Operation of monetary policy

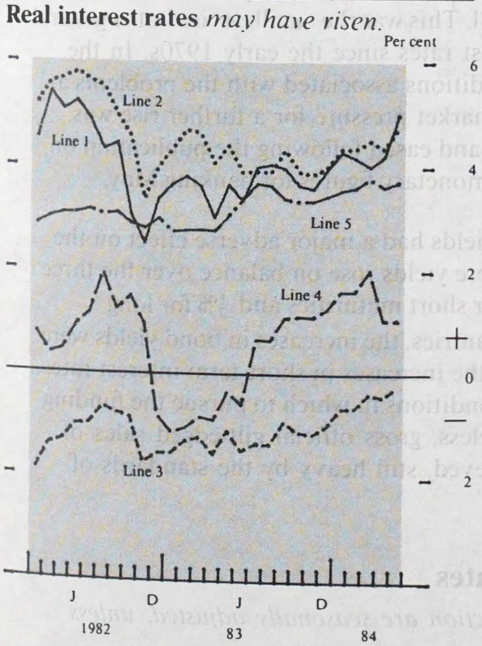
This article covers the three months mid-February to mid-May 1984

Review

Domestic monetary conditions—though not without particular areas of uncertainty—remained satisfactory judged overall during the three months under review, and policy continued to exert moderate downward pressure on the rate of inflation, as intended. Nevertheless, financial markets went through a period of severe turbulence largely under the impact of developments in the United States. In operating monetary policy, the Bank, having endorsed a ½% reduction in the general level of short-term interest rates around the time of the Budget, leant against the subsequent spasmodically strong upward market pressures with the aim of moderating the rise in rates.

Among the indicators of monetary conditions, M0 was near the bottom of its target range, and sterling M3 (£M3) was only a little above target despite a bunching of the PSBR in the early months of the 1984/85 financial year. Among the other monetary aggregates the twelve-month growth rate of M2 was little changed if effects arising from changes in the terms of existing accounts are excluded; the acceleration in M1 was largely the result of a very rapid increase in interest-bearing sight deposits, which partly reflected new types of accounts offered by some clearing banks, although non-interest-bearing M1 also accelerated. On the other hand, PSL2 continued to grow rapidly, fuelled by building society mortgage lending. There was also some market concern over the pace of sterling bank lending to the private sector. The substantial increases in such lending in banking March and April raised fears that monetary growth could be excessive unless the funding programme was increased to contain it; but monthly lending figures tend to be erratic and the figure for banking May showed a much smaller increase.

Real interest rates *may have risen.*



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.

More broadly, underlying economic activity continued to grow at a moderate pace and the prospect for inflation remained favourable. The twelve-month rate of retail price inflation was little changed at just over 5% throughout the period; and although producer prices accelerated somewhat, unit labour costs in manufacturing continued to rise very modestly. Sterling's effective exchange rate held up quite well in the face of a persistently strong US dollar. Forecasts of inflation by market analysts tended to fall over the three months, bringing them closer to the official forecast made at the time of the Budget. On this basis, real interest rates may have risen and certainly remained clearly positive before tax, as the chart shows.

Early in the period, despite some rise in US interest rates, market conditions were generally buoyant in advance of the

Budget, partly reflecting the earlier restrained monetary growth, and there was downward pressure on interest rates. Indeed, Barclays Bank reduced its base rate by $\frac{1}{4}$% (to $8\frac{3}{4}$%) before the Budget, and the other clearing banks cut their base rates by $\frac{1}{2}$% (to $8\frac{1}{2}$%) afterwards. The Bank endorsed these moves by accepting lower rates in its bill dealings.

Thereafter, market sentiment became adverse. The predominant influence was the United States, where interest rates rose sharply: the three-month eurodollar rate went up by nearly 2% (to $11\frac{1}{16}$%), most of the rise occurring in the second half of the period. The underlying influences on US rates were the combination of the large Federal budget deficit and the continuing indications of the strength of the economic recovery in the United States. Around the end of the period, markets became especially nervous as a result of the difficulties of Continental Illinois National Bank. US bond yields also rose sharply, particularly towards the end of the period; over the three months the 30-year Treasury bond yield rose by $1\frac{1}{2}$% to $13\frac{7}{16}$%.

These US developments had a major effect on sterling financial markets in the second half of the period under review. The continuing decoupling of interest rates and bond yields in the United Kingdom from those in the United States was reflected in the fact that US prime rates rose by a total of 1% in March and early April, while UK rates declined. The further rise of $\frac{1}{2}$% in prime rates on 8 May, however, contributed to the rise of about $\frac{1}{2}$% in interest rates in sterling money markets, roughly reversing the earlier fall. This was the smallest rise in the general level of sterling interest rates since the early 1970s. In the unusually volatile conditions associated with the problems at Continental Illinois, market pressure for a further rise was subsequently resisted, and eased following the publication on 5 June of provisional monetary figures for banking May.

The rise in US bond yields had a major adverse effect on the gilt-edged market, where yields rose on balance over the three months, by over $\frac{3}{4}$% for short maturities and $\frac{1}{2}$% for long maturities. In both countries, the increases in bond yields were comparable in size to the increases in short-term interest rates. These were difficult conditions in which to pursue the funding programme. Nevertheless, gross official gilt-edged sales of £2.9 billion were achieved, still heavy by the standards of earlier years.

Time/yield curves of British government stocks

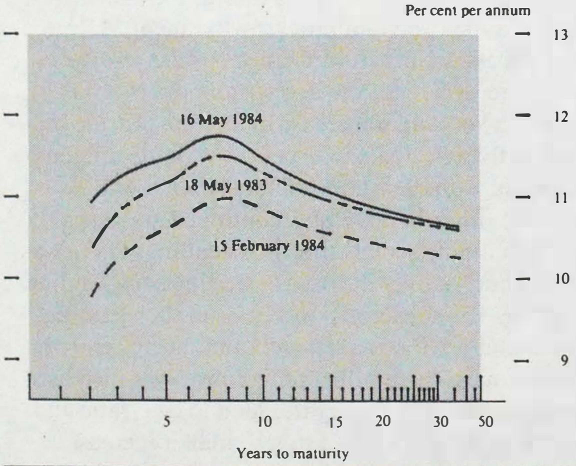


Table A
Growth of the monetary aggregates

Percentage increases (annual rates); *seasonally adjusted*

Banking months	June 83–Aug. 83	Sept. 83–Nov. 83	Dec. 83–Feb. 84	Mar. 84–May 84
M0(a)	3.9	9.0	3.7	4.2
Non-interest-bearing M1	10.2	7.3	4.5	17.2
M1	11.9	8.0	8.5	29.0
M2(b)	8.8	7.9	8.0	7.9
			10.3	*10.3*
£M3(c)	10.4	5.7	7.9	10.5
PSL1	9.2	5.2	5.6	13.5
PSL2	11.3	6.3	12.8	17.8
M3(c)	10.6	8.8	15.6	4.2

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

(b) Not seasonally adjusted. The figures show the increase over the twelve months ending with the latest month shown in the caption and exclude increases arising from changes in the terms of existing accounts which bring them into M2; figures including those increases are shown in *italics*.

(c) New definition, excluding public sector holdings of bank deposits.

Monetary aggregates

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

During the period under review M0 and £M3 grew at annual rates of 4.2% and 10.5% respectively. Among the other aggregates, the twelve-month growth rate of M2 was little changed; PSL2 grew at an annualised rate of 17.8%.

Narrow monetary aggregates

M0, on the weekly averaged basis, grew at an annual rate of 4.2% over the three months under review. This was much the same as in the preceding three months, but less than last autumn. Excluding the effects of changes in the terms of existing accounts, the twelve-month growth rate of M2 (for which seasonal adjustments are not available) remained steady at just under 8%. M1 grew extremely fast: its annualised growth rate was as high as 29.0%. To a large extent this rapid growth was the result of a big increase (some £1.6 billion) in interest-bearing sight deposits—two of the clearing banks having introduced interest-bearing chequing accounts during the period—but even non-interest-bearing M1 grew at an annual rate as high as 17.3%, despite possible shifts of sight deposits into interest-bearing accounts.

Table B
Change in £M3 and its counterparts[a]
£ billions: *seasonally adjusted*

Banking months	June 83– Aug. 83	Sept. 83– Nov. 83	Dec. 83– Feb. 84	Mar. 84– May 84
1 Central government borrowing requirement(b)	+4.0	+3.5	+2.7	+3.2
2 Other public sector(b)	−1.3	+0.1	−0.5	−0.2
3 Purchases (−) of central government debt by the non-bank private sector	−3.0	−4.6	−3.1	−2.2
of which:				
Gilt-edged stocks	*−2.8*	*−3.3*	*−2.4*	*−1.4*
National savings	*−0.4*	*−1.1*	*−0.9*	*−0.8*
CTD's	*+0.3*	*−0.2*	*+0.1*	*+0.1*
4 External finance of the public sector(c)	−0.2	−0.1	−0.4	−0.4
of which, gilt-edged stocks (purchases−)	*−0.3*	—	*−0.1*	*−0.5*
5 Sterling lending to the private sector	+3.0	+3.8	+4.0	+3.5
6 External finance of the monetary sector(d)	−0.4	−0.3	+1.3	−0.1
7 Net non-deposit liabilities (increase −)	+0.3	−1.1	−2.1	−1.1
8 **Change in £M3**	**+2.3**	**+1.3**	**+1.9**	**+2.5**

(a) This table relates to £M3 on the new definition, ie excluding public sector holdings of bank deposits. Counterparts may not add up to £M3 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 C
Building society operations
£ billions: *not seasonally adjusted*

	1983 Q2	1983 Q3	1983 Q4	1984 Q1	April and May
Liabilities					
Shares and deposits held by the non-bank private sector:					
Liabilities included in PSL2	+2.2	+2.0	+3.1	+3.4	+1.5
of which CDs and time deposits	*+0.1*	*+0.1*	*+0.3*	*+0.2*	
Term shares and SAYE deposits(a)	—	+0.9	+1.2	+0.3	
Interest accrued but not credited	−0.2	+0.3	−0.1	+0.3	
To the monetary sector:					
CDs and time deposits	+0.1	+0.3	+0.3	−0.1	
Other loans	—	—	—	—	
Reserves and other liabilities(b)	+1.0	+0.4	+0.8	−1.0	
Total	**+3.1**	**+3.9**	**+5.3**	**+2.9**	
Assets					
Mortgage advances	+2.8	+2.6	+2.8	+2.9	+2.6
Short-term assets:					
Claims on the monetary sector	+0.3	+0.6	+1.5	−0.8	−0.4
Other(c)	+0.1	—	—	+0.2	+0.2
British government stocks and local authority long-term debt	+0.1	+0.6	+0.9	+0.6	
Other assets(d)	—	+0.1	+0.1	—	
Total	**+3.1**	**+3.9**	**+5.3**	**+2.9**	

(a) Excluding CDs.

(b) Including negotiable bonds.

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

(d) Mainly premises etc.

Counterparts to the growth of £M3

£M3 grew by £0.6 billion more than in the preceding three months. In part this was associated with an increase of £0.8 billion in the PSBR[1] to £3.0 billion in the three months under review, reflecting the time profile of government borrowing in 1984/85. Net purchases of central government debt by the non-bank private sector were £2.2 billion, so that the PSBR was underfunded by £0.8 billion, having been overfunded by £0.9 billion in the preceding three months.

The pace of sterling bank lending to the private sector moderated to £3.5 billion. Of this, some £1¼ billion may have been lent to persons, within which bank lending for house purchase may have been around £½ billion; thus last year's gradual slowdown in mortgage lending continued, though other personal lending increased. The rate of lending to businesses also slackened somewhat.

The banks' net non-deposit liabilities increased by £1.1 billion over the period, continuing the recent strong growth which has in part reflected banks' desire to strengthen the capital base of their balance sheets. To the extent that the banks have raised capital in foreign currencies rather than in sterling, the effect on net non-deposit liabilities will have been matched by an equal and opposite effect on the banks' net foreign currency position, included as part of external finance of the monetary sector.

Building societies and PSL2

The rate of inflow of retail funds into building societies slackened from the £1.3 billion a month (including interest credited) recorded in the first quarter of 1984 to £1.0 billion a month in calendar April and May after the reduction in share rates. Moreover, the rate at which the societies have drawn funds from the wholesale markets (net) slackened during the first quarter, though it picked up again in May. Mortgage lending, however, continued to be strong, averaging as much as £1.3 billion in April and May. The combination of heavy mortgage lending and reduced inflows caused the societies' liquidity ratios to fall: by the end of May their combined ratio had fallen to 18.7%, compared with the recent peak of 19.8% at the end of February and the trough of 17.4% at mid-1983. Because the societies were drawing on their liquid assets, including bank deposits and CDs, the gap between the growth rates of PSL2 and £M3 was not narrowed by the slowdown of inflows to the building societies.

(1) The figures quoted are for the PSBR *minus* net purchases of local authorities' and public corporations' debt by the non-bank private sector.

Total mortgage lending from all sources may have been about £4¼ billion during the three months under review, rather more than in the preceding three months.

Official operations in financial markets

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

Net official sales of gilt-edged were lower during the period under review than in the preceding three months. Although net sales of central government debt in other forms were higher, the increased CGBR made possible some net reduction in the total of official assistance to the money market.

Despite the generally difficult market conditions in the three months under review, gross official sales of gilt-edged were £2.9 billion. Redemptions and purchases of stocks approaching maturity accounted for £1.2 billion, so that net official sales to all sectors were £1.7 billion. The monetary sector sold stock on balance, but the overseas sector made net purchases of £0.4 billion; net purchases by the non-bank private sector were £1.4 billion. In seasonally-adjusted terms, inflows into national savings were some £0.8 billion, and net sales of central government debt in all forms to the non-bank private sector were £2.2 billion.

Table D
Official transactions in gilt-edged stocks[a]

£ billions; *not seasonally adjusted*

Banking months	June 83– Aug. 83	Sept. 83– Nov. 83	Dec. 83– Feb. 84	Mar. 84– May 84
Gross official sales(b)	+4.1	+4.3	+3.6	+2.9
less				
Redemptions and net official purchases of stock within a year of maturity	−0.7	−0.9	−1.2	−1.2
Equals net official sales(c)	+3.5	+3.4	+2.4	+1.7
of which, net purchases by:				
Monetary sector(c)	*+0.3*	—	*−0.2*	*−0.1*
Overseas sector	*+0.3*	—	*+0.1*	*+0.4*
Non-bank private sector	*+2.8*	*+3.3*	*+2.4*	*+1.4*

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 the 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.

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

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

Banking months	Dec. 83– Feb. 84	Mar. 84– May 84	June 83– May 84
Factors affecting the market's cash position			
CGBR (+)	+0.4	+4.3	+12.3
Net sales of central government debt(b)(−)	−2.7	−2.6	−13.7
of which:			
Gilt-edged	*−2.4*	*−1.7*	*−10.9*
National savings	*−0.9*	*−0.9*	*− 3.2*
CTDs	*+0.6*	*−0.1*	*+ 0.4*
Currency circulation (increase −)	−0.1	−0.3	− 0.7
Other	−0.4	−0.5	− 0.8
Total (A)	**−2.8**	**+0.8**	**− 2.8**
Official offsetting operations			
Net increase (+) in Bank's holdings of commercial bills(c)	+2.6	−1.0	+ 2.5
Net increase (−) in Treasury bills in market	+0.1	−0.1	− 0.1
Other	+0.2	+0.2	+ 0.4
Total (B)	**+2.8**	**−0.9**	**+ 2.9**
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.

The main influence on the net flows of cash into and out of the money market was the CGBR which, for seasonal reasons, was much larger than in the preceding three months. This was largely offset by central government debt sales and by other factors, including an increase in the note circulation. Nevertheless the balance of transactions affecting the cash position of the money market was expansionary and the total of official assistance to the money market fell on balance over the period. It was not a steady fall, however: half-way through the period, at the end of March, the total of official assistance to the money market, other than that extended by transactions in Treasury bills, was little changed from the mid-February level of £11½ billion. By the end of the period the total had fallen to £10½ billion. The National Loans Fund held a credit balance with the Bank for a substantial part of the period under review.

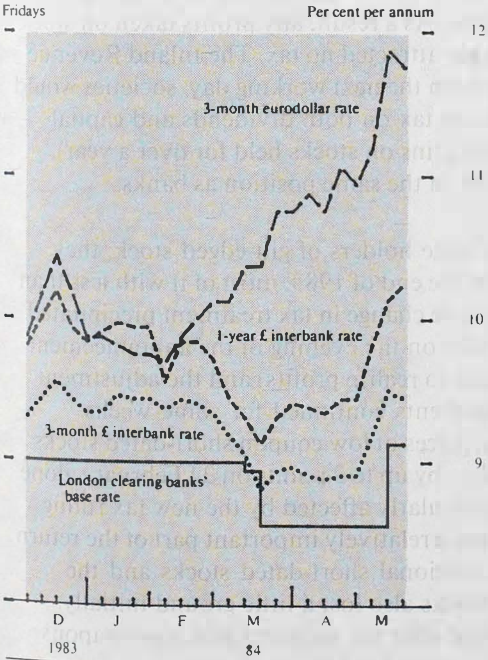
As in 1983, the Bank offered arrangements to the banks for the purchase and resale of gilt-edged securities, and for the provision of finance against promissory notes related to guaranteed export credit and shipbuilding paper during the period when the market's shortage of cash was exceptionally large because of tax payments by oil companies. These facilities were made available on 2 March and reversed on 30 March. Roughly £650 million was taken up under these arrangements, so that the Bank's need to buy bills during this period was correspondingly less than it would otherwise have been.

The money market

Interest rates fell early in the period under review. But, after about six weeks of little further movement, rising interest rates in the United States and fears about the pace of domestic monetary expansion reversed the earlier fall.

The impetus in the markets towards lower interest rates early in March came despite a modest upward drift in short-term US rates. Sterling was reasonably firm (by the end of February, it had risen to over 83 in effective terms, the highest level since November) and both monetary growth and the PSBR seemed well under control. On 6 March, Barclays Bank announced a reduction in its base rate by $\frac{1}{4}$% to $8\frac{3}{4}$%; this was the first time a clearing bank had begun a round of base rate changes with a move of $\frac{1}{4}$%. The next day the Bank accepted offers of bills $\frac{1}{4}$% below its previous dealing rates. The Budget, on 13 March, was well received and the next day money-market rates again moved lower. The London clearing banks other than Barclays all reduced their base rates by $\frac{1}{2}$% to $8\frac{1}{2}$% and the Bank accepted offers of bills a further $\frac{1}{4}$% down from previous levels. From then until the end of April no firm market expectations about the direction of the next move in interest rates developed. Increases of $\frac{1}{2}$% in US banks' prime rates on 19 March and 5 April caused only temporary caution. Sterling tended to ease in the foreign exchange market, however.

Sterling **short-term interest rates in London** *rose, but by less than dollar rates.*



Early in May, the money market did become nervous about the likely course of interest rates in the United States and more generally concerned over domestic monetary conditions. Market rates moved up a little ahead of the May Day holiday, and sharply after it (on 8 May). Although sterling was slightly weaker against a strong dollar, particularly after the further rise of $\frac{1}{2}$% in American prime rates to $12\frac{1}{2}$% on 8 May, it did not fall any further in effective terms, its effective index remaining steady at around 80. Also, rather better than expected provisional figures for £M3 growth in banking April were published on the afternoon of 8 May. Nevertheless, under the influence of US developments, interest rates (except for very short maturities) continued to rise and on 9 May all the London clearing banks announced rises in their base rates to 9% or $9\frac{1}{4}$%. On 10 May, the Bank accepted offers of bills at rates $\frac{1}{2}$% higher than previously. This action was interpreted in the market as facilitating consolidation of rates at the new, higher, levels and by the end of banking May (16 May) interest rates had steadied, although, with monetary conditions in the United States still unsettled, the sterling money markets remained nervous.

In its money-market operations, the Bank faced continuing large daily cash shortages in the first half of the period. Indeed, in calendar March, the shortage averaged £600 million per working day. Initially, this was mainly the result of the seasonal collection of taxes and also of some reluctance by the discount houses to sell longer-dated bills to the Bank.[1] After the cut in base rates in mid-March, the second factor ceased to be important; but, with central government expenditure seemingly running well below forecast, large daily shortages continued until the end of March.

The net changes in short-term interest rates over the period under review were mixed. In the money market, the one-month interbank rate fell by $\frac{1}{2}$% to $8\frac{13}{16}$% and the three-month rate by $\frac{1}{8}$% to $9\frac{5}{16}$%, but the one-year rate rose by $\frac{5}{16}$% to $10\frac{3}{16}$%. Clearing bank base rates rose by up to $\frac{1}{4}$% on

(1) The shorter the maturity of the bills bought (or of the purchase and resale arrangements made) the sooner—other things equal— does the Bank's operation need to be repeated.

balance, but building societies' basic mortgage rates fell by 1% to $10\frac{1}{4}$%; some bank mortgage rates also fell.

The gilt-edged market

The authorities began the period having secured £0.3 billion of receipts through earlier sales of partly-paid issues. One stock matured during the period, of which £0.7 billion remained in market hands at the beginning of the period; and in addition two stocks (with nominal value totalling £2.3 billion) were due to mature in banking June.

Initially, in banking March, gilt-edged prices showed no obvious trend. There was some unease over the course of US interest rates; but this was offset by a rise in sterling's effective rate and by the publication of figures for the money supply and the PSBR in January that were slightly better than expected.

Early in the period, at the end of normal business on 23 February, the Inland Revenue announced that it had reviewed the way in which building societies' holdings of gilt-edged stocks should be taxed. Hitherto, the societies had been liable to corporation tax on dividends from gilt-edged but to capital gains tax on capital gains. As a result, any profits taken on stock held for more than a year attracted no tax. The Inland Revenue ruled that, with effect from the next working day, societies would be subject to corporation tax on both dividends and capital gains (including capital gains on stocks held for over a year), putting them effectively in the same position as banks.

Building societies are large holders of gilt-edged stock; they held over £$9\frac{1}{2}$ billion at the end of 1983, most of it with less than five years to maturity. The change in tax treatment precipitated active trading (some of it on the evening of the announcement as some societies sought to realise profits) and the adjustment to the new tax arrangements continued for some weeks. During the period, the prices of low coupon short-dated stocks fell particularly sharply—by up to 2 points on 24 February alone. (These stocks were particularly affected by the new tax ruling because capital gains are a relatively important part of the return on them.) Other conventional short-dated stocks and the shorter index-linked stocks also lost a little ground initially. But sentiment improved after the weekend and, low coupons and index-linked apart, prices recovered.

Early in March, expectations of a fall in short-term interest rates led to a further rise in prices and, on 2 March, the Bank announced a new issue—10% Exchequer Stock 1989 'A' for tender on 7 March (Table F). Before this tender, demand exhausted the previous issue, $9\frac{3}{4}$% Exchequer Stock 1998 and sentiment in the conventional market was underpinned by the announcement, on 6 March, that £M3 had been unchanged in banking February and by Barclays' decision to cut its base rate. A substantial amount of the new stock was sold at the tender on 7 March, but a setback to bond prices in the United States dampened demand until Budget day.

The Budget was well received and the 1989 'A' stock was sold out the day after (14 March). Index-linked stocks remained out of favour, however, and the 1988 stock reached a record real

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
10% Exchequer 1989 'A'	1,250(a)	2/3	Minimum price tender	7/3	98.00	40	30 (9/4) 28 (14/5)	10.50	14/3
10% Treasury 1987	200	26/3	Direct to Bank	26/3	—	—	Fully paid	—	27/4
10¼% Exchequer 1995	200	26/3	Direct to Bank	26/3	—	—	Fully paid	—	26/4
10¼% Conversion 1999	100	26/3	Direct to Bank	26/3	—	—	Fully paid	—	28/3
3% Treasury 1986	100	13/4	Direct to Bank	13/4	—	—	Fully paid	—	—
3% Treasury 1987	150	13/4	Direct to Bank	13/4	—	—	Fully paid	—	—
9½% Treasury Convertible 1989	1,100(b)	27/4	Minimum price tender	2/5	95.50	50	45.50 (4/6)	10.70(c)	—

(a) Of which £250 million was reserved for the National Debt Commissioners.
(b) Of which £100 million was reserved for the National Debt Commissioners.
(c) Yield to 1989. Holdings may, at the option of the holder, be converted in whole or in part into 9½% Conversion Stock 2005, as on the following dates:

Date of conversion	Nominal amount of 9½% Conversion Stock 2005 per £100 nominal of 9½% Treasury Convertible 1989	Implied redemption yield(%)
18 April 1985	£99	9.91
18 October 1985	£97	9.72
18 April 1986	£95	9.54
18 October 1986	£93	9.37
18 April 1987	£91	9.22

yield of over 4½%.[1] At this point, selective demand appeared and the 1990 index-linked tap stock, which had been issued late in December, was exhausted on 27 March.

During the first half of banking April, the conventional market remained quietly firm, permitting the issue of small tranches of 10% Treasury Stock 1987, 10¼% Exchequer Stock 1995, and 10¼% Conversion Stock 1999—direct to the Issue Department of the Bank—on 26 March. The smallest of these, the 10¼% Conversion Stock 1999, was quickly sold.

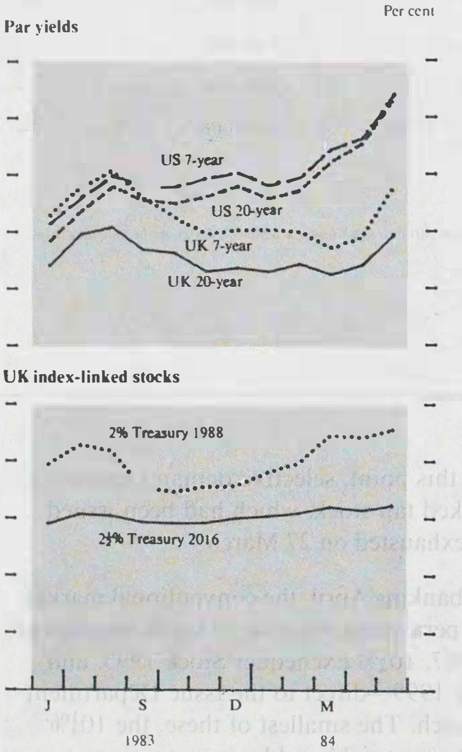
For the rest of the banking month (which ended on 18 April) conditions changed little. Periodic unease over American interest rates was evident and US prime rates rose ½% on 5 April. Index-linked stocks, however, continued to meet demand. The low coupon market also showed signs of consolidation as yields reached 1% above those ruling just before the change in building societies' taxation. On 13 April, small tranches of two low coupon stocks—3% Treasury 1986 and 3% Treasury 1987—were issued to the Bank. Thereafter, most prices fell modestly until the end of the banking month.

The market remained cautious at the beginning of banking May, fairly resistant to downward pressure but nervous about developments in the United States and at home. On 26 April demand was sufficient to absorb the balance of the 1995 tranche issued in March and the next morning the remaining March tranche was also sold out. With little stock available, and needing to maintain the momentum of the funding programme, the Bank announced on 27 April an issue of 9½% Treasury Convertible Stock 1989, £50 paid, for tender the next week.

The minimum price for the new stock was in line with those of existing stocks, but before the tender short-term interest rates

(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 1983 *Bulletin*, page 484.

Gross redemption yields on government stocks



in the United States began to move up further and sterling weakened against the dollar. Nevertheless, a significant amount of the new stock was sold at the tender on 2 May. Shortly afterwards, continuing fears over interest rates in the United States were augmented by speculation that the provisional money supply figures for banking April—to be published on 8 May—would show rapid growth. Prices eased before the May Day bank holiday weekend. They fell sharply when the market reopened after the holiday, sterling having reached new lows against the dollar in New York the previous night. The provisional money figures proved better than expected but news of another $\frac{1}{2}$% rise in US prime rates reversed the brief rally. The increase in clearing bank base rates announced on 9 May and a major setback to bond prices in the United States led to further price falls, and on 11 May the FT gilt-edged index reached its lowest point since September.

The market opened nervously the following week. But with short-term interest rates showing signs of consolidation at their new levels and with sterling remaining steady at an effective rate of around 80, a small rally occurred on the last day of banking May. The Bank sold some of the 1989 convertible tap at £47$\frac{5}{8}$ (£50 paid), the proceeds of which—following the normal next day settlement—fell into banking June.

Over the three months, gilt-edged yields rose: on five-year stocks from 10$\frac{5}{8}$% to 11$\frac{7}{16}$%, on ten-year stocks from 10$\frac{7}{8}$% to 11$\frac{7}{16}$% and on twenty-year stocks from 10$\frac{3}{8}$% to 10$\frac{7}{8}$%. Yields in the United States rose further: the margin of US over UK government bond yields rose from 1$\frac{5}{8}$% to 2$\frac{11}{16}$% at the twenty-year maturity. Real yields on index-linked gilts also rose: on the 1988 stock from 3.85% to 4.39% and on the 2016 stock from 3.05% to 3.18%.(1)

Other capital markets

The *equity market* began the period quietly but soon developed a firmer tone; on 2 March the FT-Actuaries all-share index reached 501.49 representing an increase of 2.5% since the beginning of the period.

The market remained very steady during the week before the Budget and, although shares in life assurance companies and clearing banks were adversely affected by fears of forthcoming taxation changes, buying interest was strongly encouraged on 6 March by the provisional money supply figures for February, which showed no change in £M3, and by the announcement by Barclays Bank of a $\frac{1}{4}$% base rate reduction. Trading subsequently became more subdued until after the Chancellor's speech on 13 March. There followed a strong advance, reinforced by demand from the United States and encouraging results from several leading British companies. Turnover in equities rose to a new daily record of £558 million on 16 March and in the following week the all-share index rose to a new high of 531.00. During the second half of March, however, prices tended to drift lower as some profits were taken. Sentiment was adversely affected by a resumption of rights issues after a lull around the Budget and by weakness in the US equity market; but life assurance shares, which had weakened

(1) These yields are based on the assumption of a 5% annual rate of increase in the retail price index—see the December 1983 *Bulletin*, page 484.

Table G
Amounts raised in the capital market

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

Banking months	June 83– Aug. 83	Sept. 83– Nov. 83	Dec. 83– Feb. 84	Mar. 84– May 84
UK private sector				
Loan capital and preference shares	+153	+ 94	+ 27	+ 99
Equity capital(a)	+852	+477	+193	+314
Unit trusts(b)	+354	+425	+499	+372
Issues on the unlisted securities market	+ 48	+ 31	+ 49	+ 42
Local authorities				
Stocks	– 94	– 37	+ 22	– 11
Negotiable bonds	– 16	+ 3	+ 38	– 66
Overseas	+148	+283	+ 85	+260

(a) Net issues by listed UK public companies.
(b) Calendar months.

Table H
Debt issues announced on the London capital market, mid-Feb. to mid-May 1984[(a)]

Date of Announcement	Issuer	Nominal amount (£ millions)	Coupon (per cent)	Maturity
Domestic borrowers				
22 February	Scottish Northern	11	$11\frac{15}{16}$	2009
28 March	English and International	5	$10\frac{5}{8}$	2014
17 April	Border and Southern Stockholders	15	$11\frac{1}{2}$	2014
Overseas borrowers				
20 February	Asian Development Bank	100	$10\frac{1}{4}$	2009
26 March	Republic of Finland	50	$11\frac{1}{2}$	2009
11 April	Province of Nova Scotia	60	$11\frac{3}{4}$	2019
30 April	Republic of Trinidad and Tobago	50	$12\frac{1}{4}$	2009
9 May	Electricité de France	75	$11\frac{3}{4}$	2012

(a) All these issues were placed apart from those by Asian Development Bank, Republic of Finland and the Republic of Trinidad and Tobago. Issues of convertible stock and issues of less than £3 million are not included.

Table J
Outstanding droplock arrangements

Trigger levels(a)	Amount committed as at end-May 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.

after the Budget, showed some recovery as results published by a number of companies were well received. In early April, despite an encouraging CBI survey on the prospects for UK manufacturing, share prices continued to drift lower under the influence of a weakening in sterling and selling for tax reasons before the end of the tax year.

Early in the new financial year equities came back into demand, encouraged by the optimistic remarks on economic prospects made by the Chancellor on 10 April. Prices subsequently eased around mid-month owing to concern over industrial unrest, but this setback proved short-lived and shares advanced steadily during the remainder of the month and into May, helped by a firmer tone on Wall Street and an encouraging CBI survey on industrial trends. The all-share index reached a new record level of 536.26 on 3 May. Thereafter, the market entered a significant reverse. The results of the local government elections were unsettling, while the fall of sterling to a new low against the dollar led to defensive mark-downs as fears of higher interest rates grew. Prices continued to weaken following the increase in base rates. The all-share index closed on 16 May at 519.92, having risen on balance over the period, by 6.3%.

The strength of share prices during much of the period under review was reflected in some increase in the net amount of new equity finance raised during the three months, although not to the high levels recorded during the earlier part of last year (Table G). Several companies announced substantial rights issues. In addition, the government sold by tender its remaining $48\frac{1}{2}$% stake in Associated British Ports, raising £52.4 million. On 16 May, 57 million shares in Reuters Holdings were offered for sale by tender at a minimum price of 180p (and it was announced that the equivalent of 49.8 million further shares would be offered for sale in the United States).

Activity by domestic borrowers in the *fixed-interest market* was lower than during the previous three months with only three placings of stock totalling £31 million by investment trust companies (Table H). *Local authorities* made no issues and no stock was issued under droplock arrangements by local authorities or other borrowers. Droplock arrangements currently outstanding are shown in Table J. *Overseas borrowers,* on the other hand, continued to tap the market, making five issues, the largest being a £100 million offer for sale from the Asian Development Bank.

The *eurosterling market* was very active from mid-February to mid-April with thirteen fixed-rate issues which raised a total of £690 million; three issues of floating-rate notes with a total value of £275 million were also made. After mid-April interest in eurosterling issues fell away and only one further issue—of £50 million at a floating rate—took place during the remainder of the period under review.