-year stocks by about $\frac{3}{8}$% to $11\frac{3}{4}$%, and on twenty-year stocks by about $\frac{1}{8}$% to around $10\frac{7}{8}$%. Index-linked stocks were neglected for much of the period and their real yields rose, by $\frac{7}{8}$% to $4\frac{1}{4}$% on

(1) An additional £200 million was reserved for the National Debt Commissioners.
(2) The conversion terms are shown in Table F.

the 1988 stock and by $\frac{3}{8}$% to just over 3% on the 2016 stock.[1] During August, however, interest in these stocks revived and their yields fell back.

Other capital markets (Table G)

Three months to end-August

The *equity market* advanced steadily throughout most of June with a weakening in sterling and concern about the mortgage rate causing only a temporary setback in the middle of the month. Two large rights issues in successive weeks were absorbed with ease and, helped by overseas demand for UK shares, the FT-Actuaries all-share index had risen to a new peak of 460.81 by 27 June. Thereafter, fears began to re-emerge about the outlook for both US and domestic interest rates and, with Wall Street also weaker and with the market expecting further sales of government assets, prices fell back in the first two weeks of July. The all-share index dropped to 431.39 on 13 July, but this proved to be a turning point and the rest of the month saw a revival of investor confidence, helped by some encouraging company results, a stronger trend on Wall Street and good trade figures for June. In these firm conditions, the Chancellor's statement on 25 July of the Government's intention to sell some £500 million of its holding of BP shares during the current financial year and the announcement of another large rights issue (by a clearing bank) produced little adverse impact.

Renewed concern about higher interest rates caused prices to ease at the turn of the month, but buyers quickly returned and prices rose in early August with hopes of economic recovery further encouraged by the latest CBI survey. Conditions were quiet during the holiday period, but indications that growth in US money supply was moving closer to target helped the all-share index to move forward to new record levels, reaching a peak of 465.74 on 18 August. Investors began to take profits at these levels, however, and prices fell sharply on 23 August. Sentiment was further depressed by a pessimistic report from the National Institute of Economic and Social Research and a more gloomy CBI survey, and with optimism about monetary growth in the United States dampened by the latest money supply figures, the mood remained unsettled for the rest of the month. The all-share index ended August at 450.36, a rise of 2.9% over the period.

Demand for new equity finance continued at a high level during the period (see Table H). During June, Rio Tinto Zinc and Beecham announced rights issues of £196 million and £200 million (gross) respectively—the two largest such issues on the London market since BP (£624 million in 1981) and ICI (£204 million in 1976). These were followed towards the end of July by the announcement of a £161 million rights issue by Midland Bank.

The domestic *fixed interest market* was less active than in the previous three months, although the total included issues by three industrial borrowers. The largest of these was a placing of £75 million of debenture stock by Allied Lyons in June. No *local authority* issues were made during the period, except that in June one local authority exercised its option to draw down a droplock facility resulting in the issue of £6 million of stock. Also in June,

(1) The real yields quoted are calculated broadly on the assumption that the retail price index will change in the future at the same rate as over the most recent six months for which figures have been published.

Table G
Amounts raised in the capital market
£ millions; *not seasonally adjusted*
Net cash raised +

Calendar months	Sept. 82– Nov. 82	Dec. 82– Feb. 83	Mar. 83– May 83	June 83– Aug. 83
UK private sector				
Loan capital and preference shares(a)	+110	− 24	+412	+ 72
Equity capital(a)	+248	+234	+746	+737
Unit trusts	+237	+340	+309	+226(b)
Issues on the unlisted securities market	+ 16	+ 16	+ 35	+ 47
Local authorities				
Stocks	− 65	− 58	+ 45	−124
Negotiable bonds	+ 78	+ 13	+ 23	− 16
Overseas	+270	+ 99	+ 46	+153

Note: This table shows amounts paid over in respect of capital issues: amounts paid in respect of partly-paid issues are shown as they are paid over, not at the time the issue was announced.

(a) Net issues by listed UK public companies.
(b) June and July only.

Table H
Debt issues announced on the London capital market: June–August 1983(a)

Date of announcement	Issuer	Nominal amount (£ millions)	Coupon	Maturity
Domestic borrowers				
20 June	Ecclesiastical Holdings	6	13%	2018
20 June	Oldham Metropolitan Borough Council(b)	6	11$\frac{1}{4}$%	2010
22 June	Allied Lyons	75	11$\frac{3}{4}$%	2009
19 July	Transport Development Group	10	12$\frac{1}{2}$%	2008
22 July	Westland	30	12$\frac{3}{8}$%	2008
Overseas borrowers				
8 June	Société Générale de Banque SA(b)	7.25	11.49%	2007
13 June	Malaysia	50	12$\frac{1}{4}$%	1988
29 June	CCCE	50	12$\frac{1}{4}$%	2013
23 August	Cigna Overseas Finance	30	13%	2008

(a) All these issues were placed except that for Malaysia which was offered for sale. Issues of convertible loan stock and issues of less than £3 million are not included.
(b) Issued pursuant to a droplock agreement.

Table J
Outstanding droplock arrangements

Trigger levels(a)	Amount committed as at end-August 1983 (£ millions)
$10\frac{1}{2}$% up to 11%	7
10% up to $10\frac{1}{2}$%	39
$9\frac{1}{2}$% up to 10%	81
9% up to $9\frac{1}{2}$%	12
$8\frac{1}{2}$% up to 9%	20
No specified level	26

(a) Usually set with reference to the yield on high coupon, long-dated gilt-edged stocks.

£7.25 million of stock was issued by an overseas borrower under a similar facility. (Droplock arrangements currently outstanding are shown in Table J.)

Besides the droplock-related issue three other issues were made by *overseas borrowers* in the domestic fixed interest market during the period. These included an offer for sale of £50 million by Malaysia.

The *eurosterling market* continued active with seven issues raising a total of about £330 million, including one issue of £100 million by the IBRD, the largest so far seen in this sector. The recent innovatory trend continued with two borrowers bringing issues to be sold partly on tap, thereby following the example set by Investors in Industry in May. In addition, a West German company launched an issue of some £50 million on a coupon of only $6\frac{7}{8}$%, but with warrants attached to subscribe for shares in the company.