International financial developments

The article on page 54 discusses international banking developments last year in some detail. This review is accordingly shorter than usual, omitting material which can be found in the article and focussing on the latest developments. The main points are:

- *Non-oil developing countries' deficits on current account contracted in 1983; there was a change in the pattern of their borrowing, with banks supplying less and the IMF more. In the second half of the year, oil exporting countries returned to small surplus.*
- *The combined current account deficits of major OECD countries widened during the course of 1983, but experience varied considerably.*
- *The amount raised in syndicated credits remained low in the fourth quarter, though large sums were involved in rescheduling packages and new money associated with them.*
- *Fixed-rate bond issues, by contrast, recovered in the fourth quarter, and record amounts were raised through floating-rate notes, which are now an attractive alternative to syndicated credits for some borrowers. The floating-rate note sector remained very active in January and February.*
- *UK banks were heavy net lenders in foreign currencies to banks abroad in the fourth quarter, but the amount of interbank business in London fell back.*
- *In the foreign exchange market, the focus of attention was the dollar which weakened sharply during February. Sterling's effective exchange rate moved narrowly.*

Balance of payments positions

Last year saw a contraction in the combined current account deficit of non-oil developing countries, although the improvement had occurred by mid-year. Higher commodity prices and restraint on imports were important factors. Smaller improvements were recorded in the positions of the oil exporting economies and the smaller OECD countries, while the deficit of the major OECD countries grew during the course of the year. The overall deterioration in the last category, however, conceals marked increases in the US deficit and in the Japanese surplus and moves towards balance elsewhere. While smaller than in 1982, the statistical discrepancy in total current account positions(1) was still equivalent to 5 per cent of world trade.

Although the oil exporters' combined current account deficit was only slightly smaller in 1983 as a whole than in 1982, there was a sharp improvement between the first and second halves of the year, with the combined current account in small surplus in the final two quarters. Higher oil exports helped, but most of the improvement came from a fall in imports. Financial constraints forced several countries, notably Indonesia, Nigeria and Venezuela, to take action to improve their balance of payments.

World current accounts

$ billions; *seasonally adjusted*

	1982	1983				
	Year	Year	Q1	Q2	Q3(a)	Q4(a)
OECD countries:						
Canada	2.5	1.4	0.2	1.0	– 0.1	0.3
France	–12.1	– 4.2	–3.9	–0.9	0.3	0.3
Germany	3.5	3.0	1.9	0.6	– 0.5	1.0
Italy	– 5.4	0.7	–0.5	0.2	—	1.0
Japan	7.5	21.0	3.4	6.1	6.1	5.4
United Kingdom	9.6	3.1	1.7	–0.1	1.0	0.5
United States	–11.2	–40.6	–3.6	–9.7	–12.0	–15.3
Major economies	– 6	– 15	– 1	– 3	– 5	– 6
Other OECD	– 26	– 24	– 5	– 6	– 6	– 7
Total OECD	– 32	– 39	– 6	– 9	– 11	– 13
Oil exporting countries	– 14	– 9	– 10	– 4	2	3
Other developing economies	– 67	– 45	– 14	– 10	– 10	– 11
Other countries(b)	3	5	3	3	2	– 3
World discrepancy(c)	– 110	– 88	– 27	– 20	– 17	– 24

(a) Includes Bank estimates/forecasts.
(b) South Africa and the centrally planned economies.
(c) Reflecting errors and omissions arising from incomplete coverage, timing differences and other statistical deficiencies.

The major OECD economies' current account deficit (on provisional estimates) widened further in the final quarter of last year and more than doubled in 1983 as a whole. The largest imbalance (some $40 billion) was in the United States, where the strength of the dollar, the pickup in

(1) Virtually all the groups were (inconsistently) recorded as being in deficit. Underrecording of service receipts and investment income is a likely explanation.

domestic activity and the sharp decline in Latin American markets, adversely affected trade. By contrast, the Japanese surplus rose to over \$20 billion. The current accounts of the other major OECD economies were little changed or moved towards balance: the UK and Canadian surpluses shrank, as did the French and Italian deficits, to some extent reflecting the different rates of growth of these economies.

In 1983 as a whole, the UK surplus on current account shrank from £5½ billion in 1982 to £2 billion.[1] The balance of trade in goods other than oil worsened by over £5 billion, most of the deterioration being in manufactured goods. The balance of trade in oil, by contrast, improved by £2½ billion. The surplus on services rose by £½ billion, but from a rather low figure in 1982 (trends in trade in services are discussed on page 34). Slow growth in many UK markets abroad, together with rather weak competitiveness and more rapid growth in domestic demand, were factors underlying the worsening balance on goods and services. The balance on interest, profits and dividends, and on transfers, also moved adversely in 1983. These trends did not, however, intensify during the course of the year; the current account surplus was approximately £1 billion in each half-year. Among recorded capital flows, outward portfolio investment was much the same as in 1982 (just over £6 billion), but much lower in the second half of the year. Overseas investment in the United Kingdom rose sharply, but UK banks borrowed much less foreign currency (net) abroad than in 1982, when the amount was exceptionally large, and indeed reduced their net external liabilities in foreign currency in the fourth quarter.

There was an improvement in the smaller OECD countries' current account position, but this was somewhat limited despite continuing tight financial policies and sluggish domestic activity.

The upturn in the world economy has contributed to a gradual easing in the external position of the non-oil developing countries since late 1982. Export volumes have grown more rapidly than expected, rising by about 4% in 1983, while imports have continued to be restrained by financing pressures. The increase in commodity prices in the course of last year benefited these countries' terms of trade, which strengthened by about 1% in 1983 (as against a cumulative worsening of some 10% in 1980–82). In consequence, there was a marked improvement in the developing countries' current account (especially in Latin America), largely reflected in their trade position with OECD countries, the United States in particular. As for their invisibles account, the developing countries were helped by lower nominal interest rates than in 1982.

Developing countries' borrowing

\$ billions; *figures in italics are percentages of combined current account deficit plus reserve changes*

	1979	1980	1981	1982	1983(a)
Borrowing from:					
IMF(b)	2	4	6	5	10
	4	*6*	*7*	*8*	*20*
Commercial banks(c)	36	41	40	20	11
	69	*62*	*48*	*33*	*22*

(a) First nine months at an annual rate (not seasonally adjusted).
(b) Including SDR allocations.
(c) Actual borrowings, not announced credits.

These developments brought a further reduction in the non-oil developing countries' current account deficit, to \$32 billion (not seasonally adjusted) in the first nine months of last year, compared with some \$45 billion in the same period of 1982.

Developing countries' balance of payments

\$ billions; *not seasonally adjusted*

	1981 Year	1982 Year	1983(a) Q1	Q2	Q3
Current account	**−82**	**−67**	**−13**	**−9**	**−10**
Capital account	**77**	**52**	**11**	**10**	**11**
of which:					
Concessionary and other official flows	26	27	7	7	7
Direct investment	13	9	2	2	2
Borrowing from banks(b)	40	20	2	5	2
Borrowing via bond issues	4	3	—	—	1
Other capital flows(c)	−5	−7	—	−4	−1
Official financing balance	**5**	**15**	**2**	**−1**	**−1**
of which:					
Use of IMF credit	6	5	4	2	2
Liabilities to other CMIs	—	3	—	—	−2
Reserves(b) etc (increase −)	−1	7	−2	−3	−1

(a) Includes Bank estimates/forecasts.
(b) Adjusted to exclude valuation effects.
(c) Including errors and omissions.

The capital account of developing countries can be seen alongside their current transactions in the table. Capital inflows have been broadly maintained since mid-1982, though at a rate much below that of the previous period, and in the first three quarters of last year they covered the reduced current account deficit. Compared with 1981 and early 1982, borrowing from commercial banks has been sharply reduced, and indeed during the first three quarters of 1983 the IMF supplied developing countries with almost as much finance as did the banks, Brazil, India, Argentina and Mexico all making large drawings.

Distribution of new IMF lending[a] in 1982 and 1983

\$ billions

	1982	1983
Developing countries' total	**5.0**	**10.1**
of which:		
Argentina	0.9	1.2
Brazil	0.5	2.2
Mexico	0.2	1.1
India	1.7	1.6

(a) Amounts actually drawn.

International borrowing and lending

Some of these developments in current balances are reflected in recorded flows of international borrowing and lending. The correspondence is not close, however, because of coverage and timing difficulties. To avoid overlap with the article on page 54, this section is confined to the latest developments.

(1) These figures incorporate the reclassification of certain transactions in gold, which add £0.3 billion to the current account surplus in 1982 and £0.4 billion in 1983.

Trade in services

Services make an important contribution to the UK current account, earning a surplus in 1983 equal to 5.5% of total exports. Much of the improvement took place in the mid-1970s; since 1978, the surplus has remained around £4 billion, but has tended to fall as a proportion of total exports (Chart A). Exports of services were equivalent to 6.3% of GDP in 1983.

There have been substantial changes in the last decade in the composition of services; in particular sea transport has lost share considerably, while civil aviation and travel have much increased in relative importance. The favourable balance on financial and various 'other' services has grown strongly.[1]

The relative importance of both exports and imports of *sea transport* services has shrunk, and the balance changed very little until 1981 (Chart B). There are two reasons for this. First, the shipping account shows both earnings from transporting goods between foreign countries by UK shipping companies (a credit), and their spending on fuel, provisions etc overseas (a debit). The decline of the UK fleet has therefore tended to reduce both credits and debits, in a partially offsetting way. Second, charter payments for ships by UK companies (a debit) declined from 36% of shipping debits in 1973 to 15% in 1982 as UK companies owned a larger proportion of the fewer ships employed. This substitution seems to have ended; the fall of nearly a quarter in the gross tonnage of the UK fleet in 1982 and 1983, coupled with the rise in payments for imports to overseas lines, brought deficits on the account.

Financial and other services have been consistently and increasingly in surplus and the United Kingdom may have maintained its share of world markets for financial and other services as a whole in recent years (see also chart on page 42).[2] The problems of measuring trade and output in this area are however severe. The experience of different components in this sector has varied. Consultancy and construction work overseas made a major and growing contribution through the 1970s. Insurance growth was lower, although it showed a strong rise in 1983, probably as a result of the strength of the dollar.

Travel has become more important with rising incomes (and lower real costs). The account broadly balanced up to 1973; subsequently, exchange rate movements encouraged tourism in the United Kingdom, and substantial surpluses accrued. These surpluses fell away following the appreciation of the pound, and deficits have been recorded since 1980 though on a smaller scale than in the mid-1960s.

Civil aviation has also become much more important. Although overseas airlines' earnings from UK residents have grown faster than UK airlines' earnings overseas, the United Kingdom nevertheless continues to earn a surplus on air transport.

The proportion of service debits accounted for by *government* has fallen considerably since 1963. The share of government credits has remained quite stable, so there has been some fall in the deficit on the account.

Chart A
Balance of trade in services as percentage of exports of goods and services (by value)

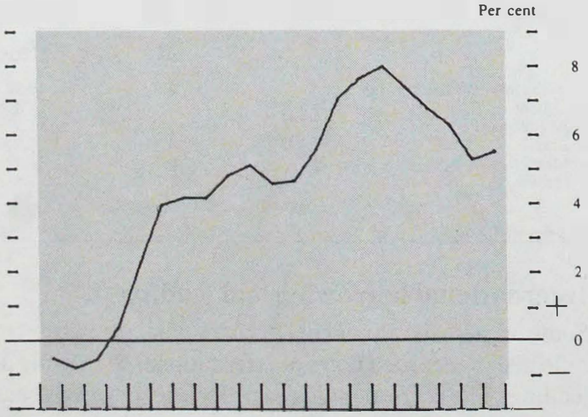
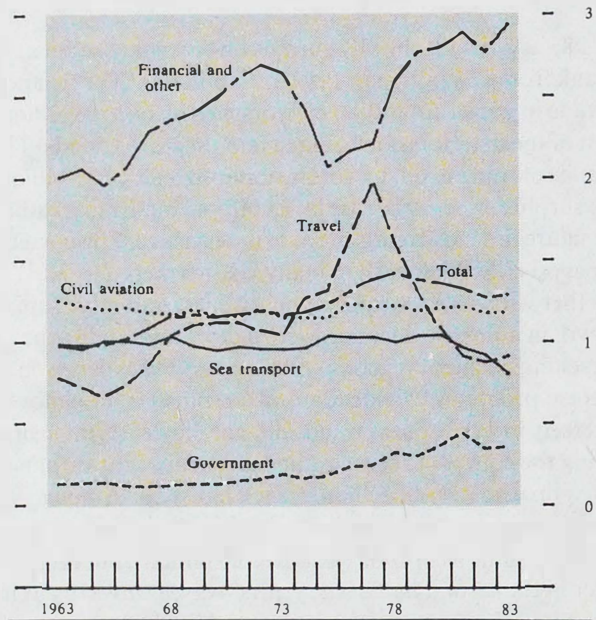


Chart B
Ratio of value of exports to imports in various categories of service trade



(1) An article in the December 1981 *Bulletin* described the categories.
(2) See *World Invisible Trade*, published by the British Invisible Export Council.

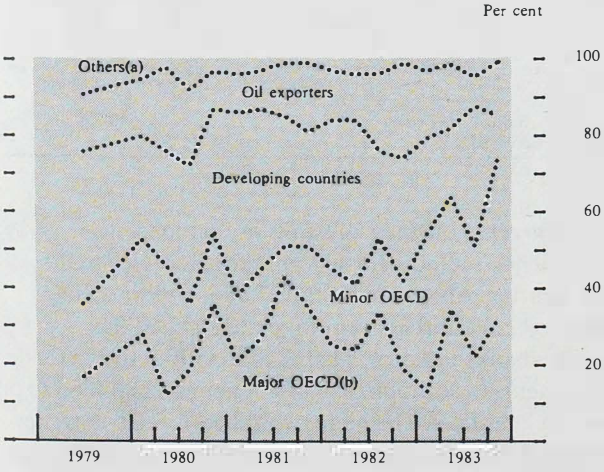
Medium-term syndicated bank credits[1]

Medium-term credits remained at a depressed level ($7.5 billion) in the fourth quarter of 1983. After two especially quiet months, December saw increasing activity as borrowers completed their 1983 fund-raising programmes, but there was no follow-through into the new year, and announcements in January, at $1.1 billion, were the lowest in any month since August 1975.

These figures relate to 'spontaneous' market credits. In addition, the amount of rescheduling and associated new money was higher in the fourth quarter than in any previous quarter; rescheduling packages announced for Brazil and Mexico provided $6.5 billion and $3.8 billion of new money respectively.

While the commitment of funds to reschedulings and new money packages may be discouraging banks from advancing market loans, there seems also to be less demand for syndicated credits from good-quality borrowers. This may be a result of improving balance of payments positions or associated with the growing use of floating-rate notes (see below). Spreads for most of those borrowers active in the market continued to decline.

'Spontaneous' medium-term credits: breakdown by economic grouping



(a) Including Eastern bloc.
(b) Including international institutions.

OECD borrowers raised 75 per cent of the 'spontaneous' market loans in the fourth quarter, although their market share returned to the more normal level of around 50 per cent in the first two months of 1984. Among the major countries, borrowers in France, Italy and the United States were the most active; however, with the exception of an $800 million arrangement for the Kingdom of Belgium, the largest loans raised in the fourth quarter were for borrowers from minor OECD countries—Portugal, Australia and Norway. Early 1984 saw a record ECU 450 million loan for an Italian borrower, following renewed interest in the currency unit in the fourth quarter, along with major loans for borrowers from the United Kingdom and Turkey.

Total syndicated lending

$ billions

		'Spontaneous' market loans	*of which, to developing countries*	Rescheduling	New money included in rescheduling packages	Total
1982	Q1	22.7	*10.9*	1.1	—	28.8
	Q2	29.2	*12.5*	1.1	—	30.3
	Q3	22.7	*5.1*	2.9	—	25.6
	Q4	11.4	*3.5*	9.2	11.2	31.8
1983	Q1	13.1	*3.3*	13.2	1.3	27.6
	Q2	10.1	*1.8*	10.0	1.7	21.8
	Q3	7.3	*2.6*	10.0	0.2	17.4
	Q4	7.5	*0.9*	10.1	11.9	20.2
1984	Jan.–Feb.	3.7	*0.7*	4.0	0.8	8.5

The *oil exporting countries'* borrowing picked up in the fourth quarter, with Algerian banks raising $0.8 billion. Indonesia's $0.6 billion loan arranged in February 1984 confirmed the market's appetite for lending to oil exporters; there was also a favourable reception for the USSR and Hungary, the first *Eastern European* borrowers for some months.

Developing countries borrowed less than $1 billion in the fourth quarter, with South Korea the most active borrower. Other major borrowers included Thailand, India and Hong Kong, and facilities were arranged for Colombia and Mexico in conjunction with international institutions.

Fixed-rate bonds and floating-rate notes

While the amount of market syndicated credits has fallen sharply since mid-1982, issues of bonds have been broadly maintained and floating-rate notes have increased considerably. Issues of fixed-rate bonds and floating-rate notes combined rose to $20.7 billion in the fourth quarter, bringing the total for the year to a record $75.7 billion.

Fixed-rate bonds

After a sharp decline in the third quarter, fixed-rate dollar placements rose by $4.7 billion in the fourth, when changes in relative costs encouraged a switch from domestic to eurobond sources by US companies. Japanese corporate borrowing and borrowing by international institutions and minor OECD governments also picked up. In contrast, fixed-rate borrowing by banks was subdued.

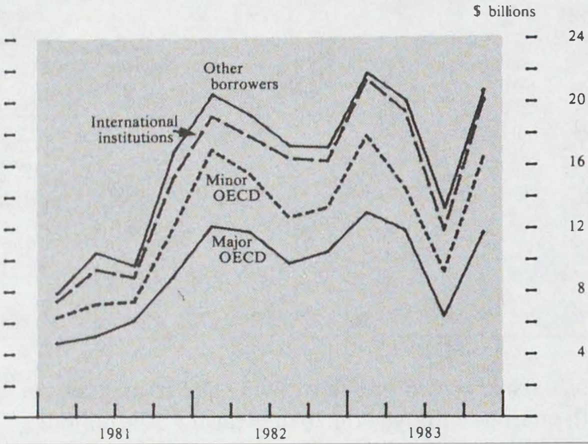
Towards the end of the year, and in January and February, borrowers appeared keen to obtain the going terms on dollar issues while they were available. Strong stock markets brought interest in convertibles but investors hesitated to take straight dollar issues, substantial portions of which were left with underwriters or traded at sizable discounts. Non-dollar placements, by contrast, have varied less from quarter to quarter. Fixed-rate issues totalled $9.6 billion in January and February.

Floating-rate notes

Like borrowers in the fixed-rate bonds market, issuers of floating-rate notes are mostly international organisations or based in industrial countries. Banks in particular are prominent borrowers. Floating-rate notes offer holders an

(1) Figures and comments relate to announcements, not to drawings on credits.

International bonds and notes: completed issues



attractive combination of marketability and, subject to the creditworthiness of the borrower and the willingness of holders as a group to retain them, near certainty of capital value, which is particularly attractive to banks trying to improve the flexibility of their balance sheets. Strong competition for mandates has pushed spreads very low in some cases. A record $6.1 billion was raised in the fourth quarter, with a $1 billion issue by Sweden, for twenty years, breaking new ground on maturity.

The floating-rate note market was even more active in the first quarter of 1984. Denmark and Spain managed to borrow at longer maturities and lower cost than would have been likely in the syndicated credits market, and several banks were able to make issues paying the London interbank offer rate. The IBRD raised $250 million for ten years at a rate linked to US Treasury bill rate. Sweden announced an issue for forty years, twice the period of the longest maturity previously available. Altogether in January and February issues amounting to $6.3 billion were announced.

International banking developments

The article on page 54 discusses transactions of banks in the BIS reporting area in the year to September 1983. In the third quarter of last year, the main feature of the BIS statistics was a further slowdown in lending to less developed countries and, in contrast, a pickup in lending to countries within the reporting area, with a recovery in interbank business. For the second quarter running (but contrary to earlier experience) the United States was a net user of eurocurrency funds. The latest maturity analysis, for the six months ending in June 1983, shows that lending to countries outside the BIS reporting area with a remaining maturity of less than one year fell back as a proportion of total lending, in part reflecting rescheduling of debt by non-oil developing countries.

BIS area banks' short-term lending as a percentage of total lending(a)

	1981		1982		1983
	30 June	31 Dec.	30 June	31 Dec.	30 June
Western Europe(b)	40.7	39.9	39.5	41.1	41.0
Eastern Europe	39.4	42.0	39.7	38.5	38.0
Australia, New Zealand and South Africa	42.7	46.3	49.7	45.0	43.9
Major oil exporting countries	56.5	58.4	58.9	58.3	57.0
Non-oil developing countries	46.9	47.0	47.1	46.7	45.7
of which:					
Middle East and North Africa	*69.2*	*69.6*	*70.5*	*66.6*	*65.3*
Other Africa	*33.9*	*34.8*	*33.8*	*33.3*	*30.5*
Asia	*55.0*	*55.2*	*53.4*	*53.8*	*51.9*
Latin America	*44.1*	*44.1*	*44.9*	*44.2*	*63.5*
All countries	**46.3**	**47.1**	**47.2**	**46.8**	**46.0**

(a) Debt due for repayment within one year as a percentage of total outstanding lending to each group of countries. Based on the series in Table 13.2 in the statistical annex.

(b) Except BIS area.

UK banks' foreign currency liabilities and assets by customer(a)

$ billions

	1983			
	31 Mar.	30 June	30 Sept.	31 Dec.
Foreign currency deposit liabilities of UK banks to:				
Other UK banks	172.0	147.0	157.2	145.2
Other UK residents	20.6	20.6	21.5	24.0
Overseas central monetary institutions	44.5	42.8	45.7	44.4
Own offices overseas	83.5	80.7	89.4	87.3
Other banks overseas	207.8	207.9	208.3	212.9
Other non-residents	124.0	127.0	126.6	130.7
Other liabilities(b)	9.8	8.6	10.7	11.8
Total liabilities	**662.2**	**634.6**	**659.4**	**656.3**
Foreign currency assets of UK banks with:				
Other UK banks	168.6	143.1	154.4	141.0
Other UK residents	28.9	29.9	32.0	32.3
Own offices overseas	147.3	144.8	152.1	155.0
Other banks overseas	168.2	167.7	168.6	172.5
Other non-residents	127.3	127.3	128.6	128.4
Other assets(c)	21.0	21.4	23.7	26.5
Total assets	**661.3**	**634.2**	**659.4**	**655.7**

(a) The reporting population is broader than the UK monetary sector (see the notes and definitions to Table 14.1 in the statistical annex) although data on 'own offices overseas' are available only for the UK monetary sector.

(b) Mainly capital and other internal funds.

(c) Mainly investments.

Foreign currency business of banks in London with non-residents (including banks abroad) increased in the fourth quarter. About half of the $7 billion increase in lending to banks abroad went to related offices, the American banks in London being especially active in this development. In addition, banks lent about $2½ billion to oil exporting countries. The increase in their foreign currency lending to UK residents was very small; indeed, net foreign currency claims on UK residents fell in the fourth quarter as companies in particular added to their deposits of foreign currencies.

The unwinding of positions taken by Japanese banks in September accounted for the fall of some $13 billion in foreign currency business in the London interbank market. This fall was partly offset by the end-year activities of continental banks and an increase in the issue of certificates of deposit.

Banks in London continued to buy long-term marketable paper and as a consequence their net assets with a remaining maturity of over one year rose by $3 billion in the three months to mid-November. At the same time, their liabilities in foreign currencies with under three months to maturity rose by $7 billion, also rising slightly as a proportion of the banks' total book.

Identified deployment of oil exporters' funds[(a)]

$ billions

	1981	1982	1983			
	Year	Year	Q1	Q2	Q3	Q4(b)
United Kingdom:						
Sterling bank deposits	0.5	1.2	0.4	−0.3	−0.1	0.2
Eurocurrency bank deposits	7.8	−9.2	−3.8	−1.4	0.6	−2.9
British government stocks	0.9	0.1	0.1	0.1	—	—
Other investments(c)	0.2	−0.6	−0.1	−0.1	−0.1	−0.1
	9.4	−8.5	−3.4	−1.7	0.4	−2.8
United States:						
Bank deposits	−1.9	4.7	−0.4	−0.4	0.3	1.3
Treasury bonds, notes and bills	10.4	7.3	−1.3	−2.1	−1.6	−1.8
Other investments(c)	6.9	−1.3	−1.4	−1.3	1.2	—
	15.4	10.7	−3.1	−3.8	−0.1	−0.5
Other industrialised countries:						
Bank deposits	−5.1	−12.7	−4.3	−6.2	2.1	..
Other investments(c)	19.5	6.6	−1.5	0.1	0.9(b)	..
IMF and IBRD(d)	2.4	2.1	0.2	2.7	−0.3	1.6
Loans to developing countries	7.2	3.9	0.4	0.1	—	..
Total identified uses of funds	**48.8**	**2.1**	**−11.7**	**−8.8**	**3.0**	**..**
External borrowing etc.(e)	6.4	13.8	5.7	−1.4	−0.1	
Current balance	48.2	−13.9	−13.0	−6.3	3.0	
Total identified sources of funds	**54.6**	**−0.1**	**−7.3**	**−7.7**	**2.9**	

.. not available.

(a) The notes and definitions to Table 16 in the statistical annex gives a list of oil exporting countries.

(b) Provisional.

(c) Mainly loans and holdings of equities.

(d) Includes holdings of gold.

(e) Oil exporting countries' liabilities arising from net borrowing and inward direct investment, together with changes in credit given by them for oil exports.

External sterling business of UK banks rose more in the fourth quarter than in the two previous quarters. Liabilities rose by £1.5 billion, almost half the increase being in deposits from non-banks. UK banks' sterling lending abroad rose by £0.9 billion. (External business in sterling is discussed on page 65.)

UK banks' external sterling liabilities and assets by customer[(a)]

£ billions

	1982		1983				
	30 Sept.	31 Dec.	31 Mar.(b)		30 June	30 Sept.	31 Dec.
UK banks' sterling liabilities to:							
Overseas central monetary institutions(c)	1.5	1.5	1.7	1.8	1.7	2.1	2.3
Own offices overseas	2.1	2.2	2.6	2.6	2.7	2.9	3.0
Other banks overseas	5.6	6.4	6.3	6.5	6.9	6.7	7.2
Other non-residents	9.4	9.0	9.8	9.9	10.1	10.4	11.1
Total liabilities	**18.6**	**19.1**	**20.4**	**20.8**	**21.4**	**22.1**	**23.6**
UK banks' sterling assets:							
Loans and advances to:							
Own offices overseas	1.3	1.4	1.6	1.6	1.6	1.5	1.6
Other banks overseas	2.8	3.0	3.0	3.1	2.9	2.8	3.0
Other non-residents	3.0	3.7	4.1	4.1	4.2	4.3	4.6
Bills	5.3	5.4	5.6	5.6	5.7	5.8	6.0
Acceptances	2.4	2.5	2.9	2.9	2.7	2.9	3.0
Total assets	**14.8**	**16.0**	**17.2**	**17.3**	**17.1**	**17.3**	**18.2**

(a) The reporting population is broader than the UK monetary sector (see the notes and definitions to Table 16 in the statistical annex).

(b) For details of break in series at 31 March 1983, see notes and definitions to Table 16.

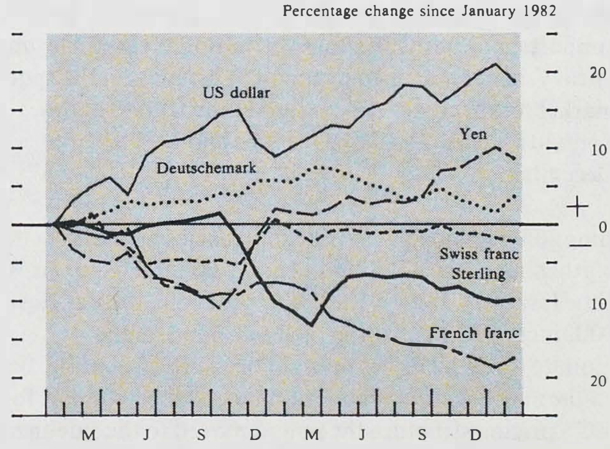
(c) Includes international organisations.

Deployment of oil money

As noted earlier, the oil exporting countries had a surplus (of $3 billion, not seasonally adjusted) on current account in the third quarter. This improvement was reflected in a modest rise in their identified assets, which had been reduced by about $20 billion in the first half of the year. Placements in the United States were little changed but oil exporters increased their foreign currency deposits in the United Kingdom and their bank deposits and investments in other industrial countries.

Provisional figures for the fourth quarter indicate a renewed fall in bank deposits in the United Kingdom, and a continued reduction in holdings of Treasury bonds, notes and bills in the United States ($1.8 billion).

Indices of effective exchange rates



Foreign exchange and gold markets

(Three months to end-February)

The focus of attention throughout the period was the dollar. Trading conditions were volatile and hectic for much of the time, chiefly because of a growing unease about the dollar's longer-run prospects in the face of the increasing current account deficit. As a result, the dollar, which reached fresh peaks in January, weakened on balance. This happened despite expectations that US monetary policy would remain tight—due to the strength of the economic recovery, the high budget deficit, and concern about the longer-term outlook for inflation—and despite international tensions which highlighted the dollar's attractions as a safe-haven currency. The counterpart to the activity in the dollar was mainly centred on the deutschemark, which rose to the top of the narrow band of the European Monetary System (EMS). Although the EMS was reasonably settled, the Belgian franc remained weak at the bottom of the system and, towards the end of the period, the deutschemark's strength began to create problems for the other EMS currencies. The yen traded very narrowly against the dollar.

Sterling shared in the general activity on the exchanges, though this chiefly reflected the volatility of the dollar. Sterling's effective index (ERI) moved within a narrow range and was little changed on balance. The steadiness of the ERI reflected a number of factors: the firmness of spot oil prices allayed earlier fears of a cut in prices; the markets foresaw little change in UK interest rates for the time being; and the trade figures, though erratic, were reasonably favourable overall. Towards the end of the period, however, the pound weakened against the EMS currencies.

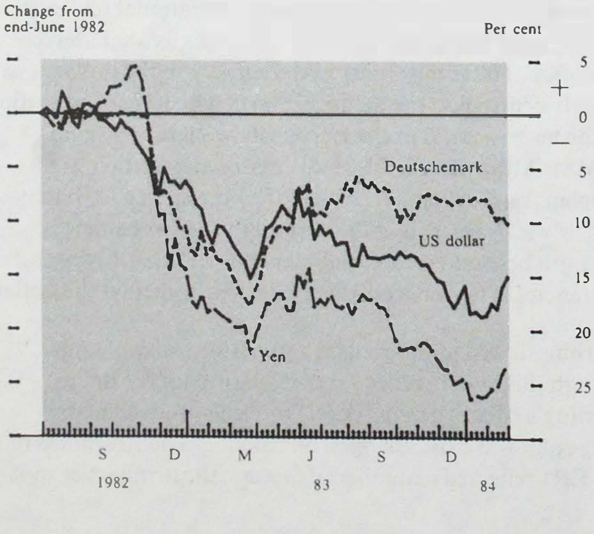
Sterling

After opening at \$1.4623, DM $3.93\frac{3}{4}$ and ERI 83.0 on 1 December, the pound came under persistent and widespread selling pressure during the first half of the month. The weakness of spot oil prices and rumours that BNOC would cut its prices in the new year added to the problems for sterling of a strengthening dollar. The pound fell nervously to \$1.41, DM $3.91\frac{7}{8}$ and ERI 81.8 on 14 December. However, sterling began to recover as BNOC's proposal to leave its prices unchanged began to be accepted by its customers. The pound traded quietly but firmly for a spell thereafter as oil price uncertainties became less important. After Christmas, as the dollar eased, sterling met heavy demand, helped by renewed firmness in the spot oil market following severe weather in the United States. The pound reached \$1.4540, DM 3.96 and ERI 83.0 on 30 December.

Sterling suffered along with other currencies from the sharp strengthening of the dollar in the new year, and fell to an all-time low of \$1.3865 as the dollar peaked in the Far East on 10 January. Fears that the Nigerian coup might precipitate lower oil prices brought pressure on sterling, but when the new Nigerian regime announced their support for OPEC's pricing structure the pound moved to the sidelines. However, as the dollar weakened rapidly, the pound rose sharply with the European currencies in a lightly traded market. Despite sharp fluctuations against the dollar during the remainder of January, sterling saw little business for the most part and held steady just above DM 3.95.

The pound began to ease against the EMS currencies in early February as the deutschemark, in particular, rose sharply against the dollar and sizable commercial sales of sterling for deutschemarks affected the market. Although sterling enjoyed some spells of good demand as developments in the Iran/Iraq war increased fears of a disruption of oil supplies from the Persian Gulf, it failed to make ground against the EMS currencies which remained the prime beneficiaries of the weaker dollar. The pound closed at \$1.4915 (up 2% over the period), DM $3.86\frac{7}{8}$ (down $1\frac{3}{4}$%) and ERI 83.3 (up $\frac{1}{4}$%).

Sterling against selected foreign currencies



Official reserves

During the three months to end-February there was an underlying fall in the reserves of \$266 million. Net public sector borrowing under the exchange cover scheme totalled \$283 million, while \$129 million was repaid in respect of long-term North American loans. The reserves were reduced by \$4 million on account of the valuation adjustment arising from the quarterly roll-over of the European Monetary Co-operation Fund swap. At the end of February, the reserves totalled \$17,983 million.

Changes in UK official reserves
\$ millions

	1983	1984	
	December	January	February
Change in reserves	**−282**	**− 44**	**+210**
of which:			
Net borrowing (+)/repayment (−) of public debt	− 87	+ 71	+170
Valuation change on roll-over of EMCF swap	—	− 4	—
Underlying change in reserves	−195	−111	+ 40
Level of reserves (end of period)	**17,817**	**17,773**	**17,983**

US dollar

The dollar strengthened for much of December and early January on concern that the pace of the economic recovery and the longer-term outlook for inflation might induce a tightening of US monetary policy, although these fears diminished somewhat after publication of the 'flash' estimate of GNP for the fourth quarter on 21 December. International tension (notably in the Lebanon, but also in Nigeria and Tunisia in early January) also contributed to the dollar's strength. After surging to DM 2.85 (a ten-year high) on 10 January, and to record highs against several major currencies, the dollar retreated sharply on profit-taking. A period of hectic trading ensued in which the dollar moved erratically as dealers reacted to economic indicators which were eagerly awaited for the light they cast on the pace of economic growth. However, no clear trend emerged, with the markets believing that little change in monetary policy was likely in the short term.

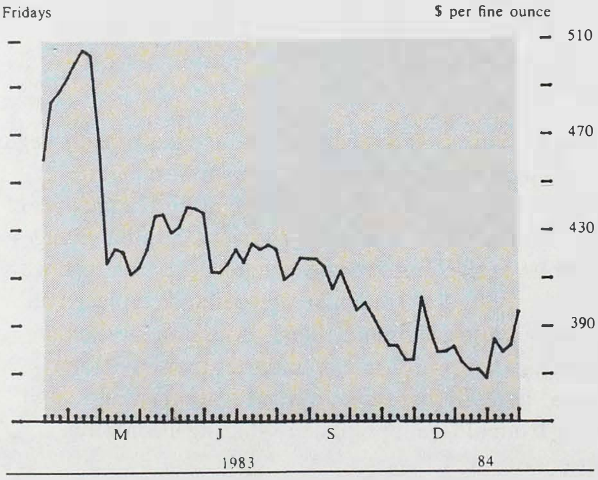
In early February the dollar began to weaken sharply on reports that investment funds were being switched from the United States to Europe and on concern about the US current account deficit. For the remainder of the month the dollar moved erratically lower as a result of growing unease about prospects for the currency. The decline occurred in spite of a firming of US interest rates and renewed international tension, either of which might earlier have caused the dollar to strengthen. The dollar closed at DM 2.5940 (down $3\frac{3}{4}$%) and ERI 126.6 (down $1\frac{1}{4}$%).

EMS

Conditions within the EMS were reasonably settled at first, and the narrow band was generally less than fully stretched during December and January. The Belgian franc was at the bottom, while the French franc and the Irish pound were mostly at the top, although they were occasionally displaced by the Danish krone and the Dutch guilder. The deutschemark, which stood in the middle of the narrow band in early December, strengthened steadily thereafter.

In early February, with sentiment towards the German currency improving as signs of a faster recovery in the economy prompted substantial inflows into the stock market, the deutschemark moved to the top of the narrow band. There was some increase in pressure on the Belgian franc, which remained generally at its margin at the bottom of the system. While the other EMS currencies strengthened against the dollar, they softened somewhat on their cross-rates against the deutschemark. The lira remained the strongest currency in the system, but weakened to $2\frac{3}{4}$ per cent above the Belgian franc.

London gold price



Other currencies

The yen was rather on the sidelines, trading within a narrow range against the dollar; the sharp improvement in the Japanese current account appeared to be well discounted in the market. The yen closed $\frac{1}{4}$% weaker at $233.28, and $1\frac{1}{2}$% lower on its effective index.

The Swiss franc strengthened against the dollar in February, but failed to match the deutschemark's gain. Three-month commercial bank deposit rates fell to 3% following cuts of $\frac{1}{4}$% on both 4 January and 2 February. Over the entire period, the Swiss franc weakened by $\frac{1}{2}$% to $2.1665, and by $1\frac{3}{4}$% on its effective index.

Gold

Although the gold market remained subdued, with little investor interest against a background of high real interest rates and a strong dollar, there was some recovery towards the end of the period as the dollar weakened and international tension increased. After an initial fixing at $398.50 on 1 December, gold at first traded nervously following a brief spell of activity in the market and as a result of the tense situation in the Lebanon. However, the market again settled down to a period of quiet trading with the strength of the dollar causing the gold price to weaken somewhat. Gold dipped to $364.25 (a seventeen-month low) on 9 January, but then recovered a little as the dollar fell from its peak. The price remained within a narrow range for a spell but, as the dollar weakened sharply and silver recovered, gold moved ahead sharply in early February. Thereafter, the price rose further on balance, touching $404 on 23 February as a result of tensions in the Lebanon and elsewhere in the Middle East, and the general weakening of the dollar. After a spell of active trading either side of $400, gold closed at $394.25.