Operation of monetary policy

This article covers the three months from mid-August to mid-November 1985.

Review

Earlier difficulties in interpreting the behaviour of the monetary aggregates persisted during the period under review, but the objectives of monetary policy remained unchanged. Short-term interest rates were stable.

The disparate behaviour of broad and narrow monetary aggregates continued during the period. The twelve-month growth rate of M0 fell back from 4.5% to 3.4% though the twelve-month growth rate of M2 increased. The broad aggregates presented a quite different picture, however. Growth in £M3 continued at a rate well above both its target range and its growth rates in recent years. The Bank's judgement was that the acceleration in £M3 reflected particular factors—explained in greater detail in the following section—so that it was not to be taken at its face value in terms of its implications for the assessment of monetary conditions. This judgement was supported by the behaviour of those broader aggregates that include building society liabilities, which have not accelerated over the last year. It was against this background that the £M3 target for the current financial year was in effect suspended.

Because the interpretation of the monetary aggregates continued to pose difficulties, other indicators came to bear a heavier weight in monetary policy decisions during the period.

This does not mean, however, that the authorities became indifferent to broad money, or to its credit counterparts. The faster the growth of broad money generally, taking £M3 alongside the other broad aggregates, the greater the reassurance that will be sought in the other available indicators before it will be accepted that monetary conditions remain appropriately firm and that policy is continuing to put downward pressure on inflation.

GDP grew by about 4½% in real terms over the year to the second quarter of 1985; this is a rapid growth rate by historical standards even if allowance (of about 1%) is made for the effects of the miners' dispute in depressing output in the second quarter of 1984. In the third quarter, however, GDP grew more slowly (the output measure was some ½% up on the second quarter). The twelve-month rate of growth of the retail price index fell back from its peak of 7% in June to 5.4% in October, but this fall (like the earlier rise) largely reflects changes in the mortgage interest component. Excluding that component the twelve-month change has been fairly steady at just over 5%. Producer input prices, however, fell by over 10% between February and October, and this should benefit retail prices in the period ahead. Average earnings growth rose a little to 7¾%

Table A
Growth rates of the monetary aggregates
Percentages; *seasonally adjusted*

Banking months	12 months to Aug. 85	12 months to Nov. 85	June 85–Aug. 85	Sept. 85–Nov. 85
M0(a)	4.5	3.4	0.6	0.7
£M3	13.5	14.4	3.4	4.7
Non-interest-bearing M1	2.5	1.5	0.6	0.9
M1	18.4	17.1	5.3	4.9
M2(b)	7.1	8.8		
	7.1	*9.5*		
PSL1	13.5	13.4	3.2	4.4
PSL2	14.2	13.8	2.8	4.4
PSL2, *plus* term shares with building societies	13.3	12.6	2.8	3.4
M3	13.9	13.1	3.2	4.3

(a) Weekly average.

(b) Not seasonally adjusted; excluding the effect of changes in the terms of existing accounts. Figures including such effects are shown in *italics*.

per annum, so that the rate of increase of unit labour costs continued to be the highest, by a wide margin, among the main industrial countries. Sterling's exchange rate fell slightly over the period in effective terms, but this concealed an appreciation of about $3\frac{1}{2}$% against the dollar, mainly in the wake of the Group of Five meeting in New York, and a depreciation of $3\frac{1}{4}$% against the deutschemark and $11\frac{1}{2}$% against the yen.

The effective suspension of the £M3 target, announced by the Chancellor in his Mansion House speech, carried implications for funding policy, which had previously been broadly directed at £M3 control. This had at times involved significant 'overfunding' of the public sector (defined as the PSBR less public sector debt sales to the non-bank private sector) to offset strong growth in credit to the private sector. This in turn had had the side-effect of aggravating money-market shortages which had been relieved principally through purchases of commercial bills by the Bank from the banking system, resulting in the buildup of the 'bill mountain'.

The provision of money-market assistance in this form, that is, the acquisition of claims on the banking system, is analytically no different from the repayment of liquid liabilities to the banking system—which has been traditionally the accepted technique of the Bank's money-market operations, There were, however, widespread reports that it was causing distortions to the structure of money-market interest rates and to the monetary aggregates. Although close investigation by the Bank suggested that these reports were greatly exaggerated, they were nonetheless harmful to the credibility of policy. Given these factors—the suspension of the £M3 target and worries about the public perception of policy—the pragmatic decision was taken to limit government debt sales year by year to the amount necessary to cover the PSBR, taking together sales of debt to the non-bank private sector and external and foreign currency finance of the public sector.

The Chancellor made it clear in his speech, as a corollary of the change in funding policy, that, should it at any time become desirable to tighten monetary conditions, this would be achieved by bringing about a rise in short-term interest rates.

The Bank's assessment of monetary conditions during the period under review did not point to a movement in either direction in short-term interest rates. Moreover, as indicated in the section below on the money market, there was no market pressure for such a move, so that the general level of short-term interest rates remained unchanged at around $11\frac{1}{2}$%. Yields on conventional gilt-edged, too, were little changed over the period. Index-linked yields, however, rose by some $\frac{3}{16}$% (for long maturities), so that by the end of the period they stood only some $\frac{3}{4}$% above equity yields, which fell further during the period.

Monetary aggregates and credit

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

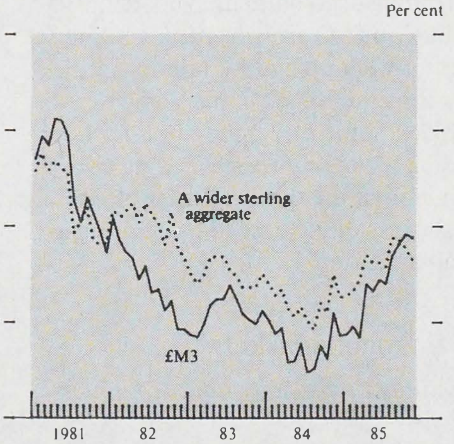
During the three months under review, the growth rates of the narrow and broad monetary aggregates continued to diverge.

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

	Banking months	June 85–Aug. 85	Sept. 85–Nov. 85	Level outstanding at mid-Nov. 85
1	Non-interest-bearing M1	+0.2	+0.3	34.3
2	Interest-bearing sight deposits	+2.6	+2.5	24.5
3	**M1 (= 1+2)**	**+2.8**	**+2.8**	**58.8**
4	Private sector holdings of time deposits with banks and bank CDs	+1.1	+2.8	65.4
5	**£M3 (= 3+4)**	**+3.9**	**+5.6**	**124.2**
	Non-bank private sector holdings of:			
6	Building society shares and deposits(a)	+2.8	+4.6	84.3
7	Building society wholesale liabilities(b)	+0.3	—	1.6
8	Other	-1.4	-1.1	4.8
9	**PSL2 (= 5+6+7+8)**	**+5.6**	**+9.1**	**214.9**
10	Building society term shares(c)	+0.6	-1.4	18.0

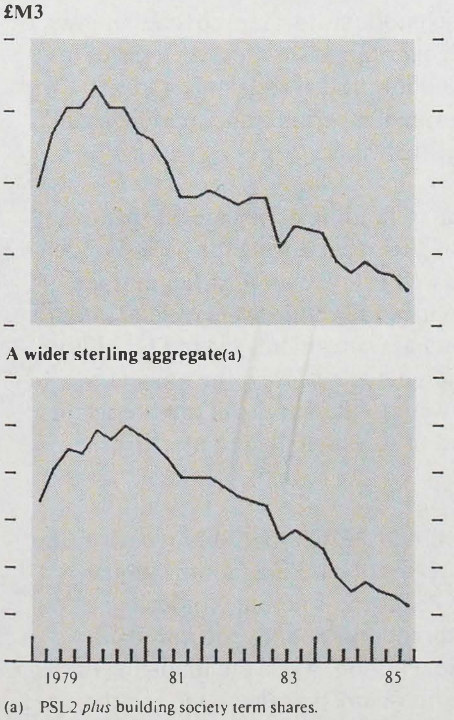
(a) Other than term shares; including interest credited.
(b) CDs and time deposits.
(c) Including interest credited.

12-month growth rates of £M3 and a wider sterling aggregate[(a)]



(a) PSL2 *plus* building society term shares.

Velocity of broad monetary aggregates



(a) PSL2 *plus* building society term shares.

The twelve-month growth rate of M0 declined further, to 3.4%, taking it to just above the bottom of its target range. M1 growth remained rapid, reflecting continued heavy inflows into interest-bearing chequable accounts, and M2 accelerated modestly.

The wider aggregates, meanwhile, continued to grow more quickly. The twelve-month growth rate of £M3 exceeded 14% throughout the period, an acceleration from earlier recorded rates of growth and well above its target range. PSL2 also accelerated, albeit less markedly; but, when building society term shares are added to PSL2, little, if any, acceleration can be perceived.

The acceleration in £M3 growth over the past year in particular raises the question whether monetary policy has been sufficiently tight during the period.

The Bank's view is that the recent behaviour of £M3 has understated the tightness of monetary conditions. This view is based on the judgement that £M3 has been distorted by particular factors which are unlikely to be relevant to the general monetary situation, and that a better impression of recent broad monetary growth has been given by broader aggregates than £M3 that include building society liabilities.

For example, the twelve-month growth rate of a wider measure of liquidity which encompasses all the assets included in PSL2 as well as building society term shares was no higher in November 1985 than it had been a year earlier, although, at 12.6%, it was well above the growth rate of nominal GDP. As the upper chart shows, the twelve-month growth rate of this aggregate has been steadier than that of £M3 over the last few years; moreover the downward trend in the velocity of this broader aggregate has been steadier than that of £M3 (see lower chart).

Against this background the relatively rapid growth of £M3 can be ascribed to two particular factors. First, banks have been particularly successful this year in attracting retail deposits away from building societies through such devices as high-interest retail accounts and, moreover, have used these deposits to finance a substantially increased share of total mortgage lending. This contributes to £M3 growth but leaves unaffected wider measures of money that include building society accounts. Second, the building societies have themselves contributed to the growth of bank deposits by switching part of their holdings of liquid assets out of gilt-edged and into bank deposits and CDs. This switch, coinciding with lower gilt sales to the non-bank private sector overall, has also tended to inflate £M3 (which includes building societies' deposits with banks) while not affecting broader aggregates (which do not).

More generally, the steady fall in the velocity of the broadest liquidity aggregates, which has been in progress since 1980, reflects a number of factors:

- the removal of official restraints on the scale of banks' and building societies' business;

Table C
Financing of the public sector
£ billions; *seasonally adjusted*

Banking months	Mid-Mar. 84–mid-Mar. 85	Mid-Mar. 85–mid-Nov. 85
CGBR		
own account	+6.0	+4.6
on-lending	+3.3	+4.2
Other public sector borrowing from the banking system	+1.0	-2.8
'Modified' PSBR (a)	**+10.3**	**+6.0**
Net sales of central government debt to the non-bank private sector	-13.1	-5.2
of which:		
Gilt-edged stocks (b)	*-9.3*	*-3.0*
National savings	*-3.2*	*-2.1*
CTDs	*-0.8*	—
External and foreign currency finance of the public sector	-2.0	-1.9
of which, gilt-edged stocks (b)	*-1.1*	*-2.2*
Total financing of the government from the non-bank private and overseas sectors (c)	**-15.1**	**-7.1**

(a) Equals the PSBR *less* net purchases of local authorities' and public corporations' debt by the non-bank private sector.

(b) Not seasonally adjusted

(c) This total (like the 'Modified' PSBR shown above) excludes net purchases of local authorities' and public corporations' debt by the non-bank private sector.

Table D
Official transactions in gilt-edged stocks
£ billions; *not seasonally adjusted*

Banking months	Dec. 84–Feb. 85	Mar. 85–May 85	June 85–Aug. 85	Sept. 85–Nov. 85
Gross official sales (a)	+3.5	+4.0	+3.9	+2.7
less				
Redemptions and net official purchases of stock within a year of maturity	-0.7	-0.6	-2.5	-1.0
Equals net official sales (b)	+2.9	+3.4	+1.4	+1.7
of which, net purchases by:				
Monetary sector (b)	*-0.4*	*+0.5*	—	*-0.3*
Overseas sector	*+0.6*	*+0.8*	*+1.1*	*+0.6*
Non-bank private sector	*+2.7*	*+2.1*	*+0.2*	*+1.4*

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

(a) Gross official 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.

(b) Apart from transactions under purchase and resale agreements.

- partly as a result, the intensification of competition between and among banks and building societies, and the offering of more attractive returns and facilities to savers; and

- the persistence of positive real interest rates.

This combination of factors may have led to a steady increase in the demand for liquid balances as a home for savings. If this is the reason for the steady downward trend in velocity, then the relatively rapid growth of broad liquidity over the past few years does not imply a commensurate easing of monetary conditions. But the fact that the economy is becoming increasingly liquid means that monetary policy will increasingly have to recognise and take account of the risks that this implies.

Among the counterparts to broad monetary growth, central government own-account borrowing totalled £2.1 billion. In addition, the central government on-lent £2.7 billion to the rest of the public sector but the bulk of the funds thus on-lent were used either to repay bank lending or to build up bank deposits, so that they did not contribute to £M3 growth. Bank lending in sterling to the private sector went up by £5.0 billion, a little more than in the preceding three months. Of this, some £2.0 billion was lent to persons, some £1.2 billion of it for house purchase. The rate of building society mortgage lending also picked up to around £3.9 billion in the three calendar months to end-November, so that the rate of increase of total mortgage lending was about £5 billion a quarter.

Official operations in financial markets

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

As in the preceding three months, the CGBR was made larger (with no consequential effect on the PSBR) by substantial on-lending to the rest of the public sector; moreover, there was a reduction in the scale of government funding. As a result of these developments the need for official assistance to the money market declined during the period under review, as did the average size of the daily cash shortages.

The change in the approach to funding policy meant that the rate of gross official sales of gilt-edged during the period under review, at £2.7 billion, was well below that of earlier periods (Table D). With redemptions of £1.0 billion, net official sales to all sectors (excluding repurchase agreements) were £1.7 billion. There were some £0.2 billion net gilt sales by the monetary sector, so that £1.9 billion went to the non-bank private sector and the overseas sector and thus contributed to meeting the funding objective.

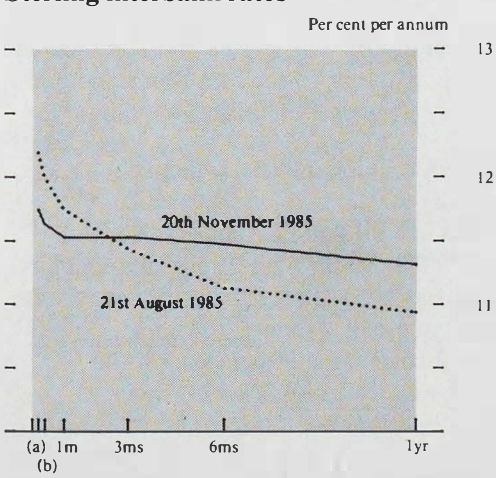
Over the eight months from mid-March to mid-November (the nearest approximation, in terms of banking months, to the financial year to date), the PSBR (plus net sales of local authorities' and public corporations' debt by the non-bank private sector) was some £6.0 billion, while the financing of the central government by the non-bank private sector and the

Table E
Influences on the cash position of the money market
£ billions; *not seasonally adjusted*
Increase in the market's cash +

Banking months	June 85– Aug. 85	Sept. 85– Nov. 85	Dec. 84– Nov. 85
Factors affecting the market's cash position			
CGBR (+)	+3.8	+4.9	+10.8
Net sales (–) of central government debt(a)	–2.5	–2.4	–12.5
of which:			
Gilt-edged	*–1.4*	*–1.7*	*– 9.4*
National savings	*–0.7*	*–0.7*	*– 2.7*
CTDs	*–0.4*	—	*– 0.4*
Currency circulation (increase –)	–0.4	+0.2	– 0.5
Other	+0.9	–0.3	+ 1.2
Total (A)	**+1.8**	**+2.4**	**– 1.0**
Official offsetting operations			
Net increase (+) in Bank's holdings of commercial bills(b)	–2.2	–0.4	– 0.4
Net increase (–) in Treasury bills in market	–0.2	—	– 0.3
Securities(c) acquired (+) under purchase and resale agreements with banks	+0.1	–1.8	+ 1.6
Other	+0.4	–0.1	+ 0.2
Total (B)	**–1.9**	**–2.3**	**+ 1.1**
Change in bankers' balances at the Bank (= A + B)	–0.1	+0.1	+ 0.1

(a) Other than Treasury bills.
(b) By the Issue and Banking Departments of the Bank of England.
(c) Gilt-edged stocks and promissory notes related to guaranteed export credit and shipbuilding paper.

Sterling interbank rates



(a) Overnight.
(b) For one week.

overseas sector[1] was £7.1 billion. This meant that the PSBR was overfunded on this definition by some £1.1 billion over those eight months.

Continued on-lending (amounting to £2.7 billion) by the central government to the rest of the public sector (mainly local authorities), meant that the CGBR (before seasonal adjustment) was as large as £4.9 billion in the three months under review. This, in combination with the reduction in the rate of government funding, meant that the stock of money-market assistance outstanding fell by about £2¼ billion over the period to about £13 billion at mid-November; of the latter amount, £10¾ billion consisted of bills held outright and £1¾ billion of other securities held under purchase and resale agreements direct with the banks. As the need for assistance declined towards the end of the period, the Bank, foreseeing a rise in the need in the tax revenue season early in 1986, chose to allow purchase and resale agreements with the banks to run off rather than to reduce its bill holdings by large amounts, in order to avoid unnecessarily large fluctuations in the supply of bills.

The average daily cash shortages in the money market fell back to some £700 million during the period under review, compared with £890 million in the preceding three months. The change reflected not only the reduction in the stock of assistance needed, but also the dimming of market expectations of lower interest rates, which made the discount houses more willing to sell longer-dated bills to the Bank, so that the average maturity of the Bank's bill portfolio lengthened.

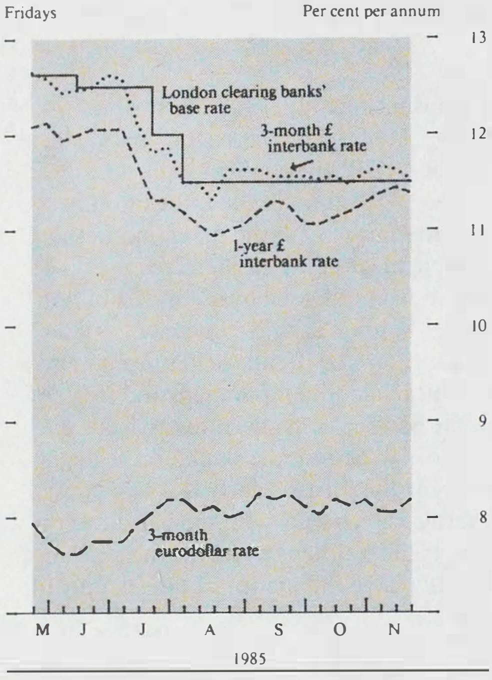
The money market

The money market was quiet during the period under review, with no change (from around 11½%) in the general level of short-term interest rates nor any strong market expectation at any stage that such a change might be imminent. Indeed such expectations as there had been at mid-August that the next move in interest rates would be downwards weakened over the three months, and by the end of the period the downward slope of the profile of interbank rates had become markedly shallower (see chart).

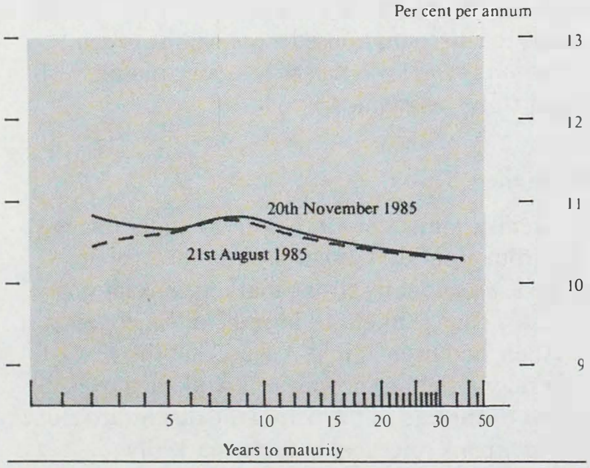
During the first month of the period, sterling was generally falling both against the dollar and in effective terms, though it was steady against the deutschemark. This did not give rise to any expectation of an increase in the general level of short-term interest rates; it did, however, mean that hopes of a fall in rates were further deferred. Nevertheless the profile of interbank rates from a month out to a year remained downward-sloping. The announcement on 10 September of a large rise in £M3 in banking August had little effect on the money market. Sterling began to recover against the dollar in mid-September on indications of a slowing in US economic growth, and this led to some modest fall in longer-term interbank rates. The meeting of the G5 in New York on the weekend of 21 and 22 September led to a sharp further rise in sterling's exchange rate against the dollar. This led to some further fall in the longer interbank

(1) That is, net sales of central government debt to the non-bank private sector plus external and foreign currency finance of the public sector.

Short-term interest rates in London



Time/yield curves of British government stocks



rates, but the effect on the general level of rates proved to be short-lived as sterling once more began to soften, particularly against the deutschemark and the yen.

Market conditions once more became generally quiet, and the provisional money figures for banking September, published on 8 October, had little market impact, although they showed a larger rise in £M3 than had been expected. After the Mansion House speeches on 17 October, the downward slope of the interbank interest rate profile from a month out to a year became gradually less marked, reflecting the Chancellor's remark that, should it at any time become desirable to tighten monetary conditions, this would be achieved by bringing about a rise in short-term interest rates rather than by overfunding of the PSBR.

Over the period as a whole, interbank deposit rates fell by $\frac{7}{32}$% to 11$\frac{9}{16}$% at the one-month maturity, rose by $\frac{3}{32}$% to 11$\frac{9}{16}$% at three months and rose by $\frac{3}{8}$% to 11$\frac{5}{16}$% at twelve months. Clearing bank base lending rates were unchanged at 11$\frac{1}{2}$%. Building society rates remained broadly unchanged following the 1$\frac{1}{4}$% cut in both share and mortgage rates which, for most societies, took effect on 1 September and which brought base annuity mortgage rates down to 12$\frac{3}{4}$%.

The gilt-edged market

The authorities began the period with the objective of fully funding the PSBR through debt sales to the non-bank private sector and external and foreign currency finance of the public sector. As the period progressed, the estimate of the monthly rate of gross sales that this objective implied was revised upwards, both because of the increase in the forecast of the PSBR for 1985/86 and because of unexpectedly heavy repayments by local authorities of borrowings from the non-bank private sector.

Only one stock, of which some £0.7 billion was in market hands at mid-August, was due to be redeemed during the period under review.

At the beginning of the period, the Bank had available for sale the bulk of the 9$\frac{3}{4}$% Treasury 2002 partly-paid tap stock. A substantial amount of this was sold on 22 August as sterling strengthened against the dollar. Market conditions subsequently became quiet, except that there was some demand for short-dated low-coupon conventional stock. In response, the Bank announced on 30 August further small tranches of this kind of stock—£100 million of 3% Treasury Stock 1989 and £150 million of 3% Treasury Stock 1990.

Market conditions remained quiet until 16 September, when the Government announced a \$2.5 billion borrowing through the issue of floating-rate notes. There were substantial sales of the 2002 tap stock that day, and over the remainder of that week there was demand for both index-linked and short-dated low-coupon stocks. On the morning of Friday, 20 September there were further sales of the 2002 tap stock; and after the publication of the 'flash' estimate of US GNP in the third quarter, the market moved further ahead. At 3.30 pm that day the Bank announced the issue of two small tranches of index-linked stock to replenish its holdings—£100 million of the 2001 stock and £150 million of the 2020 stock; immediately

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
3% Treasury 1989	100	30/8	Direct to Bank	30/8	—	—	Fully paid	—	3/10
3% Treasury 1990	150	30/8	Direct to Bank	30/8	—	—	Fully paid	—	23/9
2½% Index-Linked Treasury 2001	100	20/9	Direct to Bank	20/9	—	—	Fully paid	—	7/11
2½% Index-Linked Treasury 2020	150	20/9	Direct to Bank	20/9	—	—	Fully paid	—	—
10½% Exchequer 1997	250	23/9	Direct to Bank	23/9	—	—	Fully paid	—	4/10
9½% Conversion 2004	250	23/9	Direct to Bank	23/9	—	—	Fully paid	—	2/10
10% Treasury Convertible 1990	100	·23/9	Direct to National Debt Commissioners	23/9	—	—	Fully paid	—	
10% Treasury 2001	800	11/10	Minimum price tender	17/10	98.25	40.00	58.25 (25/11)	10.23	18/10
9½% Treasury 1999	200	18/10	Direct to Bank	18/10	—	—	Fully paid	—	18/11
9½% Conversion 2005	400	18/10	Direct to Bank	18/10	—	—	Fully paid	—	13/11
11% Exchequer 1989	100	18/10	Direct to National Debt Commissioners	18/10	—	—	Fully paid	—	
10¼% Exchequer Convertible 1989	1,100(a)	22/11	Minimum price tender	27/11	98.75	40.00	58.75 (13/1)	10.64(b)	27/11

(a) Of which £100 million was reserved for the National Debt Commissioners.

(b) Yield to 1989. Holdings may, at the option of the holder, be converted in whole or in part into 10% Conversion Stock 1996 or 9¾% Conversion Stock 2006, or any combination thereof, as on the following dates:

Date of conversion	Nominal amount of 10% Conversion Stock 1996 per £100 nominal of 10¼% Exchequer Convertible Stock 1989	Implied redemption yield (%) to 1996	Nominal amount of 9¾% Conversion Stock 2006 per £100 nominal of 10¼% Exchequer Convertible Stock 1989	Implied redemption yield (%) to 2006
15 May 1986	£101	10.35	£100	9.91
15 November 1986	£100	10.22	£99	9.83
15 May 1987	£99	10.10	£98	9.76
15 November 1987	£98	9.99	£97	9.70
15 May 1988	£97	9.90	£96	9.64
15 November 1988	£96	9.81	£95	9.59

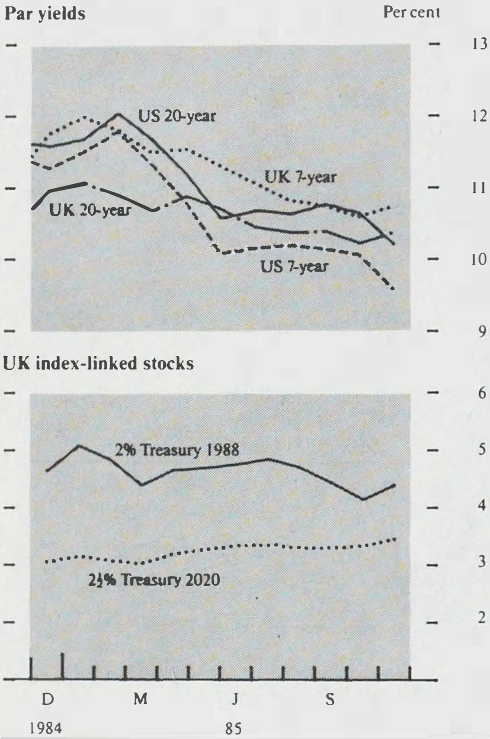
after this announcement there was further demand for conventional stock which led to the exhaustion of the 2002 tap stock.

The weekend meeting of the G5 in New York provoked additional demand for stock on the morning of Monday 23 September, exhausting the tranche of 3% Treasury 1990. At the close of business that day, the Bank's holdings of full-coupon conventional stock being by now somewhat depleted, the Bank announced two small tranches of stock—£250 million each of 10½% Exchequer Stock 1997 and 9½% Conversion Stock 2004. In addition £100 million of 10% Treasury Convertible 1990 was issued to the National Debt Commissioners.

After a quieter period, demand for stock revived with the strengthening of the exchange rate, and the 2004 tranche was sold out on 2 October, followed by the 1989 low-coupon tranche on 3 October and by the 1997 tranche on 4 October. These sales left the funding programme for banking October well advanced and meant that the next step could be the issue (announced on 11 October) of a new partly-paid stock—£800 million of 10% Treasury Stock 2001, £40 paid—for sale by tender on 17 October (the first day of banking November), with the balance due in banking December, which is only a three-week banking month.

The new stock was undersubscribed at the tender. However, the initial market reaction the following morning to the Mansion House speeches was favourable to medium and long-dated conventional stocks (though the short-dated stocks fell back), and all residual supplies of the 2001 stock were sold early in the first morning's trading. Index-linked stocks fell, however,

Gross redemption yields on government stocks



and the Bank responded to offers of these stocks by buying modest amounts in the market.

In order to carry the funding programme forward, the Bank announced more tranches of conventional stock on 18 October—£200 million of $9\frac{1}{2}$% Treasury Loan 1999 and £400 million of $9\frac{1}{2}$% Conversion Stock 2005. In addition £100 million of 11% Exchequer 1989 was issued direct to the National Debt Commissioners. Market conditions then became quieter, however, and softened, in particular on 25 and 28 October, in the wake of the rise in Japanese interest rates.

Conditions remained generally quiet until mid-November, though there were sales of the 1999 and 2005 tranches on 4 November and some revival in the index-linked market leading to the exhaustion of the 2001 tranche on 7 November. There was a burst of demand for stock on 13 November after the Chancellor's Autumn Statement, which led to the exhaustion of the 2005 conventional tranche. After a few days of quieter conditions, demand for stock re-emerged on 18 November in the wake of the encouraging PSBR figure for October, enabling the authorities to sell out the 1999 tranche.

Over the period as a whole, conventional yields at all maturities rose by around $\frac{1}{16}$%, on 5-year stocks to $10\frac{3}{4}$%, on 10-year stocks to $10\frac{15}{16}$% and on 20-year stocks to $10\frac{1}{2}$%.

Although the real yield on the 1988 index-linked stock fell by $\frac{3}{16}$% to $4\frac{1}{2}$%, yields on long-dated index-linked stocks rose, that on the 2020 stock by $\frac{3}{16}$% to $3\frac{1}{2}$%.

Other capital markets

The *equity market* began the period under review quietly before weakening during September. Thereafter, however, the market recovered vigorously and share prices moved to new record levels, helped in part by a number of sizable takeover bids and by a strong US market. Over the period as a whole, the FT-Actuaries all-share index rose by 8.6% and the all-share yield fell by $\frac{1}{4}$% to $4\frac{1}{4}$%.

Early in the period market conditions were quiet, but towards the end of August demand for equities began to revive following the withdrawal of the threat of a national rail strike and the announcement of favourable results by several major UK companies, and on 2 September the all-share index closed at a new record level of 646.82. Thereafter, the market tone gradually deteriorated, reflecting the announcement on 10 September of the August money supply figures, the news that Saudi Arabia was proposing to sell oil at below the official OPEC price, and the strengthening of sterling around the time of the G5 meeting. By 26 September, the all-share index had fallen some 4.4% from its previous peak.

Towards the end of September equity prices advanced strongly. After the Chancellor's optimistic statement on 10 October, with its favourable inflation and growth predictions and his renewed pledge to reduce taxation, investors were further encouraged. Thereafter, prices advanced very firmly, helped by a more favourable outlook for oil prices and speculation about possible take-overs. Although towards the end of October sterling

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

Banking months	Dec. 84– Feb. 85	Mar. 85– May 85	June 85– Aug. 85	Sep. 85– Nov. 85
UK private sector				
Loan capital and preference shares	+ 84	+ 159	+ 485	+147
Equity capital(a)	+322	+1,916	+1,119	+443
Unit trusts(b)	+503	+ 456	+ 470	+669(c)
Issues on the unlisted securities market	+ 10	+ 67	+ 48	+ 28
Local authorities				
Stocks	− 47	− 14	− 3	− 90
Negotiable bonds	−116	− 122	− 88	−108
Overseas	+159	+ 164	+ 175	+134

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

Table H
Debt issues announced on the London capital market, mid-August to mid-November 1985[a]

Date of Announcement	Issuer	Nominal amount (£ millions)	Coupon (per cent)	Maturity
Domestic borrowers				
10 September	Estates & General Investments	5	11¼	2018
17 September	Evans of Leeds	12	11	2025
15 October	Hampton Trust	10	11⅛	2025
23 October	Halifax Building Society	15	3⅞ (b)	2020
23 October	Libra Bank	20	11¾	2010
30 October	Haslemere Estates	20	10½	2016
5 November	Land Securities	100	10	2025
20 November	Bristol Waterworks Company	4	11½	2005/9
20 November	East Anglian Water Company	3	11½	1995/7
20 November	Essex Water Company	3½	11½	1995/7
20 November	Essex Water Company	3½	11½	2005/9
Overseas borrowers				
3 September	Bank of Greece	75	10¾	2010
28 October	Safeway	100	3–8¼ (c)	2010
11 November	Kingdom of Sweden	100	9¾	2014

(a) With the exception of the issue by the Kingdom of Sweden, all these issues were placed. Issues of convertible loan stock and issues of less than £3 million are not included.
(b) Index-linked stock.
(c) 'Stepped' coupon.

strengthened against the dollar, share prices continued to rise steadily. The advance continued into November and, with further encouragement from Wall Street, the Chancellor's Autumn Statement, and overseas buyers, share prices rose almost continuously. The FT-Actuaries all-share index closed the period at a new record level of 689.71.

Companies raised less new money in the domestic capital market than in the previous two quarters (Table G). Notable issues, however, included a combined equity and convertible loan stock offer in September on behalf of National Home Loans Corporation to raise £100 million, while Lucas Industries announced a £90 million rights issue in November. In early September the government announced that it would sell its remaining shareholding in Cable and Wireless. The sale of the government's 102.5 million shares took place in early December and was combined with a simultaneous rights issue of 56.4 million new shares by the company. Gross proceeds of the sale totalled £933 million, of which £477 million was payable on application, with the balance due in March 1986. It was also announced during November that the flotation of the Trustee Savings Bank, which had been planned for February 1986, would be deferred pending the outcome of court action.

In the *domestic fixed-interest market,* ten UK borrowers raised a total of £196 million (Table H). These included the Halifax Building Society, which made a £15 million issue of index-linked stock, the first such stock to be issued by the UK private sector. There were also three issues by overseas borrowers, who raised £275 million, including a £100 million (nominal) stepped coupon issue by Safeway.

In the eurosterling market three fixed-rate issues were made by overseas borrowers to raise a total of £135 million. In addition, there was an issue of zero-coupon bonds (ZEBRAs) based on the coupon and redemption payments of four gilt-edged stocks maturing between 1992 and 1996: the amount raised through the issue was £94 million while the redemption proceeds will total £193 million. In the floating-rate note market activity was dominated by building society issues: seven societies raised a total of £675 million, while three other borrowers raised a further £300 million.