Operation of monetary policy

This article covers the three months from mid-May to mid-August 1984.

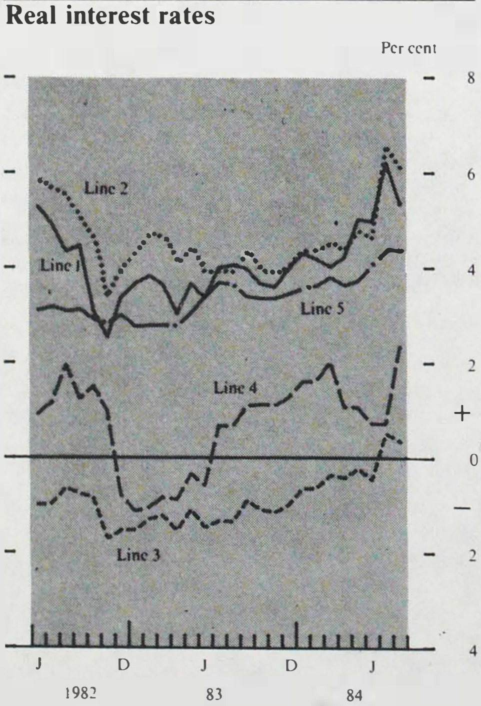
Review

Underlying monetary conditions taken as a whole remained satisfactory throughout the period under review, despite the erratic behaviour of the monetary statistics. There was, however, severe turbulence in the financial markets in the early summer, arising from concerns about industrial disputes in the United Kingdom, the financial situation in the United States and market anxieties about domestic monetary conditions. The authorities acted to resist the resulting upward pressure on interest rates, as they had in earlier months, but the strength of the pressure was such that there were nevertheless sharp and unwelcome increases in interest rates and bond yields in July. These increases were substantially reversed in August after the market anxieties had moderated.

At the beginning of the period, M0 was within the target range; and £M3 was only a little above target, despite the concentration of the PSBR early in the target period, which meant that, other things being equal, the pace of growth of broad money was likely to be faster in the early part of the target period than was expected over the period as a whole. Among the other aggregates, M2 was not growing rapidly, though it was difficult to interpret as a result of changing withdrawal terms on some building society accounts. PSL2, on the other hand, was growing rapidly. This was largely accounted for by the building society component and was to a considerable degree attributable to more intense competition in the market for personal savings, particularly among building societies; it could be expected to be accompanied, therefore, by a shift downwards in the velocity of building society liabilities. For this reason PSL2 could not be taken at face value for policy purposes. More generally, underlying activity continued to grow at a moderate pace, the prospect for inflation remained favourable, and most measures of real interest rates remained clearly positive.

The authorities had expected that the monetary figures early in the period under review would be unfavourable because of the concentration of the PSBR and the exceptionally heavy gilt-edged maturities in banking June. When they appeared, however, the figures for banking June were worse than expected. Besides the unfavourable factors mentioned, narrow money and bank lending to the private sector appeared to be substantially and adversely influenced by effects which the authorities judged likely to prove erratic, as indeed proved to be the case. This influence reversed in banking July, producing falls in the broad money aggregates, and left the target aggregates comfortably placed in relation to the target ranges for the period since mid-February. This went a long way towards

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%, adjusted 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.

vindicating the official view of underlying monetary conditions. Monetary growth remained restrained in banking August.

Nevertheless, for much of the period under review there were repeated bouts of strong upward market pressure on short-term interest rates. The main sources of this pressure were threefold. First, the rise in US interest rates, which had taken the three-month eurodollar rate from below 10% in mid-February to $11\frac{5}{8}$% in mid-May, continued, taking that rate to a peak of $12\frac{3}{8}$% early in July. This reflected the combination of continued rapid growth in the US economy and the large Federal budget deficit which gave rise to a great deal of uncertainty about the future course of Federal Reserve policy. Second, there was increasing market concern about domestic industrial relations as the miners' strike continued and was accompanied, for a time, by a national dock strike. Finally, there was market anxiety about the domestic monetary and fiscal position. In the prevailing nervous atmosphere, this anxiety appeared to find support in the financial statistics published early in the period, which, as already noted, did not accurately reflect the underlying position. In addition the weakening of the oil price in July raised concern about its implications for the PSBR and its effect on the exchange rate.

Against this background, the Bank resisted the market pressures for higher interest rates. But the market pressures, which were reinforced by new developments in the United States, by the sudden emergence of a national dock strike in the United Kingdom, by weakening oil prices, and by the publication of the discouraging money figures for banking June, became so strong that bank base rates, which had begun the period at 9%–$9\frac{1}{4}$%, were pushed up to 12% by mid-July.

The market's anxieties moderated quite quickly. The US bond market began to improve, the national dock strike came to an end, oil prices strengthened, and the money figures for banking July were very encouraging. As a result, market pressures for some reversal of the earlier rises in short-term interest rates then emerged, and the authorities encouraged a gradual reduction, which took base rates back down to $10\frac{1}{2}$% by soon after the middle of August. These events are described further in the section on the money market.

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

Banking months	Sept. 83– Nov. 83	Dec. 83– Feb. 84	Mar. 84– May 84	June 84– Aug. 84
M0(a)	9.0	3.7	4.3	4.6
Non-interest-bearing M1	8.9	5.3	16.2	6.9
M1	9.9	9.1	28.0	11.1
M2(b)	7.7	7.9	7.8	9.3
		10.2	*10.4*	*12.1*
£M3	5.9	7.6	10.9	7.1
PSL1	6.0	5.0	12.1	7.6
PSL2	6.9	11.5	16.9	13.6
M3	9.0	15.2	4.6	9.0

(a) Based on averages of weekly figures.
(b) Not seasonally adjusted. The figures show the increase over the 12 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*.

Monetary aggregates and credit

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

Over the period under review taken as a whole, the growth rate of M0 was little changed and £M3 decelerated, so that over the first six months of the target period both were inside their target ranges. Among the other aggregates, PSL2 also decelerated but the 12-month growth rate of M2 picked up somewhat (disregarding changes resulting from the reclassification of building society accounts whose terms had been changed).

Narrow aggregates

On the weekly averaged basis, M0 grew at an annual rate of 4.6% over the three months under review, much the same as over the preceding three months. The 12-month growth rate of M2, which had been steady at around 8% since the end of

1983, picked up to about 9%. M1 decelerated sharply, reflecting slowdowns in both its interest-bearing and non-interest-bearing components.

Table B
Change in £M3 and its counterparts[(a)]

£ billions; *seasonally adjusted*

	Banking months	Sept. 83– Nov. 83	Dec. 83– Feb. 84	Mar. 84– May 84	June 84– Aug. 84
1	Central government borrowing requirement(b)	+3.3	+2.4	+3.0	+2.3
2	Other public sector(b)	+0.2	−0.6	−0.3	+0.3
3	Purchases (−) of central government debt by the non-bank private sector	−4.6	−2.8	−2.3	−3.5
	of which:				
	Gilt-edged stocks	*−3.3*	*−2.4*	*−1.4*	*−2.5*
	National savings	*−1.1*	*−0.6*	*−0.8*	*−0.7*
	CTD's	*−0.2*	*+0.2*	*−0.1*	*−0.1*
4	External finance of the public sector(c)	−0.1	−0.4	−0.6	—
	of which, gilt-edged stocks (purchases −)	—	*−0.1*	*−0.4*	*+0.3*
5	Sterling lending to the private sector(d)	+3.8	+3.9	+4.0	+2.7
6	External finance of the monetary sector(e)	−0.4	+1.3	−0.2	+0.1
7	Net non-deposit liabilities (increase −)	−0.9	−2.0	−1.0	−0.1
8	**Change in £M3**	**+1.4**	**+1.8**	**+2.6**	**+1.8**

(a) Counterparts may not add up to the total of £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) Including Issue Department's holdings of commercial bills.

(e) 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 Q3	1983 Q4	1984 Q1	1984 Q2	1984 July and Aug.
Liabilities					
Shares and deposits held by the non-bank private sector:					
Liabilities included in PSL2	+2.0	+3.0	+3.4	+3.4	
of which, CDs and time deposits	*+0.1*	*+0.3*	*+0.2*	*+0.3*	+1.4
Term shares and SAYE deposits(a)	+0.9	+1.2	+0.3	—	
Interest accrued but not credited	+0.3	−0.1	+0.3	−0.2	
To the monetary sector:					
CDs and time deposits	+0.3	+0.3	−0.1	—	
Other loans	—	—	—	—	
Reserves and other liabilities(b)	+0.4	+0.8	−1.2	+0.5	
Total	**+3.9**	**+5.2**	**+2.7**	**+3.6**	
Assets					
Mortgage advances	+2.6	+2.8	+2.9	+4.0	+2.9
Short-term assets:					
Claims on the monetary sector	+0.6	+1.5	−0.8	−0.5	−0.2
Other(c)	—	—	+0.2	+0.2	
British government stocks and local authority long-term debt	+0.6	+0.8	+0.4	−0.2	−0.1
Other assets(d)	+0.1	+0.1	—	+0.1	
Total	**+3.9**	**+5.2**	**+2.7**	**+3.6**	

(a) Excluding CDs.

(b) Including negotiable bonds.

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

(d) Mainly premises etc.

£M3 and its counterparts

Sterling M3 was very erratic from month to month, but over the three months as a whole it increased by £0.9 billion less than over the preceding three months. Among the counterparts to £M3, the PSBR[(1)] was little changed, but net sales of central government debt to the non-bank private sector were £1.1 billion higher (details of government funding are given in the following section).

Bank lending in sterling to the private sector fell back to £2.7 billion from £4 billion in the preceding three months. About half of this deceleration represented repayments, by leasing subsidiaries[(2)] of two clearing banks, of loans from their parent banks in exchange for transfers of reserves from the parents to the subsidiaries. The counterpart to the effect on sterling lending of these special transactions was an unusually small increase in net non-deposit liabilities; there was no net effect on £M3. Within the total of sterling bank lending to the private sector, personal borrowing may have been some £1¼ billion, of which £½ billion was for house purchase.

External influences on £M3 (the sum of rows 4 and 6 in Table C) were broadly balanced, having been contractionary by £0.8 billion over the preceding three months; this counterpart is notably erratic in its behaviour.

Building societies and PSL2

For most of the period the Building Societies Association's advised ordinary share rate was 6¼% net of basic rate tax, a level established when clearing bank base rates stood at 8½%–8¾%. Although most building society accounts yielded more than 6¼%, the rise in bank base rates in May and subsequently in July reduced the competitiveness of building society shares and retail inflows into the societies accordingly remained subdued at around £0.9 billion a month. Nevertheless building society lending accelerated further to over £1.3 billion a month. The societies' residual financing came from further drawings on the wholesale markets and reductions in their liquidity ratios, which by the end of August averaged 17.6%, compared with the first quarter peak of 19.8%.

PSL2, which includes much of the societies' wholesale as well as retail liabilities, grew at an annual rate of 13.6% over the three months under review, despite the slowdown in retail inflows, partly because the retail inflows were concentrated in accounts included in PSL2; there were net outflows from accounts outside PSL2.

Official operations in financial markets

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

The market anxieties about rapid monetary growth made it necessary, during the three months under review, to aim for a

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

(2) These subsidiaries were not in the monetary sector.

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

Banking months	Sept. 83– Nov. 83	Dec. 83– Feb. 84	Mar. 84– May 84	June 84– Aug. 84
Gross official sales(b)	+4.3	+3.6	+2.9	+4.6
less				
Redemptions and net official purchases of stock within a year of maturity	-0.9	-1.2	-1.2	-2.0
Equals net official sales(c)	+3.4	+2.4	+1.7	+2.6
of which, net purchases by:				
Monetary sector(c)	—	*-0.2*	*-0.1*	*+0.4*
Overseas sector	—	*+0.1*	*+0.4*	*-0.3*
Non-bank private sector	*+3.3*	*+2.4*	*+1.4*	*+2.5*

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	Mar. 84– May 84	June 84– Aug. 84	Sept. 83– Aug. 84
Factors affecting the market's cash position			
CGBR (+)	+4.3	+3.1	+10.5
Net sales of central government debt(b)(−)	-2.7	-3.2	-13.3
of which:			
Gilt-edged	*-1.7*	*-2.6*	*-10.0*
National savings	*-0.9*	*-0.4*	*- 3.2*
CTDs	*-0.1*	*-0.2*	*- 0.1*
Currency circulation (increase −)	-0.3	-0.4	- 0.7
Other	-0.5	-0.1	- 1.0
Total (A)	**+0.8**	**-0.5**	**- 4.5**
Official offsetting operations			
Net increase (+) in Bank's holdings of commercial bills(c)	-1.0	+0.6	+ 4.3
Net increase (−) in Treasury bills in market	-0.1	—	+ 0.2
Other	+0.2	-0.2	- 0.1
Total (B)	**-0.9**	**+0.4**	**+ 4.4**
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.

rate of funding higher than that expected to be needed over the target period as a whole. In the event, the rate of debt sales was exceptionally high, even after allowance for heavy gilt-edged maturities. Consequently the Bank had to increase the amount of assistance to the money market in order to offset the drain of cash.

Gross official sales of gilt-edged totalled £4.6 billion; after maturities of £2.0 billion, net official sales to all sectors were £2.6 billion. Net purchases of stock by the monetary sector were largely offset by net sales by the overseas sector, and net purchases by the non-bank private sector were £2.5 billion. In addition, national savings raised £0.7 billion (seasonally adjusted). Total net purchases of central government debt by the non-bank private sector were £3.5 billion.

The CGBR was slightly exceeded by net sales of central government debt. A rise in the note circulation and other factors also acted to withdraw cash, totalling £0.6 billion, from the money market. The Bank offset this mainly by buying additional commercial bills. At the end of the period the amount of assistance provided (other than through official operations in Treasury bills) stood at £11 billion, compared with £10½ billion at the beginning of the period.

The money market

The period began on 17 May with the money market having steadied after the rise of ½% in the general level of short-term interest rates on 9–10 May brought about mainly by US developments. Nevertheless, the yield curve from a month out to a year remained upward-sloping, with the one-month rate at just below 9%, the three-months rate at $9\frac{7}{16}$% and the one-year rate at $10\frac{3}{16}$%. Two of the four large London clearing banks' base rates were 9% and the other two were 9¼%.

The buying rates for bills established by the Bank implied roughly equal yields in the four maturity bands out to three months; but because of the upward slope in the market yield curve, the Bank's purchases were concentrated in the longer maturity bands throughout the first half of the period.

During the last week of May there were further market fears of rises in short-term interest rates both in the United States and the United Kingdom, provoked by unsettling rumours about the stability of certain US banks and by general unease about the US monetary situation, as well as by domestic concerns about industrial relations and the PSBR. The upward slope of the yield curve in the sterling money market became steeper, reflecting depositors' increased preference for shorter maturities, and the three-month interbank rate rose to $9\frac{15}{16}$%. A further rise in base rates was widely considered inevitable, but the Bank resisted the pressure by continuing to buy bills at its established dealing rates. Early in June the market concerns eased and conditions in the money market became calmer, helped by the publication on 5 June of better-than-expected UK money figures for banking May. During this phase the dollar strengthened as US interest rates rose, particularly after the 'flash' estimate of US GNP in the second quarter of 1984 was published on 20 June, but sterling remained steady in effective terms. The upward slope in the money-market yield curve was less pronounced than previously, though still present; the three-month interbank rate was fairly steady at around $9\frac{3}{8}$%.

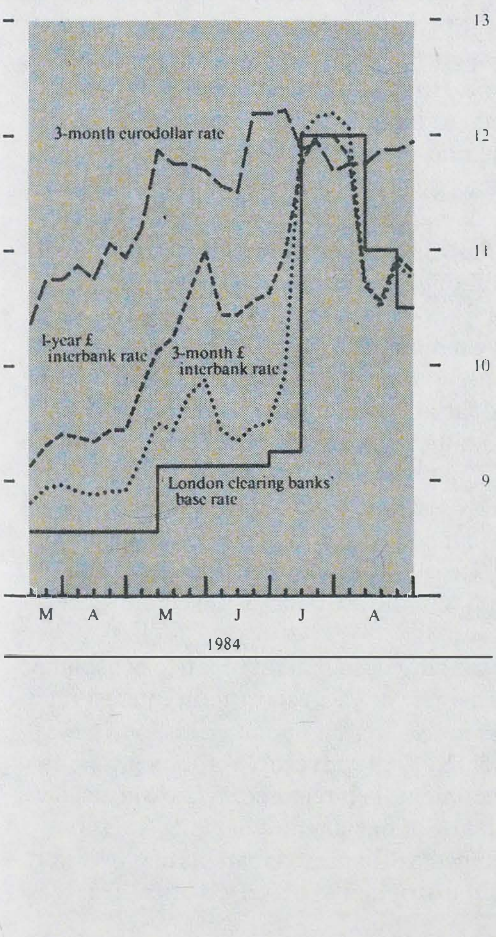
Nevertheless, money-market interest rates remained high in relation to the 9% base rates of two of the clearing banks, and Lloyds Bank announced on 25 June that it was raising its base rate to $9\frac{1}{4}$%; National Westminster Bank followed suit the next day. Also on 25 June, US banks' prime rates were raised by a further $\frac{1}{2}$% to 13%.

It was clear that these developments could reawaken the anxieties which had put upward pressure on interest rates at the end of May. Consequently, on 26 June, when the Bank took the opportunity offered by the realignment of bank base rates to make a technical adjustment bringing the profile of its bill dealing rates more into line with the market yield curve, the Bank was anxious to make clear that the rise in its dealing rate in band 4 (2–3 months bills), which was part of the adjustment, was not intended to signal a rise in the general level of interest rates. The Bank, therefore, made a public statement that it saw no need on monetary policy grounds for any general increase in the level of domestic interest rates. The immediate effect of the statement was to settle sentiment: the money market remained calm for a period thereafter and the gilt-edged market steadied; in the foreign exchange market sterling moved in line with other currencies against a strong dollar, despite some weakness in oil prices and a rise in the Deutsche Bundesbank's discount rate on 28 June.

On 5 July, however, market sentiment became sharply adverse. The trigger was an abrupt weakening of sterling against the generality of foreign currencies, and the fall continued the next day. The gilt-edged market weakened, money-market rates rose sharply and bank base rates went up to 10%. The Bank endorsed this increase by accepting higher rates in its bill dealings. With advance information about the provisional money figures for banking June, which were shortly to be announced, and which were bound to be poorly received by the financial markets, the authorities had no grounds for refusing to accept the 10% level of short-term interest rates indicated at that time by market rates. Indeed, any attempt to do so, for example by leaving the Bank's own dealing rates unchanged, seemed likely to damage sentiment further by intensifying doubts—in both domestic and foreign exchange markets—about the authorities' continuing counterinflationary resolve.

In the event the move to 10% proved wholly inadequate to stabilise the situation. Immediately afterwards the market's three main sources of anxiety were sharply intensified. On that same afternoon, 6 July, the US unemployment figures for June showed an unexpectedly large decline which reawakened alarm about the pace of US economic activity and its implications for interest rates. After the weekend, on 9 July, financial sentiment was upset further by the calling of a national dock strike which was quite unexpected and which threatened serious short-term damage to the economy. And finally the money figures for banking June, published on Tuesday 10 July, were far worse than the markets had expected. The authorities had for a long time expected a large increase in £M3 in banking June, and had sought to mitigate its market impact both through the Bank's statement on 26 June and by explaining in the June *Bulletin* the reasons why relatively high £M3 growth in the early part of the target period should not be regarded as alarming. The large increase in £M3 in banking June appeared in addition to contain a substantial erratic element and did not cause the authorities to revise their view of underlying monetary conditions. Nevertheless, in the extremely nervous atmosphere that had developed, the figures caused market sentiment to worsen further.

July's sharp rise in **short-term interest rates** *proved short-lived*



This combination of events destroyed any chance of consolidating short-term interest rates at around 10%. The money-market yield curve steepened sharply, with the three-month interbank rate rising to around 12% on the morning of 11 July, while the exchange rate and gilt-edged prices again weakened sharply. In the circumstances, with the monetary evidence in particular seeming to be so strongly in conflict with the official view, there was a serious risk that official resistance to the further general 2% rise in interest rates foreshadowed by the rise in market rates would simply have intensified the pressure as confidence fell away. Clearing bank base rates were increased to 12% on 11 and 12 July, and the Bank subsequently established a pattern of bill dealing rates consistent with that level of base rates.

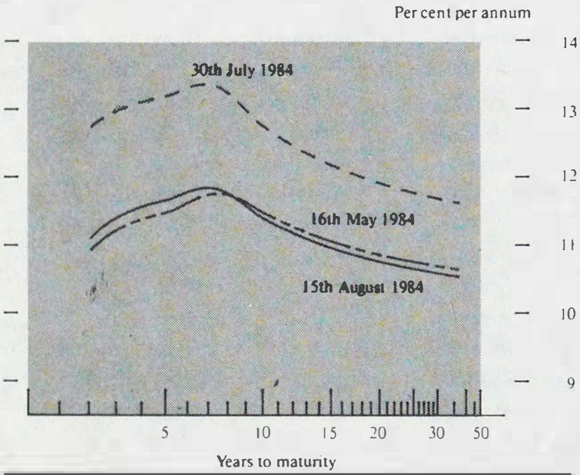
After some initial nervousness the structure of short-term interest rates consolidated around the 12% level, particularly after it became clear on 20 July that the dock strike would be settled and after Federal Reserve Chairman Volcker's congressional testimony on US monetary policy on 25 July. The effective exchange rate index stabilised and it became possible to resume large-scale official sales of gilt-edged stocks. Moreover, a downward slope in the yield curve from a month out to a year became firmly established for the first time for over a year.

This improvement in sentiment was strongly reinforced by the publication on 7 August of very encouraging provisional money figures for banking July, as well as by a harder tone in oil prices, and there was strong market pressure on the following two days for a lower general level of short-term interest rates. The Bank encouraged this movement and rates had fallen by a full percentage point by the end of that week. With sterling remaining steady, expectations of a further fall in rates persisted and the rates came down by another $\frac{1}{2}$% at the end of the following week (on 17 August), thereby bringing base rates back to $10\frac{1}{2}$%.

The daily cash shortages in the market were modest early in the period, averaging some £160 million, reflecting in part the prevailing nervousness about short-term interest rates which led the discount houses to sell longer-dated bills to the Bank and which thereby reduced the average daily total of maturing assistance. Later in the period the shortages increased—in banking August the average was £530 million—as the CGBR (before seasonal adjustment) moderated, large amounts of government debt were sold and expectations about interest rates improved, causing the average maturity of official assistance to the money market to shorten. In order to offset these larger shortages, the Bank at times entered into purchase and resale agreements in bills with the discount houses.

On balance interest rates rose over the period from 17 May to 17 August.[1] In the sterling interbank market the one-month rate rose by $1\frac{3}{4}$% to $10\frac{11}{16}$%, the three-month rate by $1\frac{1}{8}$% to $10\frac{9}{16}$% and the one-year rate by $\frac{7}{16}$% to $10\frac{5}{8}$%. All three of these rates peaked at $12\frac{7}{16}$% on 19 July. Clearing bank base rates went up from 9%–$9\frac{1}{4}$% to $10\frac{1}{2}$%, having been as high as 12% during the period. The building societies' advised mortgage rate rose from $10\frac{1}{4}$% to $12\frac{1}{2}$% with effect from 1 August.

The time/yield curve of British government stocks *rose sharply during the period but ended close to where it had begun.*



The gilt-edged market

The severe turbulence in financial markets during the period under review created a difficult environment for gilt-edged funding. For most of the period market sentiment was nervous, and the authorities issued stock only in the form of small additional tranches of existing stocks. Nevertheless it proved possible by this means to maintain the momentum of gross sales at well above the rate expected to be necessary over the target period as a whole. At the end of the period sentiment improved sharply, encouraged by the higher yields then available, and the authorities sold exceptionally large amounts of stock, leaving the funding programme well advanced.

At the beginning of the period the authorities had secured only a small amount of gilt-edged receipts through earlier sales of partly-paid stock, and faced two maturing stocks with a total nominal value of £2.3 billion in banking June, together with the need to provide for buying-in of 12% Treasury 1984 before its maturity. The Bank's portfolio included substantial amounts of the tranches of low-coupon conventional stocks issued on 13 April, and of $9\frac{1}{2}$% Treasury Convertible 1989 issued on 2 May, as well as supplies of the 2020 index-linked tap stock.

In the middle of May the gilt-edged market began to consolidate in the wake of the earlier rise of $\frac{1}{2}$% in short-term interest rates and the sharp increase in US Treasury bond yields; on 16 May substantial amounts of the 1989 convertible tap stock were sold at £$47\frac{5}{8}$ (£50 paid). Sentiment then relapsed in late May as the uncertainties about the US monetary and banking situation, the miners' strike and the PSBR affected markets and investors were attracted to liquid instruments; gilt-edged prices fell.

When some of those immediate uncertainties were dispelled in early June, demand for stock reappeared and there were very heavy official sales, which exhausted the 1989 convertible tap stock on 1 June at a price of £$91\frac{5}{8}$ (fully paid). In order to replenish official supplies of full-coupon conventional stock, the Bank announced on 4 June the issue of four small tranches of existing stocks: £200 million each of 10% Treasury 1987 and $10\frac{1}{4}$% Exchequer 1995, and £100 million each of $9\frac{3}{4}$% Exchequer 1998 and $11\frac{1}{2}$% Treasury 2001–04; in the aftermath of the better-than-expected provisional money figures for banking May published on 5 June, supplies of the 1998 stock were exhausted.

Thereafter, uncertainties about US developments again led to market conditions becoming subdued. Sentiment revived

(1) In this paragraph, interest rate movements are measured over the period 17 May (the first day of banking June) to 17 August rather than to the last day of banking August (which was 15 August). This is because the movement in interest rates which was widely expected on 15 August was not completed until 17 August. The paragraph on gilt-edged yields on page 326 measures changes over the same period.

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% Treasury 1987	200	4/6	Direct to Bank	4/6	—	—	Fully paid	—	19/6
$10\frac{1}{4}$% Exchequer 1995	200	4/6	Direct to Bank	4/6	—	—	Fully paid	—	19/6
$9\frac{3}{4}$% Exchequer 1998	100	4/6	Direct to Bank	4/6	—	—	Fully paid	—	6/6
$11\frac{1}{2}$% Treasury 2001–04	100	4/6	Direct to Bank	4/6	—	—	Fully paid	—	18/6
British Transport 3% 1978–88	250	26/6	Direct to Bank	26/6	—	—	Fully paid	—	10/8
10% Treasury 1992	200	26/6	Direct to Bank	26/6	—	—	Fully paid	—	2/8
10% Conversion 2002	200	26/6	Direct to Bank	26/6	—	—	Fully paid	—	11/7
$10\frac{1}{4}$% Exchequer 1995	300	11/7	Direct to Bank	11/7	—	—	Fully paid	—	25/7
$11\frac{1}{2}$% Treasury 2001–04	300	11/7	Direct to Bank	11/7	—	—	Fully paid	—	13/7
$9\frac{1}{2}$% Treasury 1988	250	20/7	Direct to Bank	20/7	—	—	Fully paid	—	26/7
$10\frac{1}{2}$% Treasury 1999	250	20/7	Direct to Bank	20/7	—	—	Fully paid	—	1/8
$11\frac{3}{4}$% Treasury 2003–07	200	20/7	Direct to Bank	20/7	—	—	Fully paid	—	24/7
$10\frac{1}{2}$% Treasury 1989	100	20/7	Direct to National Debt Commissioners	20/7	—	—	Fully paid	—	—
$10\frac{1}{2}$% Exchequer 1997	100	20/7	Direct to National Debt Commissioners	20/7	—	—	Fully paid	—	—
11% Exchequer 1989	1,200(a)	3/8	Minimum price tender	8/8	94.75	35	59.75 (17/9)	12.40	9/8
$10\frac{1}{2}$% Convertible 1992(b)	950(c)	10/8	Minimum price tender	16/8	95.25	30	30 (10/9) 35.25 (8/10)	11.43(d)	—

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

(b) The prospectus includes provision for exemption from UK taxation in favour of non-resident holders of both $10\frac{1}{2}$% Treasury Convertible Stock 1992 and $9\frac{3}{4}$% Conversion Loan 2003, and for $9\frac{3}{4}$% Conversion Loan 2003 to be available in bearer form.

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

(d) Yield to 1992. Holdings may, at the option of the holder, be converted in whole or in part into $9\frac{3}{4}$% Conversion Loan 2003, as on the following dates:

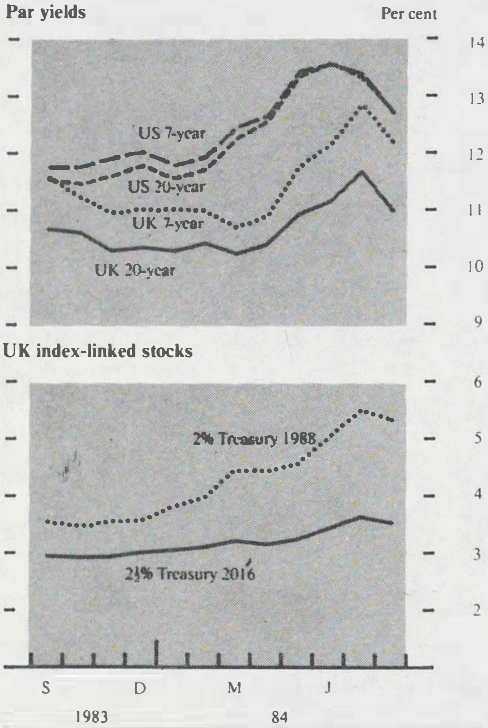
Date of conversion	Nominal amount of $9\frac{3}{4}$% Conversion Loan 2003 per £100 nominal of $10\frac{1}{2}$% Treasury Convertible Stock 1992	Implied redemption yield(%)
7 November 1985	£98	10.20
7 May 1986	£96	10.05
7 November 1986	£94	9.90
7 May 1987	£92	9.77
7 November 1987	£90	9.66

towards the end of the banking month following the publication on 18 June of the encouraging PSBR figure for May and there were heavy official sales of stock over the next few days. These sales exhausted official supplies of the other small tranches of full coupon stocks issued in early June and of the low coupon stock issued in April.

Early in banking July (which began on 21 June) there were renewed concerns about domestic interest rates, but they were allayed by the Bank's statement on 26 June. Later on the same day the Bank announced the issue of further small tranches of existing stocks to resupply its portfolio—£250 million of British Transport 3% 1978–88 and £200 million each of 10% Treasury 1992 and 10% Conversion 2002. There were substantial sales of the latter two stocks on 28 and 29 June. Thereafter, however, the money market and exchange rate developments described in the preceding section supervened and gilt-edged prices fell sharply. Only after the rise in short-term interest rates to 12% on 11 July was it possible to resume sales of stock. Official supplies of the tranche of the 2002 stock were exhausted on that day and the Bank announced further tranches of stock—£300 million each of $10\frac{1}{4}$% Exchequer 1995 and $11\frac{1}{2}$% Treasury 2001–04—in order to enable it to carry forward the funding programme. The 2001–04 stock was sold out on 13 July and there was steady further demand for stock as the new level of interest rates became consolidated.

Against this background, and following the boost given to market sentiment when it became clear that the dock strike

Gross redemption yields on government stocks



would be settled, the Bank announced further tranches of existing stocks on 20 July in order to restock its portfolio. This package consisted of £250 million each of $9\frac{1}{2}$% Treasury 1988 and $10\frac{1}{2}$% Treasury 1999, and £200 million of $11\frac{3}{4}$% Treasury 2003–07. In addition, £100 million each of $10\frac{1}{2}$% Treasury 1989 and $10\frac{1}{2}$% Exchequer 1997 were issued to the National Debt Commissioners for public funds under their management. Demand for stock persisted, encouraged by the settlement of the dock strike and Chairman Volcker's congressional testimony on US monetary policy, and the outstanding tranches of full coupon stock were all exhausted over the ensuing two weeks.

In the light of these developments, and of indications that the provisional money figures to be published the following Tuesday would be encouraging, the Bank announced on Friday 3 August the first full-scale new issue for three months—£1,000 million of 11% Exchequer Stock 1989.• The issue was made in partly-paid form, which served to emphasise that the authorities had no pressing need for immediate funds. At the tender on Wednesday 8 August the bulk of the stock was allotted at £$\frac{1}{2}$ above the minimum tender price and the remaining official supplies were exhausted the following day; in addition, official holdings of the tranche of British Transport 3% 1978–88 were exhausted on 10 August.

Also on 10 August, with the market still strong, the Bank announced another new stock in partly-paid form for tender on 16 August, the first day of banking September. This stock was £750 million of $10\frac{1}{2}$% Treasury Convertible Stock 1992,[1] convertible at the holder's option into $9\frac{3}{4}$% Conversion Loan 2003. One feature of this stock is that the prospectus provides for exemption from UK taxation for non-resident holders of both the parent stock and the conversion stock; in addition, the conversion stock will be available in bearer form at the holder's option. This was the first new issue with tax-exemption provisions for non-residents since January 1977, although tranches of existing stocks with these provisions have been issued from time to time since then.

Amid the general improvement in market conditions, demand for index-linked stock re-emerged, and the yields on these stocks, which had been rising for some months, began to fall back. This demand led to the exhaustion of official supplies of the 2020 stock on 14 August.

Over the period 17 May to 17 August, the net changes in conventional gilt-edged yields were not large. The yield on 5-year stocks rose from $11\frac{7}{16}$% to $11\frac{11}{16}$%, having peaked at $13\frac{3}{16}$%; the yield on 10-year stocks was unchanged on balance at around $11\frac{7}{16}$%, having peaked at $12\frac{3}{4}$%, and the yield on 20-year stocks fell very slightly from $10\frac{7}{8}$% to $10\frac{13}{16}$%, having peaked at $11\frac{7}{8}$%. Index-linked yields rose on balance: on the 1988 stock from 4.39% to 5.24% and on the 2016 stock from 3.18% to 3.45% (assuming inflation at 5% per annum).

Other capital markets

The *equity market* began the period with a firmer tone but this soon evaporated following the announcement on 17 May of the

(1) Further amounts of £200 million of both 11% Exchequer 1989 and $10\frac{1}{2}$% Treasury Convertible 1992 were reserved for the National Debt Commissioners.

temporary suspension of trading in Continental Illinois shares together with details of further assistance to that bank from the Federal Reserve System. Against the background of the miners' strike the bearish trend was aggravated by concern over the weakness of sterling and fears that another major US bank might be in difficulties; by 31 May the FT-Actuaries all-share index had dropped to 477.21, representing a fall of 8.2% since the beginning of the period.

In early June the market rallied somewhat, reflecting in part some optimism that US interest rates were unlikely to rise in the near future. Thereafter, prices tended to drift downwards in quiet trading conditions, the main interest tending to be focused on special situations such as the Australia and New Zealand Banking Group's bid for Grindlays Bank and rumours of an impending sale by Royal Bank of Scotland of their stake in Lloyds and Scottish. Around mid-June, the collapse of talks to end the miners' strike, fears about Latin American debt and a new low on Wall Street combined to cause a sharp fall in prices, and the market was further depressed on 20 June by the 'flash' news of US GNP growth in the second quarter which reawakened fears of higher US interest rates.

During the remainder of June and early July, despite the continuing weakness of sterling and unease over the miners' strike, the market was steadier, although trading was light. During the second week of July prices weakened sharply again following the announcement of a national dock strike and the increase in banks' base rates, and by 12 July the FT-Actuaries all-share index had fallen to 464.90. Although sentiment was improved by the settlement of the dock strike, the better trend was soon reversed when the second quarter US GNP figure was published on 23 July.

August opened with a firmer tone, helped by strength on Wall Street. The reductions in base rates announced on 8 and 10 August encouraged a strong rally. Subsequent trading, however, was thin and the FT-Actuaries all-share index closed on 15 August at 511.08, having fallen on balance over the period by 1.7%.

Despite the weaker trend in share prices there was a substantial increase in the amount of new equity finance raised by companies during the period under review (Table G). Large rights issues were made or announced by several companies including Hill Samuel, Thorn EMI (to finance the acquisition of British Technology Group's 76% stake in Inmos) and National Westminster Bank. On 18 June the government offered for sale by tender 212 million shares in Enterprise Oil at a minimum price of 185p to raise a total of £392 million. Subscriptions were received in respect of only two thirds of the shares (leaving the balance to be taken up by underwriters) and included tenders for 49% of the total shares by Rio Tinto-Zinc. On 28 June the government announced that only 10% of the shares would be allotted to Rio Tinto-Zinc, following which Rio Tinto-Zinc purchased a further 5% in secondary market dealings and announced their own tender offer to acquire further Enterprise Oil shares from investors in order to bring their total holding to 29.9%. Also, at the end of July, 177.9 million shares in Jaguar were sold to investors in a fixed-price offer which realised some £293.5 million.

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

Banking months	Sept. 83– Nov. 83	Dec. 83– Feb. 84	Mar. 84– May 84	June 84– Aug. 84
UK private sector				
Loan capital and preference shares	+ 94	+ 27	+ 99	+109
Equity capital(a)	+477	+193	+314	+497
Unit trusts(b)	+425	+499	+372	+121 (c)
Issues on the unlisted securities market	+ 31	+ 49	+ 42	+ 41
Local authorities				
Stocks	− 37	+ 22	− 11	—
Negotiable bonds	+ 3	+ 38	− 66	− 61
Overseas	+283	+ 85	+260	+224

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

Table H
Debt issues announced on the London capital market, mid-May to mid-August 1984[a]

Date of Announcement	Issuer	Nominal amount (£ millions)	Coupon (per cent)	Maturity
Domestic borrower				
6 June	Marley	25	11⅞	2009
Overseas borrowers				
7 June	Eaton Corporation	35	12½	2014
3 July	New Zealand	100	11½	2014
7 August	American Brands	30	12½	2009
13 August	International Bank for Reconstruction and Development	100	11½	2003

(a) All these issues were placed, apart from those by New Zealand and IBRD. Issues of convertible stock and issues of less than £3 million are not included.

In the *fixed-interest market* only one domestic corporate borrower appeared during the period under review (Table H) with a £25 million issue. Local authorities also remained absent from the market and no stock was issued under droplock arrangements by local authorities or other borrowers. Droplock arrangements currently outstanding remain as shown in the June *Bulletin*. By contrast, overseas borrowers continued to tap the market although both the number of issuers and the aggregate amount raised were lower than in the preceding three months.

The *eurosterling market* was fairly active during June when three fixed-rate issues totalling £100 million were made. Subsequent issues comprised a £150 million floating-rate offering in late July and a £75 million fixed-rate issue in August. (The international market for floating-rate instruments is described in an article on page 337.)