Operation of monetary policy

This article covers the three months mid-November 1983 to mid-February 1984.

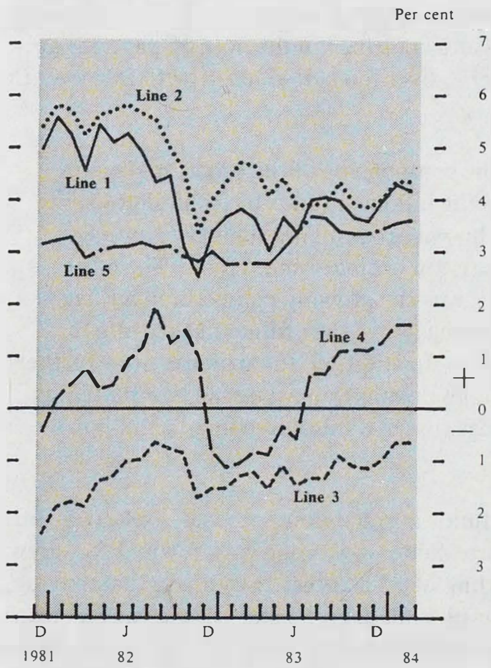
The behaviour of the monetary aggregates during the three months under review was mixed. The narrow aggregates tended to slow down, but the broader aggregates, which had grown only modestly in the preceding three months, showed some re-acceleration. This meant that, after a year of the 1983–84 target period, sterling M_3 was inside the target range and M_1 at the top of it, though PSL_2 was somewhat above target. This outcome reflected excessive monetary growth in the early part of the target period; in the most recent six months the growth rates of the three target aggregates were all within the range 7–11%. Among the other indicators of monetary conditions, the exchange rate was fairly stable in terms of the effective index, notwithstanding the fluctuations in the US dollar. Retail price figures during the period turned out better than had generally been expected. Inflationary expectations—as reflected in market commentaries—may not have changed much. On this basis both real and nominal interest rates remained broadly stable.

Bank lending to the private sector, which had accelerated in the autumn, remained high in banking December but appears to have moderated since then. Lending over the whole of the three months under review was little changed from the preceding three months even though the lower PSBR will have added to the demand for bank credit. The effect of this lending on sterling M_3 was largely offset by other factors, but faster mortgage lending by building societies, which had been expected in the light of the societies' much heavier inflows of funds since last summer, was the main counterpart to the acceleration of PSL_2.

In order to maintain restraint on monetary growth at a time of heavy gilt-edged maturities the authorities needed to sustain as far as possible the pace of central government funding, and net sales of central government debt to the non-bank private sector in the three months under review were £3.2 billion.

Despite the pace of gilt-edged funding and the adverse influence of the US Treasury bond market, which was discouraged by the size of the US Federal budget deficit, long-term gilt-edged yields rose only modestly over the period, with the 25-year yield going up to $10\frac{11}{32}$% from $10\frac{1}{16}$%. Short-term interest rates were virtually unchanged—the three-month interbank rate rose from $9\frac{5}{16}$% to $9\frac{13}{32}$%—with some moderate upward pressure in January giving way later in the period to emerging hopes of a modest decline.

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.

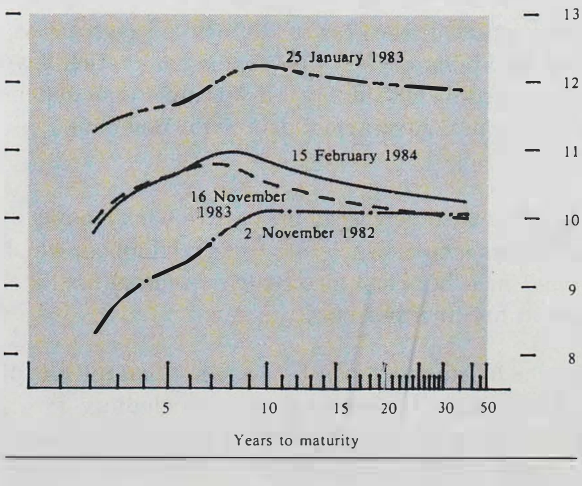
Line 3 The London clearing banks' base rate *plus* 1%, divided by two to allow for the deductibility of interest payments for corporation tax purposes *minus* the expected rate of inflation.

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.

Time/yield curves of British government stocks



Monetary aggregates and credit

In this section, the figures are seasonally adjusted, unless otherwise stated. Sterling M_3 is discussed in terms of the old definition, including public sector holdings of bank deposits.

Sterling M_3 accelerated only a little in the three months under review from its exceptionally low rate of growth last autumn, but PSL_2 accelerated more sharply. The growth rate of M_1 was little

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

Banking months	Mar. 83– May 83	June 83– Aug. 83	Sept. 83– Nov. 83	Dec. 83– Feb. 84
MO(a)	8.7	3.9	9.0	3.7
Non-interest-bearing M_1	10.6	10.2	7.3	4.5
M_1	16.5	11.9	8.0	8.4
M_2(b)	9.1	8.4	7.2	7.6
Sterling M_3(c)	15.2	10.4	5.7	7.8
Sterling M_3(d)	13.8	11.1	6.3	7.9
PSL_1	17.2	9.2	5.1	5.5
PSL_2	18.1	11.3	6.3	13.9
M_3(c)	12.7	10.6	8.6	15.7
M_3(d)	11.4	11.3	9.1	15.6

(a) Based on averages of weekly figures: see the note on page 78.

(b) Not seasonally adjusted. Figures show the increase over the 12 months ending with the period shown in the caption. The figure in the right hand column excludes increases arising from changes in the terms of existing building society accounts which bring them into M_2; the corresponding figure including those increases is 9.0.

(c) New definition, excluding public sector holdings of bank deposits (see the note on page 78).

(d) Old definition, including public sector holdings of bank deposits.

Table B
Building society operations
£ billions; *not seasonally adjusted*

	1983 Q1	1983 Q2	1983 Q3	1983 Q4	1984 Jan.
Liabilities					
Shares and deposits held by the non-bank private sector:					
Liabilities included in PSL_2	+1.6	+2.3	+2.2	+3.3	+2.4
of which CDs and time deposits	—	*+0.1*	*+0.1*	*+0.2*	*+0.2*
Term shares and SAYE deposits	+0.4	—	+0.9	+1.2	+0.3
Interest accrued but not credited	+0.1	−0.2	+0.3	−0.1	
To the monetary sector:					
CDs and time deposits	—	+0.1	+0.3	+0.3	−0.1
Other loans	—	—	—	—	
Reserves and other liabilities(a)	−1.3	+0.9	+0.2	+0.6	
Total	**+0.8**	**+3.1**	**+3.9**	**+5.3**	
Assets					
Mortgage advances	+2.8	+2.8	+2.6	+2.8	+1.8
Short-term assets:					
Claims on the monetary sector	−1.8	+0.3	+0.6	+1.5	
Other(b)	−0.1	−0.1	—	—	−0.1
British government stocks and local authority long-term debt	−0.2	+0.1	+0.6	+0.9	
Other assets(c)	+0.1	—	+0.1	+0.1	
Total	**+0.8**	**+3.1**	**+3.9**	**+5.3**	

(a) Including negotiable bonds.

(b) Mainly local authority temporary debt and certificates of tax deposit.

(c) Mainly premises etc.

changed, but MO decelerated. Seasonally adjusted figures for M_2 are not available, but after allowance for special factors the twelve-month growth rate was little changed.

Among the narrow aggregates, the increase in M_1 was again disproportionately weighted towards interest-bearing deposits, which accounted for $27\frac{1}{2}\%$ of M_1 at mid-February. The figures for M_2 were affected by changes during the period in the terms of some £1.6 billion of building society shares, which shifted them into M_2. Abstracting from that effect, M_2 (not seasonally adjusted) grew by 7.6% over the year to mid-February, compared with 6.8% (on the same basis) over the preceding year. MO (on the monthly-average measure described in the note on page 78) grew at an annual rate of 3.7% over the period; its growth rate over the last year was 6.3%.

The main feature of the components of the broad aggregates during the period was the inflow of funds into building society shares and deposits; this was even higher than last summer, immediately after the rise in ordinary share rates. The most important reason for it was the growing competition among societies in offering premia above the ordinary share rate for accounts of special kinds. In addition, the societies drew further amounts from the wholesale money markets, so that building societies' total liabilities rose at a rate exceeding £$1\frac{1}{2}$ billion a month (Table B).

This heavy inflow of funds into building societies—relatively little of which went into term shares—was one reason why PSL_2 grew much faster than sterling M_3. The other reason was that, having built up their holdings of bank deposits and CDs in the second half of last year, the societies began to draw on them at the start of 1984 when their cash flow was affected by the combination of a more rapid rate of mortgage lending and the incidence of their tax bills. Building societies' holdings of bank liabilities are included in sterling M_3 but not in PSL_2: a rundown in them therefore tends to reduce sterling M_3 in relation to PSL_2.

There was a sharp increase, of £1.8 billion, in the private sector's holdings of foreign currency bank deposits, following the increase of £0.7 billion in the preceding three months (these figures are adjusted to exclude valuation changes arising from exchange rate movements).

Among the counterparts to the growth of the broad aggregates, the PSBR[1] was £2.3 billion; it was thus running at a rather lower rate than in the preceding nine months. It was more than matched by official sales of central government debt to the non-bank private sector.

There was a slight further increase in the pace of bank lending in sterling to the private sector, which rose by £4.0 billion, of which about a third may have been lent directly to persons, either for house purchase or for other purposes.

The figures for the fourth quarter of 1983 suggest that the rate of bank lending in sterling to the personal sector (including unincorporated businesses), and to non-bank financial institutions, slowed down in that quarter, and that there was a sharp increase

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

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

Banking months	Mar. 83– May 83	June 83– Aug. 83	Sept. 83– Nov. 83	Dec. 83– Feb. 84
1 Central government borrowing requirement(b)	+5.4	+3.9	+3.5	+2.6
2 Other public sector(b)	−1.4	−1.0	+0.3	−0.3
3 Purchases (−) of central government debt by the non-bank private sector	−1.6	−3.0	−4.6	−3.2
of which:				
Gilt-edged stocks	*−0.9*	*−2.8*	*−3.3*	*−2.4*
National savings	*−0.5*	*−0.4*	*−1.1*	*−0.9*
CTDs	*−0.1*	*+0.3*	*−0.2*	*+0.1*
4 External finance of the public sector(c)	−0.4	−0.3	−0.1	−0.3
of which:				
Gilt-edged stocks (purchases −)	*−0.3*	*−0.3*	—	*−0.1*
5 Sterling lending to the private sector	+1.9	+3.0	+3.9	+4.0
6 External finance of the monetary sector(d)	+0.5	−0.4	−0.3	+1.3
7 Net non-deposit liabilities (increase −)	−1.3	+0.3	−1.1	−2.2
8 Sterling M_3	**+3.1**	**+2.6**	**+1.5**	**+1.9**

(a) This table relates to sterling M_3 on the old definition, ie including public sector holdings of bank deposits. Counterparts may not add up to sterling M_3 because of rounding.

(b) The sum of rows 1 and 2 is the PSBR, *less* net purchases of local authority and public corporation debt by the non-bank private sector.

(c) Net overseas purchases of public sector debt, less the public sector's net acquisition of claims on the overseas sector.

(d) The net external sterling liabilities of the monetary sector (increase −) plus the net foreign currency liabilities of the monetary sector to all sectors (increase −).

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. 83– Nov. 83	Dec. 83– Feb. 84	Mar. 83– Feb. 84
Factors affecting the market's cash position			
CGBR(+)	+2.8	+0.3	+14.0
Net sales of central government debt(b)(−)	−4.8	−2.7	−13.6
of which:			
Gilt-edged	*−3.4*	*−2.4*	*−10.9*
National savings	*−1.1*	*−0.9*	*−3.0*
Other	*−0.4*	*+0.6*	*+0.3*
Currency circulation (increase −)	—	−0.1	−0.7
Other	—	−0.3	−0.5
Total(A)	**−2.0**	**−2.8**	**−0.8**
Official offsetting operations			
Net increase(+) in Bank's holdings of commercial bills(c)	+2.1	+2.6	+2.0
Net increase(−) in Treasury bills in market	+0.3	+0.1	−0.2
Other	−0.2	+0.2	−0.8
Total(B)	**+2.1**	**+2.8**	**+0.9**
Change in bankers' balances at the Bank (A+B)	+0.1	+0.1	+0.2

(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.

in sterling lending to industrial and commercial companies. On the face of it this is surprising, given the evidence of improving corporate liquidity described in the economic commentary (page 17); and moreover, the analysis of lending in that quarter may be a little distorted as a result of the change, which took effect in mid-November, in the statistical classification of bank loans by industry.[1] Nevertheless, a sharp increase in sterling lending to industrial and commercial companies seems to have occurred.

The pace of mortgage lending by building societies increased sharply during the winter, as had been expected, in response to the larger inflows of funds into the societies since last summer. Their net lending was £3.0 billion in the three calendar months November 1983–January 1984, compared with £2.4 billion in the preceding three months.

In the three months under review, external finance of the public sector had a modestly contractionary effect on sterling M_3, but the external and foreign currency operations of the banks were sharply expansionary (by £1.3 billion). It is always difficult to interpret these figures, but this latter development may be in part associated with the larger current account balance of payments surplus recorded in December, and in part erratic. The banks' net non-deposit liabilities, by contrast, were contractionary by £2.2 billion; within this figure, identified capital issues by banks accounted for £0.3 billion.

Official operations in financial markets

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

As is normal during the main tax-paying season, there were severe shortages of cash in the money market as a result of the seasonally low CGBR. High funding also contributed to these shortages. A substantial increase was needed in short-term official assistance to the banking system.

Gross official sales of gilt-edged in the three months under review were £3.6 billion. This was a little lower than the rate of sales over the preceding six months, but nevertheless gross sales over the first year of the fourteen-month target period were £15·1 billion, compared with £10.6 billion over the preceding year. Redemptions and purchases of stocks approaching maturity were £1.2 billion during the three months under review, so that net official sales to all sectors were £2.4 billion. These sales were more than accounted for by net purchases of the non-bank private sector, but in addition there were small net purchases by overseas residents. National savings raised £0.9 billion but there were net surrenders of certificates of tax deposit of £0.6 billion (£0.1 billion after seasonal adjustment), so that total net sales of central government debt, other than Treasury bills, were £2.7 billion.

Owing to the normal heavy incidence of corporation tax payments in January, the CGBR over the three months was only £0.3 billion; the continuing net sales of central government debt therefore meant that the authorities had to provide additional assistance to the banking system by increasing official holdings of claims on the private sector. The amount of assistance outstanding (other than that provided by official operations in Treasury bills) therefore rose

(1) See the note on page 78.

from £8$\frac{3}{4}$ billion in mid-November to £11$\frac{1}{2}$ billion in mid-February. This increase was virtually all accounted for by an increase in the Bank's holdings of bills, some under purchase and resale agreements; during the period under review it was not necessary to re-activate the arrangements (directly with the banks) for purchase and resale of gilt-edged stocks and promissory notes related to guaranteed export credit and shipbuilding credit, though this did become necessary later.

The seasonal strength of the exchequer's financial position meant that the Bank's ways and means advances to the government fell to zero on 23 January, and on most days from then until the end of the period the National Loans Fund held a significant credit balance with the Bank, as it did in the same period last year.

The money market

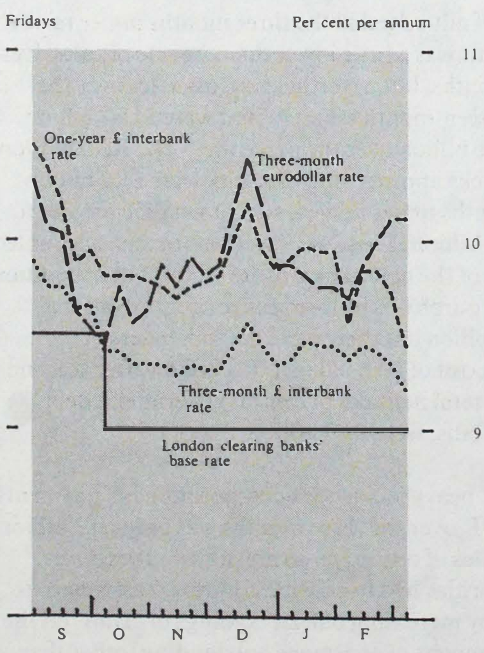
The period under review was a quiet one in the money market. At no stage was there any lasting expectation that the general level of short-term interest rates would change in either direction in the near term.

There were fluctuations in financial sentiment in the United States and the three-month eurodollar rate, which had begun the period at 9$\frac{7}{8}$%, reached 10$\frac{1}{2}$% in mid-December as evidence of the strength of the US economic recovery accumulated. It subsequently fell back, however, as it became clear that economic growth in the United States had moderated in the fourth quarter, and ended the period at 9$\frac{15}{16}$%. Although sterling interbank rates, particularly at the longer maturities, were affected by these fluctuations to some extent, US developments did not lead to any strong expectation of a change in the general level of sterling rates.

Likewise, domestic monetary developments were received calmly. There was, however, some short-lived concern that the general level of short-term interest rates might rise following the publication on 10 January of the provisional money figures for banking December, at a time when sterling had fallen back against a generally strong dollar in the foreign exchange market.

Accordingly, short-term interest rates were little changed over the period. In the interbank market the one and three-month rates increased by $\frac{3}{32}$% on balance, to 9$\frac{5}{16}$% and 9$\frac{13}{32}$% respectively, while the one-year rate rose by $\frac{3}{16}$% to 9$\frac{7}{8}$%. Clearing bank base rates and building society basic mortgage rates were unchanged throughout at 9% and 11$\frac{1}{4}$% respectively, but two clearing banks increased their mortgage rates; at the end of the period bank mortgage rates were broadly in line with average building society rates.

Short-term interest rates in London



Early in the period the daily cash shortages in the money market were rather smaller than has become customary. One reason was that the discount houses were keen to sell longer-dated paper to the Bank, so the Bank's portfolio of bills had a longer average maturity than previously, and a smaller proportion of it fell due each week. The average cash shortage in banking December was, accordingly, no more than £240 million. In that month the Bank sold bills to absorb surplus cash on three days; on one day the Bank did not need to operate at all; and on two days the shortages were sufficiently small for the Bank to invite offers of bills in maturity

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

Banking months	Mar. 83– May 83	June 83– Aug. 83	Sept. 83– Nov. 83	Dec. 83– Feb. 84
Gross official sales(b)	+3.1	+4.1	+4.3	+3.6
less				
Redemptions and net official purchases of stock within a year of maturity	−1.4	−0.7	−0.9	−1.2
Equals net official sales(c)	+1.7	+3.5	+3.4	+2.4
of which, net purchases by:				
Monetary sector(c)	*+0.5*	*+0.3*	—	*−0.2*
Overseas sector	*+0.3*	*+0.3*	—	*+0.1*
Non-bank private sector	*+0.9*	*+2.8*	*+3.3*	*+2.4*

Note: Sales are recorded in this table on a payments basis, so that payments made on partly-paid stocks are entered when they are paid 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.

bands 1 and 2 only, rather than in all four bands as is more normally necessary.

The shortages increased with the onset of the tax revenue season and the average daily shortage in banking February was £450 million. On several occasions the Bank invited the market to offer bills for sale and repurchase from the Bank at a later date. This technique enables operations to be undertaken in paper that is not usually acceptable for outright purchase, either bills with a maturity exceeding three months, or bills which have not yet run for seven days since their date of acceptance.

The gilt-edged market

At the beginning of banking December the authorities faced gilt-edged maturities of £2.3 billion over the next three banking months, and a further £1.1 billion in banking March. Of this total of £3.4 billion, some £1.9 billion was still in market hands. Against these maturities and the continuing need for substantial net sales of gilt-edged, some £0.9 billion of future receipts had been secured through earlier sales of partly-paid stocks. Moreover, the Bank had available for sale supplies of $2\frac{1}{2}\%$ Index-Linked Treasury Stock 2020 and of 10% Exchequer Stock 1989.

Market conditions were subdued for much of banking December. In the United States there was further evidence of the strength of the economic recovery. Although the US monetary aggregates were all within or below their target ranges, nevertheless hopes of a fall in US interest rates diminished and fears grew that the next move in rates there might be upwards. These US developments had an adverse effect on the gilt-edged market, where in any case very heavy official sales of stock had been absorbed over the preceding eight months, and where expectations about the size of the PSBR were being revised upwards.

There was, however, intermittent demand for low-coupon short-dated conventional stocks, though not on a large scale; and to meet that demand the Bank announced a new stock of this kind on 21 November—£500 million of $2\frac{1}{2}\%$ Exchequer Stock 1986. A substantial amount of the issue was sold at the tender and there was small but persistent demand thereafter.

Despite the adverse influence of US developments, market conditions improved after the announcement of the provisional UK money figures on 6 December. In order to secure further funding receipts the authorities announced on the next day two medium-dated tranches of stock, £300 million of $10\frac{1}{4}\%$ Exchequer Stock 1995 and £200 million of $10\frac{1}{2}\%$ Exchequer Stock 1997, both issued directly to the Bank. Developments in the United States and their effect on the sterling/dollar exchange rate inhibited any immediate demand for these stocks, but demand emerged as sterling steadied and official supplies of the new tranches ran out on 16 December (the 1997 stock) and 20 December (the 1995 stock).

Official supplies of $2\frac{1}{2}\%$ Exchequer 1986 were exhausted on 21 December, and by way of replacement the Bank announced, on 29 December, a package of small issues. This consisted of £300 million of a new index-linked stock—2% Index-Linked Treasury Stock 1990—for sale by tender, and additional amounts of two low-coupon conventional stocks—3% Treasury Stock 1986

Table F
Issues of gilt-edged stock

Stock	Amount 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
$2\frac{1}{2}$% Exchequer 1986	500	21/11	Minimum price tender	24/11	84.50	—	Fully paid	8.46	21/12
$10\frac{1}{4}$% Exchequer 1995	300	7/12	Direct to Bank	7/12	—	—	Fully paid	—	20/12
$10\frac{1}{2}$% Exchequer 1997	200	7/12	Direct to Bank	7/12	—	—	Fully paid	—	16/12
2% Index-Linked Treasury 1990	300	29/12	Tender, no minimum price	5/1	91.00(a)	—	Fully paid	3.61(b)	—
3% Treasury 1986	100	29/12	Direct to Bank	29/12	—	—	Fully paid	—	19/1
3% Treasury 1987	200	29/12	Direct to Bank	29/12	—	—	Fully paid	—	19/1
10% Treasury Convertible 1990	1,200(c)	13/1	Minimum price tender	18/1	96.00	20	45 (13/2) 31 (12/3)	10.84(d)	18/1
$9\frac{1}{2}$% Treasury 1988	250	24/1	Direct to Bank	24/1	—	—	Fully paid	—	3/2
9% Treasury 1992/96	150	24/1	Direct to Bank	24/1	—	—	Fully paid	—	2/2
$9\frac{1}{2}$% Treasury 1999	100	24/1	Direct to Bank	24/1	—	—	Fully paid	—	30/1
$9\frac{3}{4}$% Exchequer 1998	1,000	3/2	Minimum price tender	8/2	94.50	25	40 (19/3) 29.50 (16/4)	10.51	5/3

(a) Price at which stock was allotted at the tender.

(b) Real yield, calculated on the assumption of a 5% annual rate of increase in the retail price index.

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

(d) Yield to 1990. Holdings may, at the option of the holder, be converted in whole or in part into $9\frac{1}{2}$% Conversion Stock 2004, as on the following dates:

Date of conversion	Nominal amount of $9\frac{1}{2}$% Conversion Stock 2004 per £100 nominal of 10% Treasury Convertible 1990	Implied redemption yield (%)
25 October 1984	£98	9.78
25 April 1985	£96	9.61
25 October 1985	£94	9.45
25 April 1986	£92	9.31
25 October 1986	£90	9.18

(£100 million) and 3% Treasury Stock 1987 (£200 million). A significant amount of the new 1990 stock was sold at the tender and there was some demand for it thereafter, as there was for the two other stocks. Moreover, after an improvement in the US bond market, the remaining official supplies of 10% Exchequer 1989 were sold on 5 January.

With official supplies of full-coupon conventional stock thus exhausted, the opportunity was taken on 13 January, in response to continuing demand in the market, to announce the issue by tender of £1,000 million of 10% Treasury Convertible Stock 1990,[1] convertible into $9\frac{1}{2}$% Conversion Stock 2004. The stock was issued in partly-paid form, in order to tie up forward funding for the February and March banking months and was fully subscribed at the tender at £$\frac{1}{4}$% premium over the minimum tender price.

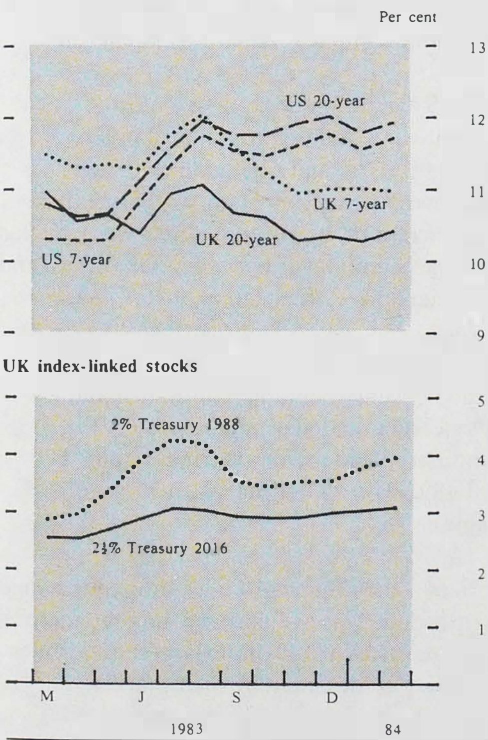
Official supplies of 3% Treasury 1986 and 3% Treasury 1987 were exhausted early in banking February. With the market remaining generally firm, the authorities announced on 24 January the issue direct to the Bank of a package of small additional amounts of full-coupon conventional stocks—£250 million of $9\frac{1}{2}$% Treasury Stock 1988, £150 million of 9% Treasury Loan 1992–96, and £100 million of $9\frac{1}{2}$% Treasury Loan 1999. The latter two stocks are so-called FOTRA[2] stocks—ie dividends on them may, on application, be paid to non-residents without deduction of income tax. FOTRA stocks are of particular interest to non-residents and to certain domestic institutions with overseas business, and they tend to yield slightly less than comparable non-FOTRA stocks.

(1) An additional £200 million was issued and reserved for the National Debt Commissioners.
(2) Free of tax to residents abroad.

There was substantial demand for these stocks and official supplies of them ran out on 30 January (the 1999 stock), 2 February (the 1992–96 stock) and 3 February (the 1988 stock). With market conditions remaining firm, on 3 February the issue by tender was announced of £1,000 million of $9\frac{3}{4}$% Exchequer Stock 1998.

This announcement attracted comment on three grounds. First, the fact that the new stock was announced so soon after the 1988 stock had been exhausted was taken by some as confirmation of 'aggressive funding' to offset accelerating bank lending to the private sector, even though the initial payment was only 25% and the later calls were well spread. Second, some commentators attached exaggerated importance to the maturity of the stock; while it is true that it was the longest full-scale new conventional issue since late 1981, there had been a number of issues since then both of tranches of longer-maturity stocks and of full-scale new stocks convertible into longer-dated conversion stocks. Finally, some commentators thought the stock underpriced, though it was, in fact, priced in line with comparable stocks in that area of the market, but not with $9\frac{1}{2}$% Treasury 1999 which matures a year later (the yield curve slopes downward in this area), which is a FOTRA stock, and which was itself expensive relative to other stocks of comparable maturity.

Gross redemption yields on government stocks



These reactions to the new stock might well have been short-lived —indeed the market was already steadier that evening—had it not been for subsequent developments in the United States, where the publication of the December Federal Open Market Committee minutes over the weekend, and the Federal Reserve Chairman's comments during the following week on the Federal budget deficit, and their implications for US monetary policy, caused both the bond and equity markets in the United States to weaken. This in turn unsettled the gilt-edged market and left the new stock substantially undersubscribed at the tender on 8 February. Thereafter, however, the gilt-edged market stabilised and had begun to move ahead again by the end of the period.

Over the three months, yields on shorter-dated gilt-edged stocks were little changed on balance: the five-year yield remained at around $10\frac{5}{8}$%. But longer yields rose a little: on twenty-year stocks, from $10\frac{1}{8}$% to $10\frac{3}{8}$%. Index-linked stocks were generally neglected, partly owing to improving inflationary expectations. Real yields rose modestly: on the 1988 stock from 3.67% to 3.85% and on the 2016 stock from 2.94% to 3.05%.(1)

Table G
Outstanding droplock arrangements

Trigger levels(a)	Amount committed as at end-February 1984 (£ millions)
10% up to $10\frac{1}{2}$%	28
$9\frac{1}{2}$% up to 10%	69
9% up to $9\frac{1}{2}$%	—
$8\frac{1}{2}$% up to 9%	20
No specified level	26

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

Other capital markets

The *equity market* was subdued at the beginning of the period; in particular, oil shares were unsettled by the OPEC Ministers' disagreement on pricing policies. The FT-Actuaries all-share index drifted down to 451.95 on 21 November, its lowest point during the three banking months.

During the last week of November, however, encouraging results from some leading UK companies and the rise of the Dow Jones index to new record levels produced a more confident mood. On 25 November the offer for sale by tender was announced of a further tranche of the government's holding in Cable and Wireless:

(1) These yields are calculated by the method recommended by the Institute and Faculty of Actuaries, on the assumption of a 5% annual rate of increase in the retail prices index. See the December *Bulletin*, page 484.

100 million shares at a minimum tender price of 275p per share, 100p payable on application and the balance by 17 February 1984. Applications were received for some 77.5% of the shares at the tender on the following Friday, with the balance being taken up by the underwriters. The market received the result calmly and the all-share index closed slightly higher on 2 December. The shares subsequently traded at a premium in the secondary market.

Increasing optimism about the economic prospects, supported by a flow of good company news, encouraged the market to advance in the following week and the all-share index reached a new high of 468.03 on 8 December. Profits were taken the following day, however, and the market then eased back further after disappointing company results and as sterling suffered from the strengthening US dollar and renewed worries about North Sea oil prices. A more stable exchange rate and forecasts of continuing economic recovery helped underpin the market in the middle of the month and although turnover was seasonally low, prices moved ahead both before and after the Christmas holiday. The prolonged takeover contest for Eagle Star was resolved on 30 December when BAT's increased bid of £7 per share was accepted by the rival bidder, the German insurance company, Allianz Versicherung.

Strong institutional and US demand produced an almost uninterrupted rise in the all-share index throughout January, to a new peak of 504.73 on the 27th, and carried the narrow thirty-share index well above 800. Sentiment on Wall Street had begun to weaken during the month, however, and this was reflected in the London market at the beginning of February. On the 6th and 7th of the month, the all-share index shed a total of 16.7 points (3.3%) to close at 483.75.

In the last few days of the February banking month, demand was revived by Wall Street's steadier tendency and by news of the December rise in UK industrial and manufacturing output. The all-share index closed at 489.33 on 15 February, a net rise of 7.8% over the period as a whole.

A new index of share prices—the Financial Times-Stock Exchange 100-share index—was introduced on 13 February. It is calculated continuously from the share prices of 100 of the largest companies listed on the Stock Exchange, as measured by their market valuation. The constituents are 69 industrial companies, 5 oil companies, 21 financial companies, 2 investment trusts, 2 mining finance companies and 1 overseas trader. The new index has been introduced to provide a continuous indicator of the market throughout trading hours and to form the basis of trading in new traded options and financial futures contracts. It is based on 3 January 1984 = 1,000 and closed on 15 February at 1,033.0.

Despite the strength of the equity market throughout much of the period, the net amount of new equity finance raised, at £193 million, was sharply lower than in the previous three months, partly reflecting seasonal influences (Table H). The amount raised over the year to mid-February, however, was over £2.1 billion. These figures relate only to issues of new shares and exclude, for example, the initial proceeds (£100 million) of the Cable and Wireless offer which involved the sale of existing shares. The largest issues of new equity announced during the period were a placing of £48 million by Hammerson Property Investment and

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

Banking months	Mar. 83– May 83	June 83– Aug. 83	Sept. 83– Nov. 83	Dec. 83– Feb. 84
UK private sector				
Loan capital and preference shares	+323	+153	+ 94	+ 27
Equity capital(a)	+616	+852	+477	+193
Unit trusts(b)	+309	+354	+425	+354(c)
Issues on the unlisted securities market	+ 36	+ 48	+ 31	+ 49
Local authorities				
Stocks	+ 45	− 94	− 37	+ 22
Negotiable bonds	+ 28	− 16	+ 3	+ 38
Overseas	+ 41	+148	+283	+ 85

(a) Net issues by listed UK public companies.
(b) Calendar months.
(c) December and January only.

Table J
Debt issues announced on the London capital market, mid-Nov. 1983 to mid-Feb. 1984[a]

Date of announcement	Issuer	Nominal amount (£ millions)	Coupon (per cent)	Maturity
Domestic borrowers				
21 November	Mid-Kent Water Company	3	12	1993
6 December	Elf UK	40	$12\frac{1}{4}$	1991
8 December	Queens Moat Houses	15	12	2013
28 December(b)	Kensington & Chelsea	10	11.15	2006
10 January	MEPC	70	$10\frac{3}{4}$	2024
26 January(b)	Rochdale	12	11.10	2006
10 February	Brixton Estate	15	$11\frac{1}{4}$	2023
15 February	TR City of London Trust	6	$11\frac{1}{2}$	2014
Overseas borrowers				
24 November(b)	Société Générale	7.25	11.31	2007
12 December	Kingdom of Spain	50	12	1988
29 December	State Energy Commission of Western Australia	40	$12\frac{1}{4}$	2018/23
8 February	Province of Quebec	50	$12\frac{1}{4}$	2020

(a) All these issues were placed apart from that by Spain which was offered for sale. Issues of convertible stock and issues of less than £3 million are not included.

(b) Issued under droplock facilities.

Development Corporation and a rights issue of £40 million by Charterhouse Petroleum.

Encouraged by the easing in interest rates, domestic corporate borrowers returned to the *fixed-interest market* following a period of inactivity during the previous three banking months: the largest of the five issues announced during the period under review was a placing of £70 million of debenture stock by MEPC, which had previously issued £30 million of stock in September 1982. Two *local authorities* exercised options to draw down droplock facilities resulting in the issue of £10 million and £12 million of stock, but there were no other new issues by local authorities during the period. Droplock arrangements currently outstanding are shown in Table G on page 29.

There were four issues by *overseas borrowers* in the domestic fixed-interest market during the three banking months, including an issue of £50 million of short-dated stock by the Kingdom of Spain.

The *eurosterling market* remained active with four fixed-rate issues which raised a total of £175 million. In addition, demand for floating-rate note issues continued following the reopening of this sector of the market in September 1983, and a further four issues were launched for a total of £350 million. Three more issues were announced after the end of the period, including one of £75 million by a financing subsidiary of Yorkshire Bank.