Operation of monetary policy

This article covers the three calendar months from January to March 1987.

Review

The period under review was dominated by increasing financial confidence in the run-up to the Budget and by bullish sentiment regarding the UK economy in general and the fiscal prospects in particular. The Budget was well received by the markets, as was the Chancellor's forecast of a PSBR of only £4 billion in 1987/88. The markets' response to these developments was sometimes magnified by reaction to political sentiment as revealed by the opinion polls. In the domestic markets, the bullish tone was manifested in strong downward pressure on short-term interest rates and gilt-edged yields. In the foreign exchange market, where sterling also benefited in the wake of the Louvre accord in mid-February, it resulted in strong upward pressure on the exchange rate. These conditions created a dilemma for the authorities. On domestic grounds, there was a reluctance to see interest rates fall too far or too fast: at the same time a substantial rise in the exchange rate would have had damaging consequences for industrial confidence.

Table A
Growth rates of the monetary aggregates

Percentages

	Unadjusted		Seasonally adjusted(a)	
Calendar months	12 months to Dec. 86	12 months to Mar. 87	Oct. 86– Dec. 86	Jan. 87– Mar. 87
M0(b)	+ 5.2	+ 3.5	+2.4	−1.0
Non-interest-bearing M1	+11.1	+10.2	−4.7	+2.1
M1	+21.1	+22.6	−0.3	+7.7
M2	+14.1	+12.8	+1.9	+1.9
£M3	+18.0	+19.0	+1.6	+6.8
M3	+21.3	+21.4	+2.1	+5.7
M4(c)	+15.2	+13.9	+2.0	+4.2
PSL2	+14.4	+13.5	+1.9	+3.9

(a) Seasonal adjustments constrained over the financial year.
(b) Weekly average.
(c) See article on page 212 for definition.

Monetary conditions appeared firmer as the period progressed. M0 growth had moved into the upper half of its target range late last year, but returned to the middle of the range with monthly falls in M0 in both January and February; even in March the notes and coin component of M0 was flat. On the other hand, £M3 growth, after a decline in January, picked up from 18% in the year to December to 19% in the year to March (Table A). Other measures of broad money growth were more comforting, with the twelve-month increase in PSL2 easing back from 14.4% in December to 13.5% in March. The slower growth of PSL2 than £M3 reflected a build-up of building society bank deposits and a slower rate of growth of the components of PSL2, including building society retail inflows, than deposits with banks. Reflecting in part the changes in the composition of broad money, no target has been set for £M3 in 1987/88. The target range set for M0, 2%–6%, is the same as for last year.

At the beginning of the period, the exchange rate and oil price changes that had taken place since the third quarter of 1985 were unfavourable as far as inflation was concerned, but later in the period the strengthening of sterling redressed the balance and contributed to the impression that monetary conditions had tightened.

The authorities' resistance to market pressures reflected a number of considerations. Indications were that the growth of money GDP was quite strong. Demand and output growth in real terms was buoyant and wage inflation had not moderated significantly; survey evidence from the CBI confirmed the buoyant picture of the economy. The growth of credit and

Table B
Composition of changes in the money stock

£ billions; *seasonally adjusted (financial year constrained)*

	Calendar months	Oct. 86–Dec. 86	Jan. 87–Mar. 87	Level outstanding at end-Mar. 87
1	Non-interest-bearing M1	−2.0	+ 0.9	41.1
2	Interest-bearing sight deposits	+1.7	+ 4.8	38.6
3	**M1 (= 1+2)**	**−0.2**	**+ 5.7**	**79.7**
4	Private sector holdings of time deposits with banks and bank CDs	+2.5	+ 4.5	80.5
5	**£M3 (= 3+4)**	**+2.3**	**+10.2**	**160.2**
6	Building society holdings of £M3 (increase–)	−1.2	− 2.4	− 12.7
	Non-bank private sector holdings of:			
7	Building society shares and deposits(a)	+3.6	+ 3.2	119.8
8	Building society £CDs and time deposits(b)	+0.4	− 0.2	2.1
9	**M4(c) (= 5+6+7+8)**	**+5.1**	**+10.8**	**269.5**
10	Non-bank private sector holdings of money-market instruments and national savings in PSL2	—	− 0.4	15.4
11	Building society holdings of money market instruments (−)	—	+ 0.5	− 1.2
12	**PSL2 (= 9+10+11)**	**+5.0**	**+10.8**	**283.8**

(a) Including term shares and interest credited.

(b) Excluding holdings by building societies themselves.

(c) See article on page 212 for definition.

Table C
Changes in £M3 and its counterparts[(a)]

£ billions; *seasonally adjusted (financial year constrained)*

	Calendar months	Apr. 86–Mar. 87	July 86–Sept. 86	Oct. 86–Dec. 86	Jan. 87–Mar. 87
1	Central government borrowing requirement	+10.5	+3.2	− 2.3	+3.7
	of which:				
	own account borrowing:	*+ 4.5*	*+2.9*	*− 2.2*	*+1.3*
	on-lending to:				
	local authorities	*+ 5.8*	*+0.5*	*− 0.2*	*+2.2*
	public corporations	*+ 0.2*	*−0.1*	*—*	*+0.2*
2	Other public sector borrowing	− 7.2	−0.7	− 0.2	−2.4
3	**PSBR (= 1 + 2)**	**+ 3.3**	**+2.5**	**− 2.5**	**+1.3**
4	Net purchases (−) of central government debt by the non-bank private sector	− 3.8	−1.5	− 1.6	+1.5
	of which:				
	Gilt-edged stocks	*− 1.3*	*−0.8*	*− 1.5*	*+1.8*
	National savings	*− 3.4*	*−0.8*	*− 0.8*	*−1.0*
	CTDs	*+ 1.0*	*—*	*+ 0.8*	*+0.8*
5	Net purchases (−) of local authorities' and public corporations' debt by the non-bank private sector	+ 2.6	+0.2	− 0.2	+0.7
6	External and foreign currency finance of the public sector(b)	− 1.7	−1.0	− 1.1	+0.7
	of which, gilt-edged stocks (purchases −)	*− 3.0*	*−0.6*	*− 0.9*	*−0.9*
7	**Overfunding (−) = (3 + 4 + 5 + 6)**	**+0.4**	**+0.2**	**− 5.3**	**+4.2**
8	Sterling lending by the banking system to the UK private sector(c)	+30.6	+7.0	+10.5	+6.6
9	External and foreign currency finance of the monetary sector(d)	− 5.4	−1.0	− 2.9	−0.6
10	Net non-deposit sterling liabilities (increase −)				
11	**Change in £M3 = (7 + 8 + 9 + 10)**	**+25.6**	**+6.2**	**+ 2.3**	**+10.2**

(a) Counterparts may not add up to the total change in £M3 because of rounding.

(b) Includes net overseas purchases of public sector debt, *less* the public sector's net acquisition of claims on the overseas sector.

(c) Includes changes in Issue Department's holdings of commercial bills and of promissory notes relating to shipbuilding paper guaranteed by the Department of Trade and Industry.

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

broad money had remained relatively high—though narrow money decelerated in the first quarter of 1987—and asset prices, including house prices and equities, were strong. With tax cuts in the Budget already likely to sustain demand in the period ahead, monetary policy could not be relaxed too far. At the same time, too rapid a rise in the exchange rate would have damaged the external prospect and the sustainability of economic growth into the future. To help ease the tension between these conflicting considerations the authorities undertook large-scale intervention in the exchange markets. The authorities viewed it as important that the confident mood should not carry the markets too far too fast, risking a disruptive reversal. Parallels may be drawn between the actions of the authorities in the period under review and those during October, when market pressures were in the opposite direction: in each case the official stance was designed to moderate market fluctuations.

Monetary aggregates and credit

The figures in this section are seasonally adjusted except for twelve-month growth rates or as otherwise stated.

M0 fell in January and February before rising again in March. This brought the twelve-month growth rate down from 5.4% in December to 4.1% in March (both seasonally adjusted) compared with the target range of 2%–6%. The decline in the twelve-month growth rate of seasonally unadjusted M0, from 5.2% to 3.5% over the same period, was exaggerated by the different timing of Easter in 1986 and 1987. Some of the recent slowdown probably reflects an unwinding of the exceptionally large build-up in M0 in the pre-Christmas period, when the spending surge appears to have started earlier than usual. A further factor was that banks' till money, which comprises about 10% of M0, having grown more rapidly than total M0 throughout 1986, decelerated sharply in the first quarter of 1987. This may have reflected a once-and-for-all stock adjustment in banks' holdings of notes and coin following the gradual withdrawal of the £1 note.

Among the measures of broad money, £M3 accelerated through the first quarter; so too did the broader monetary aggregates, PSL2 and M4,[(1)] though their growth rate was lower and their twelve-month increase declined. £M3 grew by 1.1%, 2.3% and 3.3% in the three months respectively, sufficient to increase the twelve-month growth rate from 18.0% at end-1986 to 19.0% by the end of March, well above the target range for the year of 11%–15%. By contrast, the twelve-month growth rates of broader aggregates have declined, from 14.4% at end-1986 to 13.5% at end-March in the case of PSL2.

Looked at from the components side, the slower growth of the broader aggregates relative to £M3 over the twelve months to end-March largely reflects a build-up of building societies' deposits with banks, which rose by almost 60% over the year, and the slower growth of building society retail inflows relative to the growth of bank deposits. This has been associated with slower growth in the building societies' lending relative to the banks', and, in particular, a loss of share in the mortgage market;

(1) See the article on page 212 for definition.

Table D
Contributions to twelve-month growth rates of broad aggregates

Increases in financial year 1986/87 as percentage of end-March 1986 level of aggregate, *not seasonally adjusted*

	M4(a)	PSL2
By component		
£M3	10.8	10.2
Building society holdings of £M3 (increase –)	-1.9	-1.8
Building society shares and deposits	5.0	4.7
Building society £CDs and time deposits	0.1	0.1
Other	—	0.3
Total	**13.9**	**13.5**

	£M3	M4(a)
By counterpart		
Public sector contribution(a)	0.3	-1.7
Sterling lending	22.6	20.0
Other	-3.9	-4.3
Total	**19.0**	**13.9**

(a) See article on page 212.

but it also reflects the increased reliance of the societies on wholesale funding, particularly floating-rate notes. These developments show up in the contribution of the counterparts to the overall growth of £M3 and PSL2 shown in Table D. Also, public sector debt sales restrained £M3 by less than PSL2 because building societies switched out of public sector debt and into bank deposits during the period under review. Recent falls in non-bank private sector holdings of money-market instruments have also held down the growth of PSL2 relative to £M3.

Interest-bearing sight and time deposits and certificates of deposit (CDs) rose strongly in the first quarter of 1987. The growth in interest-bearing sight deposits was largely in March, whereas time deposits and CDs grew strongly in both February and March. This pattern probably reflected the change in sentiment in the foreign exchange market in late February and the downwards pressure on interest rates it produced. It is likely that expectations of a fall in interest rates induced a substantial initial switching of funds into time deposits and CDs. However, once the fall in rates had occurred either side of the Budget, the continuing build-up in sterling assets was largely in interest-bearing sight deposits, rather than time deposits.

The main features of the £M3 counterparts in the three months were the evolution of the PSBR and funding, the slower growth of bank lending and, reflecting the change in sentiment in the foreign exchange market, the expansionary external contribution to money in March.

In unadjusted terms, in the first eleven months of 1986/87 the cumulative PSBR was zero, so that the PSBR of £3.3 billion for the year as a whole equalled that in March. The bunching of the PSBR at the end of the financial year was not unexpected in view of the pattern of tax receipts and asset sales. Cumulative overfunding during 1986/87 had been about £4 billion in unadjusted terms at the end of February, requiring a large underfund in March for the objective of a full fund over the year as a whole to be met. In the event, the outturn for the year as a whole was an underfund of just £0.4 billion.

The increase in sterling bank lending to the non-bank private sector averaged £2.2 billion per month, considerably less than the £3.5 billion average in the previous quarter, when it was boosted by takeover and merger activity and the impact of changes in the City. It is now back at levels more typical of earlier in 1986.

A significant feature of the latest three months was a large rise in net foreign currency borrowing by the non-bank private sector. The rise in borrowing was particularly strong in February and March. While some of this is likely to have financed purchases of overseas assets by securities dealers based in the United Kingdom, much of the proceeds of foreign currency borrowing were probably switched into sterling assets, including £M3 components, in order to hedge against the weakness of the dollar.

Table E
UK monetary sector: sterling and foreign currency deposits of and lending to, the non-bank private sector

£ billions, *seasonally adjusted* (a)

	1986				1987
	Year	Q2	Q3	Q4	Q1
Sterling deposits					
Other financial institutions	5.7	-0.1	1.5	2.2	4.9
Industrial and commercial companies	8.2	2.8	3.3	-0.5	3.1
Persons	8.5	3.5	1.4	0.4	2.1
Total	22.4	6.2	6.2	2.1	10.1
of which, transit items allocated to ICCs	—	*0.2*	*1.2*	*-1.0*	*- 0.5*
Sterling lending					
Other financial institutions	10.9	2.1	3.5	3.3	3.0
Industrial and commercial companies(b)	9.2	1.1	0.8	5.0	- 0.1
Persons	10.1	3.4	2.6	2.2	3.8
Total	30.2	6.5	6.9	10.5	6.7
of which, transit items allocated to ICCs	—	*-0.2*	*-0.8*	*0.7*	*0.3*
Foreign currency deposits					
Other financial institutions	4.5	1.2	0.5	2.2	0.5
Industrial and commercial companies	2.7	1.1	2.1	-0.2	0.8
Persons	—	-0.1	0.1	—	0.2
Total	7.3	2.1	2.7	2.0	1.5
Foreign currency lending					
Other financial institutions	10.7	2.4	4.9	0.6	5.2
Industrial and commercial companies	-3.3	-1.1	-1.1	—	2.1
Persons	0.8	0.3	-0.1	0.1	0.1
Total	8.8	1.6	3.7	0.6	7.4

(a) Seasonal adjustments constrained over the calendar year.
(b) Includes Issue Department take up of commercial bills and guaranteed shipbuilding paper.

Provisional estimates of the changes in bank lending and bank deposits by sector in the first quarter of 1987 are shown in Table E.[1]

Persons' sterling bank deposits rose by £2.1 billion following the 'underlying' fall in the fourth quarter of 1986 (owing largely to the financing of British Gas). Sterling lending to the personal sector increased by £3.8 billion, somewhat more than the 'underlying' increase in the previous quarter. Within this total, new lending to unincorporated businesses increased by £1 billion, to £1.4 billion, between the fourth quarter of 1986 and the first quarter of 1987. Lending for house purchase recovered by £0.5 billion while lending for consumption was lower for the second quarter running.

The increase in ICCs' sterling deposits was £3.1 billion, close to the average of the middle quarters of 1986. ICCs' sterling bank borrowing on the other hand was broadly flat in the first quarter, compared with an exceptional rise of £5.0 billion in the fourth quarter of 1986. This fall in ICCs' net sterling recourse to the banks was partly offset by a rise in their net foreign currency borrowing from banks (which may have reflected hedging, as explained earlier). The movement between the quarters may reflect lower takeover activity in recent months, the strong rise in stocks in the fourth quarter, and the deceleration of unit wage costs. Other sources of funds (shown in Table F) also indicate a slowdown in borrowing in the latest quarter. After allowance for redemptions, in particular £750 million of debentures by British Gas, gross equity issues by UK-listed ICCs totalled £1.4 billion, mainly issued during February when the stock market was particularly strong, but down on the previous quarter. On the other hand, they raised more through eurosterling issues (£0.8 billion), and the amount of sterling commercial paper outstanding issued by ICCs increased by some £0.4 billion.

OFIs' sterling deposits increased by £4.9 billion, with about half of this total attributable to a rise in bank deposits by building societies. A good part of the remainder may have been due to hedging by other OFIs via uncovered foreign currency borrowing, the proceeds being switched into sterling assets, including bank deposits; the figures may also reflect the net purchases of gilts by the authorities in the quarter. Sterling borrowing amounted to £3 billion. Foreign currency borrowing was even stronger, at £5.2 billion, a reflection both of the extent of the hedging identified above, and the behaviour of security dealers in borrowing to finance overseas purchases.

Building societies were major contributors to the increase in other sources of borrowing by OFIs (Table G). Early in the quarter, following changes in regulations associated with the Building Societies Act, several large societies issued dollar-denominated FRNs, swapping the proceeds into sterling, while in March two building societies announced the issue of the first dollar-denominated building society CDs. In addition, building societies issued further sterling FRNs, although such borrowing was not on the same scale as in mid-1986.

(1) Sterling lending and deposits in the third and fourth quarters of 1986 were distorted by the large movements in transit items associated with the TSB share sale. In Table E, following the usual convention, these items are attributed to industrial and commercial companies (ICCs) but are probably more appropriately attributed to the personal sector. This should be kept in mind when comparing the outturn for the first quarter of 1987 with previous quarters.

Table F
Industrial and commercial companies: some sources of finance
£ billions, *not seasonally adjusted*

	1985	1986				1987
	Year	Year	Q2	Q3	Q4	Q1
Net equity issues:						
Listed companies	4.1	5.9	1.6	1.6	2.0	0.4
Unlisted market	0.2	0.2	—	0.1	0.1	0.1
Gross international bond issues:						
Sterling	0.5	1.2	0.8	0.2	0.1	0.8
Foreign currency	1.1	2.2	0.8	0.3	0.6	0.3
Net commercial paper issues:						
Sterling	—	0.4	0.1	0.2	0.1	0.4
US dollar(a)	..	..	..	0.3		..
Borrowing from UK banks:						
Sterling(c)(d)	5.3	9.4	-0.1	0.3	5.4	0.9(b)
Foreign currency	2.4	-3.3	-1.1	-1.1	—	2.1(b)

— less than £50 million.
.. not available.

(a) Outstanding US commercial paper issued by ICCs increased from $1.7 billion at end-June 1984 to $2.2 billion at end-June 1985 and $3.6 billion at end-June 1986. These figures do not include euronotes or eurocommercial paper.
(b) Provisional.
(c) Includes Issue Department take-up of commercial bills and guaranteed shipbuilding paper.
(d) Includes changes in borrowing by some securities dealers up to 1986 Q3 (see the December 1986 *Bulletin*, page 478).

Table G
Non-bank financial institutions: some sources of finance
£ billions, *not seasonally adjusted*

	1985	1986				1987
	Year	Year	Q2	Q3	Q4	Q1
Net equity issues:						
Listed companies(a)	0.3	2.2	0.9	1.1	0.2	0.1
Unlisted market	—	—	—	—	—	—
Gross international bond issues:						
Sterling	1.0	3.5	0.5	2.1	0.3	0.4
Foreign currency	0.2	0.1	0.1	—	—	0.4
Net commercial paper issues:						
Sterling	—	0.1	—	0.1	—	—
US dollar	..	..	..	..	..	..
Borrowing from UK banks:						
Sterling(b)	5.6	9.8	2.1	3.5	3.2	3.0(c)
Foreign currency	1.5	10.7	2.4	4.9	0.6	5.2(c)

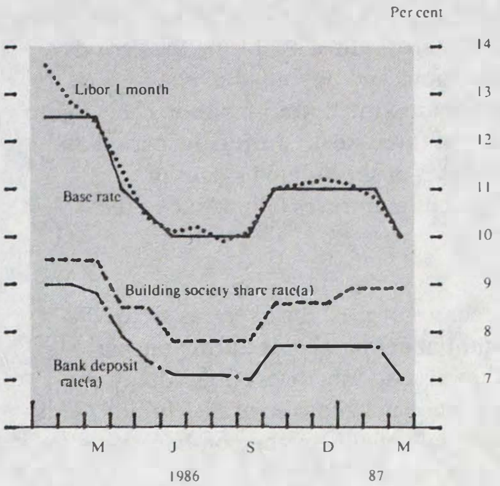
— less than £50 million.
.. not available
(a) UK public companies only.
(b) Excludes changes in borrowing by some securities dealers prior to 1986 Q4 (see the December 1986 *Bulletin*, page 478).
(c) Provisional.

Table H
Comparison of inflows to banks and building societies
£ billions; *seasonally adjusted (calendar year constrained)*

	1985	1986				1987
	Year	Year	Q2	Q3	Q4	Q1
Building society retail inflows (net, including interest credited)	13.4	12.5	3.1	1.4	3.7	3.3
Change in personal sector sterling deposits with banks(a)	4.9	8.4	3.5	1.4	0.4	2.1

(a) Includes changes in the deposits of some securities dealers up to 1986 Q3 (see the December 1986 *Bulletin*, page 478).

Bank/building society competitiveness



(a) Building society share rate and bank deposit rate are net of composite rate tax. Building society share rate is an average of the best rates from five top building societies. Bank deposit rate is an average of the best rates from seven major banks.

Table J
Financing of the public sector

£ billions: *seasonally adjusted (financial year constrained)*

Calendar months	July 86– Sept. 86	Oct. 86– Dec. 86	Jan. 87– Mar. 87	Apr. 86– Mar. 87
Central government borrowing on own account	+2.9	−2.2	+1.3	+4.5
Other public sector borrowing(a)	−0.4	−0.3	−0.1	−1.2
PSBR	**+2.5**	**−2.5**	**+1.3**	**+3.3**
Net sales of central government debt to the non-bank private sector	−1.5	−1.6	+1.5	−3.8
of which:				
Gilt-edged stocks	*−0.8*	*−1.5*	*+1.8*	*−1.3*
National savings	*−0.8*	*−0.8*	*−1.0*	*−3.4*
CTDs	—	*+0.8*	*+0.8*	*+1.0*
Net sales of local authorities' and public corporations' debt to the non-bank private sector	+0.2	−0.2	+0.7	+2.6
External and foreign currency finance of the public sector	−1.0	−1.1	+0.7	−1.7
of which, gilt-edged stocks	*−0.6*	*−0.9*	*−0.9*	*−3.0*
Total financing of the public sector from the non-bank private and overseas sectors	**−2.3**	**−2.9**	**+2.9**	**−2.9**

(a) Includes on-lending from central government to local authorities and public corporations.

Table K
Official transactions in gilt-edged stocks

£ billions: *not seasonally adjusted*

Calendar months	Jan. 86– Mar. 86	Apr. 86– June 86	July 86– Sept. 86	Oct. 86– Dec. 86	Jan. 87– Mar. 87
Gross official sales(a)	+2.0	+4.6	+3.0	+4.5	+2.7
less					
Redemptions and net official purchases of stock within a year of maturity	−1.7	−2.7	−0.9	−1.8	−3.3
Equals net official sales(b)	+0.3	+1.9	+2.0	+2.7	−0.7
of which, net purchases by:					
Monetary sector(b)	*+0.1*	*+0.2*	*+0.7*	*+0.2*	*+0.3*
Overseas sector	—	*+0.7*	*+0.6*	*+0.9*	*+0.9*
Non-bank private sector	*+0.1*	*+0.9*	*+0.8*	*+1.5*	*−1.8*

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.

The building societies' share of new mortgage lending fell from 85% to 66% during 1986—partly to the benefit of the banks but also reflecting the gains made by other mortgage lenders. Provisional figures suggest that in the early months of this year the banks' mortgage lending has increased relative to that by the societies. This has reflected weak retail inflows to the societies and their desire to build up liquidity. At the same time, some of the large societies may have been constrained by the 20% ceiling on wholesale funds. In addition, several of the banks were bidding for business by offering more attractive mortgage terms.

By contrast, in the retail deposit market the societies' slower adjustment of their rates enhanced their competitiveness relative to the banks. The difference between the average rates applying to the top bands of selected bank and building society accounts rose from 0.8 percentage points in favour of the societies in September to 0.9 percentage points in January (the largest figure for almost a year) and 1.9 percentage points by the end of March. However, this latest figure was the result of a reduction in rates offered by the banks following the cuts in base rates in March which was not matched immediately by the societies, so that a large part of their apparent competitive advantage may be only temporary.

Official operations in financial markets

This and the succeeding section include commentary on the foreign exchange market as well as the money market. The figures are not seasonally adjusted unless otherwise stated.

Over the period under review the cash position of the money market benefited from a variety of influences which tended to reduce the market's need for official assistance. The main factors were the central government borrowing requirement, net official purchases of gilt-edged stock, a fall in the note circulation and substantial official intervention in the foreign exchange market. The reduced need for official assistance was more than accounted for by a fall in the Bank's holdings of bills.

Despite the cash surplus recorded in the first three months of 1987 by the public sector as a whole, the central government's total borrowing requirement, which is usually very small or negative at that time of year, amounted to £1.3 billion. The central government had a surplus on own-account transactions of £1 billion. On-lending to local authorities and, to a much smaller extent, public corporations amounted to £2.3 billion; the bulk of this was used by the local authorities to reduce their borrowing from other sources and to build up their liquid asset holdings in anticipation of future needs. The redirection of local authority borrowing continued a trend which has the helpful effect of reducing the need for the Bank to provide assistance to the money market (see the December 1983 *Bulletin*, page 478).

The market's cash position also benefited from £0.7 billion of net official purchases of gilt-edged stock, the first quarterly net official purchase since the fourth quarter of 1974. Gross gilt sales during the quarter were £2.7 billion. This was lower than

Table L
Influences on the cash position of the money market

£ billions; *not seasonally adjusted*
Increases in the market's cash (+)

Calendar months	Jan. 86– Mar. 86	Oct. 86– Dec. 86	Jan. 87– Mar. 87	Apr. 86– Mar. 87
Factors affecting the market's cash position				
CGBR (+)	−0.8	−1.1	+1.3	+10.5
of which, on-lending to local authorities and public corporations	*+2.4*	—	*+2.3*	*+6.0*
Net sales (−) of central government debt(a)	−0.3	−3.0	+0.7	−8.5
of which:				
Gilt-edged	*−0.3*	*−2.7*	*+0.7*	*−5.9*
National savings	*−0.3*	*−0.8*	*−1.1*	*−3.3*
CTDs	*+0.3*	*+0.4*	*+1.1*	*+0.7*
Currency circulation (increase −)	—	−1.0	+1.0	+0.3
Other	+0.3	+0.9	+0.7	+2.2
Total (A)	**−0.8**	**−4.2**	**+3.7**	**+4.5**
Official offsetting operations				
Net increase (+) in Bank's holdings of commercial bills(b)	−1.6	+5.0	−5.7	−3.3
Net increase (−) in Treasury bills in market	—	−0.4	−0.4	−0.7
Securities(c) acquired (+) under sale and repurchase agreements with banks	+2.3	—	+1.1	−1.2
Other	+0.1	−0.4	+1.4	+1.0
Total (B)	**+0.8**	**+4.2**	**−3.6**	**−4.2**
Change in bankers' balance at the Bank (= A + B)	—	−0.1	+0.1	+0.2

(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.

in any of the first three quarters of the financial year, reflecting the low PSBR for 1986/87 as a whole, the full-funding target and the gilt sales made earlier. Gross gilt sales during the period were exceeded by redemptions and buying-in of near maturities, which together amounted to £3.3 billion. This figure reflected the redemption of three stocks during the period and substantial official purchases of short-dated stocks in anticipation of a bunching of maturities falling due in the early part of 1987/88.

Despite net official purchases of gilts, the overseas sector continued to be a substantial net purchaser during the period. With the monetary sector also adding to its gilt holdings, the non-bank private sector made net gilt sales of £1.8 billion. This was the first quarterly net sale of gilts by the non-bank private sector since the fourth quarter of 1974.

The contractionary effect on the money market's cash position of national savings inflows of £1.1 billion was exactly offset by net surrenders of certificates of tax deposit. The note circulation fell sharply during the period, rebounding from the large increase associated with the surge in spending around Christmas, adding £1 billion to the market's cash position. The increase in reserves added £1.6 billion further, only partly offset by £0.9 billion of other influences.

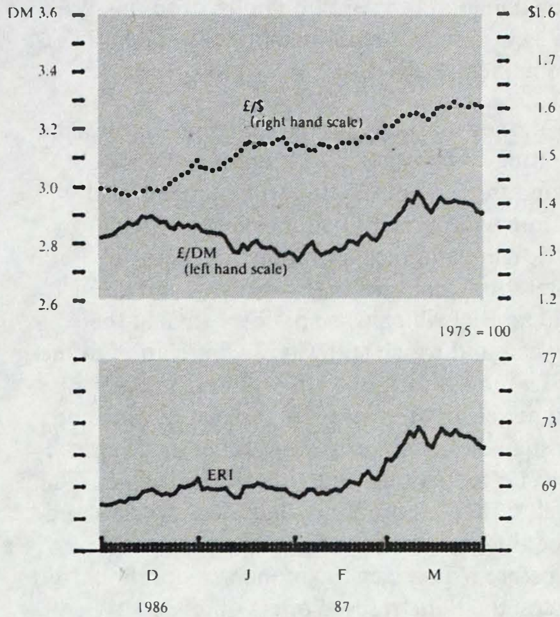
The net result of the financial flows affecting the money market was a fall of £3.7 billion in the need for market assistance during the period. Within the period, however, there were very large fluctuations: official assistance to the money market rose with heavy tax receipts in January and fell back again during February and March.

As the market became more optimistic about interest rates during the period under review, progressively shorter-dated bills were offered to the Bank in its daily operations. Consequently, the average maturity of the Bank's portfolio shortened, and the size of the daily cash shortages in the money market remained large: the average daily shortages in January, February and March were £694 million, £617 million and £693 million respectively. To help in handling these shortages the Bank made frequent use of purchase and resale agreements with the discount houses in bills.

During 1986/87 as a whole, official assistance to the money market fell by over £4 billion. In part this reflected the shift by local authorities away from market borrowing and towards reliance on central government on-lending. The reduced need for assistance resulted in a fall of £3.3 billion in the Bank's holdings of commercial bills. At the end of March, the total outstanding of official assistance to the money market, other than that provided through dealings in Treasury bills, totalled £9.7 billion. Of this, £5.0 billion consisted of outright holdings of eligible bills; £2.1 billion comprised eligible bills held under purchase and resale agreements with discount houses; £1 billion represented securities bought directly from banks on purchase and resale agreements; and £1.5 billion was market advances.

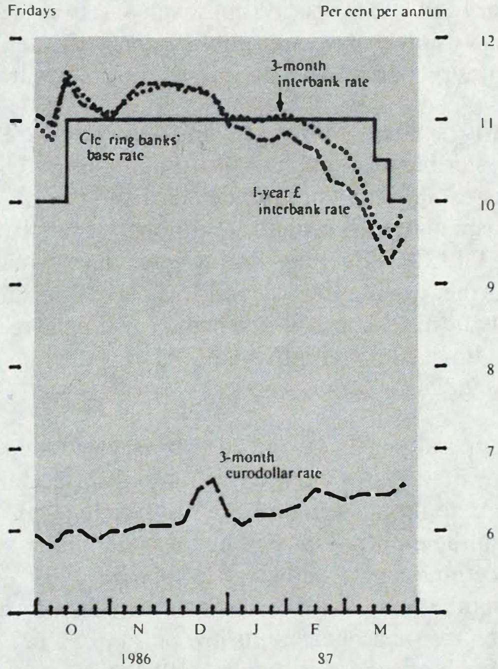
Sterling exchange rates

At the close of business in London each day



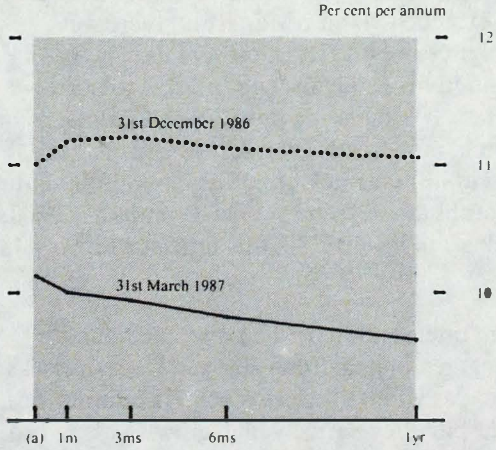
Short-term interest rates in London

Fridays — Per cent per annum



Sterling interbank rates

Per cent per annum



(a) For one week.

The money and foreign exchange markets

During the three months under review, sterling strengthened against a weakening dollar and, to a lesser extent, against other major currencies. The rise in the exchange rate reflected increasing optimism about the UK economy, reinforced by the growing evidence that the PSBR for 1986/87 would be below the £7 billion projected at the time of the Autumn Statement. The pound came under strong upward pressure following the Paris meeting in late February, encouraged by the United Kingdom's relatively high interest rates and the market's reluctance at the time to push other major currencies beyond prevailing levels, and the Budget was well received. At the beginning of the period, the exchange rate response to the rise in oil prices that had occurred in December implied an adverse effect on inflation from oil price and exchange rate changes taken together, but during the period under review the exchange rate strengthened while oil prices remained fairly steady.

In the domestic money market, there was growing downward pressure on interest rates, in particular as evidence accumulated about the likelihood of a low PSBR in 1986/87 and the extent of the Chancellor's prospective room for manoeuvre in 1987/88. In order to convey publicly the authorities' prudent approach to any possible fall in interest rates, on several occasions the discount market was invited to borrow at 2.30, for periods of up to two weeks. Towards the end of the period, the strengthening exchange rate suggested that monetary conditions were in fact sufficiently firm to make appropriate a modest fall in interest rates; rates fell by $\frac{1}{2}$% shortly before the Budget and by a further $\frac{1}{2}$% following it. A substantial amount of exchange market intervention was undertaken in March to contain upward pressure on sterling.

The period opened with a fairly flat money-market yield curve, with the one-month rate at $11\frac{1}{8}$%, the three-month rate at $11\frac{3}{32}$% and the twelve-month rate at 11%. Banks' base rates were 11% and the effective exchange rate index (ERI) was 69.2 ($1.4840 and DM 2.8530).

Sterling was generally steady early in the new year, reflecting the weakness of the dollar and expectations of firmer oil prices following the OPEC production-sharing agreement reached on 20 December. After some initial hesitation, sterling rose above $1.50 against a weak dollar on 14 January. It did not keep pace with the improvement in the deutschemark, however, reflecting market views that the extent of the EMS realignment on 12 January had been inadequate, and fell to DM 2.7551 on 15 January, with the ERI down to 68.1. This fall did not, however, have a significant effect on money-market rates. The improvement in sterling in the following week, together with the better-than-expected December PSBR figure, caused money-market rates to ease, with the one, three and twelve months' maturities at $11\frac{1}{16}$%, $10\frac{31}{32}$%, and $10\frac{3}{4}$% respectively on 19 January. The next day the Bank signalled official resistance to lower interest rates by raising the 'stop rates' at which it was willing to supply funds to the discount houses against purchase and resale agreements in bills.

Interbank rates softened, but only briefly, on news of the cut in the German discount rate on 22 January. Over the next few weeks the pound, which had opened on 22 January at 69.3 on the ERI ($1.5340 and DM 2.7980), fluctuated in response to movements in the dollar and the opinion polls, dropping briefly below $1.50 on 9 February, but remained broadly stable. The money market remained steady also.

The mood in the money market again became more optimistic in the week beginning 17 February. Expectations of a 1% cut in base rates around the time of the Budget a month ahead were becoming more widespread, encouraged in particular by the January PSBR figure and the continuing firmness of sterling. For the reasons explained in the Review, and against the background of an ERI which was no higher than at the beginning of the year, and which still was low in relation to the recent oil price rise, the authorities were cautious. In particular, there was a risk that an early reduction in interest rates would encourage rather than dampen the growing belief that there would be a further 1% reduction at the time of the Budget. The authorities also felt it more appropriate that the markets should wait until after the Budget, when the fiscal outlook would be known publicly, before reassessing the monetary situation. In these circumstances, the Bank refused offers of bills and instead invited the discount houses to borrow at 2.30 on 19 and 20 February at $11\frac{1}{2}$% for periods of seven and twelve days respectively. This was taken as a clear public signal that the authorities were not prepared to see an immediate cut in rates.

Following the Paris meeting of Finance Ministers and central bank Governors, sterling resumed its upward trend, helped by hopes that an interest rate cut would be deferred and by increasing optimism about the economy. Although scepticism as to whether the OPEC production-sharing agreement would hold brought a further dip in oil prices to $16 a barrel, sterling advanced strongly from 27 February, helped by well-received trade figures, and finished the month at an ERI of 69.9 ($1.5465 and DM 2.8267).

The 2.30 lending operations on 19 and 20 February had helped to calm the money markets for a few days, but bullish sentiment revived in response to the strengthening of the exchange rate towards the end of the month—assisted by the belief that, after the Paris meeting, sterling had greater scope for appreciation than other major currencies. A further factor was the oil price, which rose sharply from its low point of $15.92 per barrel on 2 March on evidence that the OPEC production-sharing agreement was being observed. The result was that the ERI exceeded 70 on 2 March and there was further downward pressure on UK interest rates. The Bank responded by again inviting the discount market to borrow at 2.30 on 2 March (at $11\frac{1}{2}$% for seven days). Nevertheless, by the morning of 5 March, money-market rates were firmly discounting a $\frac{1}{2}$% cut in base rates, with the one-month maturity at $10\frac{7}{8}$%, three-months at $10\frac{1}{4}$% and twelve- months at 10%. Later that day, the Bank again lent at 2.30, this time at a rate of $11\frac{3}{4}$% for eight days.

Despite significant intervention by the Bank, the pound continued to strengthen under strong demand from overseas institutions, particularly for gilt-edged stock. The authorities concluded that, despite the relatively high growth rate of broad money, monetary conditions were not loose and that a $\frac{1}{2}$%

reduction in interest rates would by that stage be appropriate. This was signalled on 9 March. Sterling eased only briefly on this action, however, and closed at an ERI of 72.4 ($1.5893 and DM 2.9482), up from 71.8 the previous day. Interbank rates closed at $10\frac{1}{2}$%, $10\frac{3}{16}$% and $9\frac{7}{8}$% for one, three and twelve months respectively. With strong demand re-emerging, the pound briefly breached $1.60 on 11 March, for the first time since late May 1983, and reached an ERI of 72.8, the high-point for the period. Profit-taking, encouraged by rumours that the Bank had intervened as the rate neared $1.60, brought sterling temporarily back to $1.5715 two days later.

Attention in both the domestic money market and the foreign exchange market was now focused on the Budget, due on 17 March. The discount houses, expecting a 1% cut in interest rates, were reluctant to offer paper to the Bank, and short-dated purchase and resale operations in bills were conducted. By the close on Budget day, period interbank rates were at $9\frac{13}{16}$%, $9\frac{5}{8}$% and $9\frac{3}{8}$% at one, three and twelve months respectively. On the following day the Bank signalled, through 2.30 lending at a rate of 10% for fourteen days, a cut of only $\frac{1}{2}$% in interest rates; in the interbank market the three-month rate closed at $9\frac{5}{8}$% while the twelve-month rate eased to $9\frac{1}{4}$%.

The Budget was well received in the foreign exchange market, and demand for sterling was further boosted by the less-than-expected cut in base rates. Thus the pound, which had opened at an ERI of 71.9 on the morning of the Budget, closed at 72.6 ($1.6076 and DM 2.9543) the next day. For the rest of the month, with attention reverting to other currencies and fluctuations in sterling dampened by continued sizable intervention, the pound held fairly steady against the dollar and eased against the deutschemark. It finished the month at an ERI of 71.4 ($1.6042 and DM 2.8972).

Bullish sentiment in the domestic money market persisted following the Budget, but with decreasing conviction. Although the trade figures, published on 26 March, were much better than had been expected, electoral uncertainties and the weakening of the exchange rate contributed to a firming in rates. By the end of the three months under review the momentum for a further reduction in base rates seemed to have largely dissipated, and the period ended with a gently downward-sloping yield curve in the interbank market, with the one-month rate at 10%, the three-month at $9\frac{7}{8}$% and twelve-month at $9\frac{5}{8}$%. Most building society interest rates remained unchanged until the end of the period, though some societies raised slightly the rates of certain high-interest accounts during January. Following the cut in banks' base rates in March, virtually all of the larger societies reduced their mortgage rate for new borrowers by about 1%. This reduction was not extended to existing borrowers until 1 May, at which time the rates on savings accounts were also adjusted.

Over the period from 2 January to 31 March, the ERI rose by $3\frac{1}{4}$%, with sterling rising by 8% against the dollar and by $1\frac{1}{2}$% against the deutschemark. Interbank rates fell by $1\frac{1}{8}$% to 10% at the one-month maturity, by $1\frac{7}{32}$% to $9\frac{7}{8}$% at the three-month maturity, and by $1\frac{3}{8}$% to $9\frac{5}{8}$% at the twelve-month maturity. Banks' base rates fell by 1% to 10%.

Table M
Changes in UK official reserves
$ millions

	1986	1987		
	Dec.	Jan.	Feb.	Mar.
Change in reserves	**−83**	**+29**	**+305**	**+4,782**
of which:				
Net borrowing (+)/payment (−) of public debt	−179	−2	+18	+107
Valuation change on roll-over of EMCF swap	—	−41	—	—
Underlying change in reserves	+96	+72	+287	+1,785
Annual revaluation of reserves	—	—	—	+2,890
Level of reserves (end of period)	**21,923**	**21,952**	**22,257**	**27,039(a)**

(a) After the annual revaluation.

Official reserves

Over the three months to end-March, there was an underlying increase in the reserves of $2,144 million, of which $1,785 million occurred in March (the largest monthly increase since October 1977). Net new borrowing under the exchange cover scheme totalled $153 million. The reserves were reduced by $41 million on account of the valuation adjustment arising from the quarterly roll-over of the European Monetary Co-operation Fund Swap, but the effect of the annual revaluation of the reserves at end-March was to increase their dollar value by $2,890 million, comprising an increase of $895 million on gold and $1,995 million on SDR-denominated assets, ECU's and non-dollar currencies. At the end of March, the reserves stood at $27,039 million.

The gilt-edged market

Developments in the gilt-edged market during the period under review fell into three distinct phases. The first continued the confident trend begun before the new year and lasted until late January, during which time the market advanced fairly steadily. This reflected a firmer sterling exchange rate against the dollar and expectations of stronger oil prices following the December OPEC accord. By the third week in January, long yields were below 10%. During the second phase, lasting from late January to mid-February, yields stabilised, prompted by a more uncertain trend in the opinion polls and a quieter period for sterling in the foreign exchange market. The release of the January PSBR figures on 17 February marked the beginning of the third phase in gilt-edged market sentiment, when developments were dominated by increasing bullishness over the PSBR and prospects for the Budget, hopes that this would be accompanied by interest rate reductions, and demand for sterling after the Louvre accord. There was a further improvement in gilt-edged prices immediately after the Budget, though yields edged up again at the end of March. The authorities were reluctant to see a precipitate fall in gilt yields during the period: this could have led to an abrupt setback, which the authorities wished to avoid, and would have undermined the effectiveness of actions taken in the money market.

During this period, the authorities issued papers describing an experimental series of auctions of gilt-edged stock (see page 203). The first such auction was due to be held in mid-May.

The objective of the authorities remained that of fully funding the PSBR over the financial year as a whole through debt sales to the non-bank private sector and external and foreign currency finance of the public sector. As the period progressed, it became apparent that the PSBR would emerge much lower than had been expected earlier, resulting in a reduced funding target for the year as a whole, not fully offset by the funding implications of the large reserves increase in March. The fact that most of the need for gross gilt-edged sales for the full financial year had been met earlier led to a reliance on part-paid issues during March, thereby securing calls in the early part of 1987/88.

The authorities began the period with calls secured on earlier sales of $2\frac{1}{2}$% Index-Linked Treasury 2024, issued on 30 December 1986. Three stocks were scheduled to mature

Table N
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(a) (£)	Payable per £100 stock: Further instalments (£)	Redemption yield (per cent)	Date exhausted
10% Treasury 1994(b)	1250(c)	2/1	Minimum price tender	7/1	98	40.00	58.00 (24/2)	10.40	22/1
9% Treasury 2008(b)	1000(d)	6/2	Minimum price tender	11/2	94½	25.00	69.50 (6/4)	9.60	19/2
2% Index-Linked Treasury 1992(e)	400	13/2	Tender, no minimum price	18/2	93½(f)			3.26(g)	3/3
9% Exchequer 2002	1200(d)	2/3	Direct to Bank	2/3	96	20.00	76.00 (27/4)	9.49	4/3
8¾% Treasury 1997 'B'(b)	1100(h)	9/3	Direct to Bank	9/3	96½	40.00	56.50 (5/5)	9.28	11/3
2½% Index-Linked Treasury 2011	150	27/3	Direct to Bank	27/3	113			3.32(g)	
2½% Index-Linked Treasury 2024(e)	100	27/3	Direct to Bank	27/3	85¾			3.15(g)	

(a) If not fully paid at time of issue.

(b) The prospectus includes provision for exemption from UK taxation in favour of non-resident holders and for the loan to be available in bearer form.

(c) Of which £250 million was reserved for the National Debt Commissioners.

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

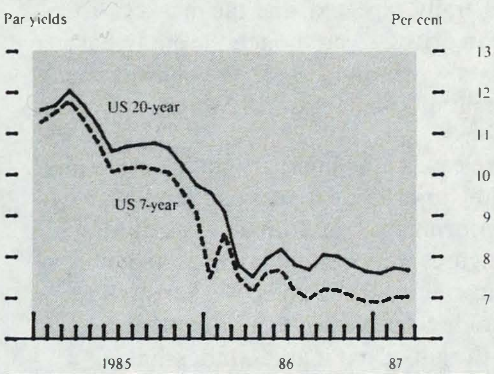
(e) The prospectus includes provision for exemption from UK taxation in favour of non-resident holders.

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

(g) Real yield, calculated on the basis of 5% annual rate of increase in the retail price index.

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

Gross redemption yields on US government securities

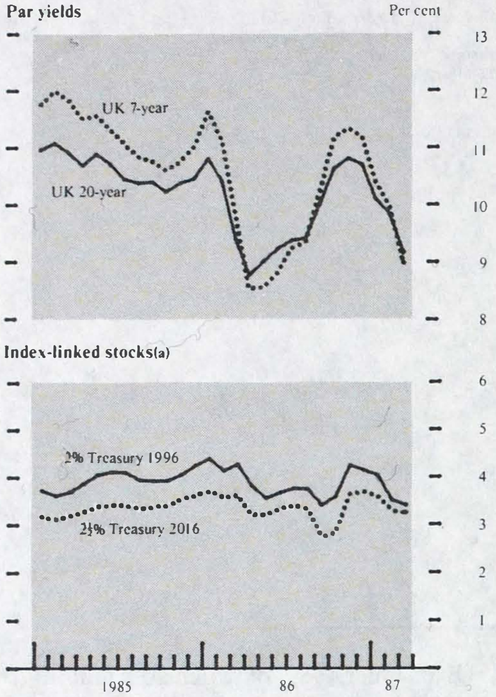


during the period: 13¼% Exchequer 1987, of which £0.8 billion was in market hands; 10¼% Treasury Convertible 1987, of which the market held £0.6 billion; and 2½% Exchequer 1987, of which market holdings amounted to £0.9 billion. Additionally, 10½% Exchequer 1987, of which £1.4 billion was in market hands, was due to be redeemed less than a week after the end of the period. The authorities still had available for sale supplies of 2½% Index-Linked Treasury 2024 and quantities of other stocks.

Following gains on New Year's Eve, as the dollar weakened on news of the US trade deficit, the market opened 1987 in confident mood and made substantial gains on 2 January. This reflected sterling's strength in the face of the weaker dollar, expectations of stronger oil prices, and softer money-market rates. The authorities took the opportunity to announce the issue by tender of £1,000 million of 10% Treasury 1994 (£40 paid). The stock was free of tax to residents abroad (FOTRA). A further £250 million of the stock was reserved for the National Debt Commissioners. Prior to the tender the exchange rate weakened and electoral uncertainties increased with a new opinion poll: the tender was undersubscribed. The market resumed its improving trend in the second and third weeks of January, long yields fell below 10% and further sales were made of 10% Treasury 1994 and 2½% Index-Linked Treasury 2024; the latter tap was exhausted on 19 January. The market's move to single-digit yields reflected firmer sterling, steady oil prices, an improvement in sentiment following the news of a PSBR surplus of £1.2 billion in December, and expectations of cuts in international interest rates. With the ½% fall in the German Lombard rate on 22 January, supplies of the 1994 tap were exhausted.

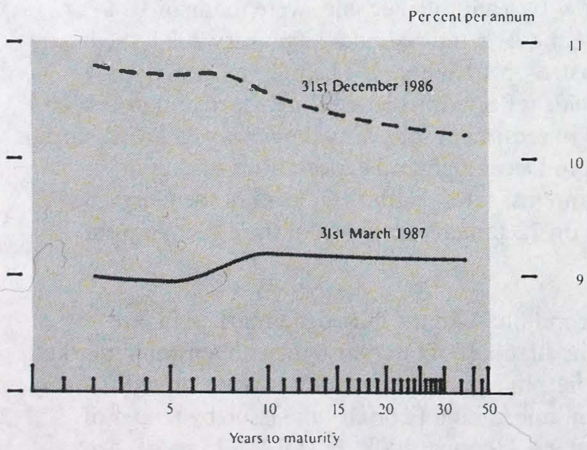
During the second phase in the gilt-edged market, in late January and the first half of February, the conventional market was generally flat. In a period of relative market strength, the authorities announced on 6 February the issue by tender of £800 million of 9% Treasury 2008 (FOTRA, £25 paid). An

Gross redemption yields on UK government securities



(a) Real yields assuming 5% inflation.

Time/yield curves of British government stocks



additional amount of £200 million was reserved for the National Debt Commissioners. The index-linked sector had continued to move forward during early February, reflecting the greater demand for indexed stock at a time of uncertainty and the edging up of inflation, and on 13 February the opportunity was taken to announce the issue by tender of £400 million of 2% Index-Linked Treasury 1992 (FOTRA).

The third phase in the market began with a pronounced change in mood on 17 February, on the back of stronger sterling and consideration of the PSBR surplus announced for January. The more bullish mood prompted a fall in yields, and the exhaustion of the 2008 tap on 19 February. By the end of the month, long yields had fallen to around 9½%. The Bank's 2.30 lending operations in the money market were reinforced by the issue of £1,000 million of 9% Exchequer 2002 (£20 paid) on 2 March; a further £200 million was reserved for the National Debt Commissioners. Combined with rumours of official sales of sterling, this calmed the market temporarily, but prices rose strongly again on 4 March, when the new tap was exhausted.

Steady progress continued to be made by the market in the following week, with continued optimism regarding the Budget and hopes of lower interest rates. Following the ½% cut in the Bank's money-market dealing rates on 9 March, less than the market had hoped for, gilt-edged prices fell back temporarily with the announcement of the issue of £1,000 million of 8¾% Treasury 1997 (FOTRA, £40 paid); a further £100 million of the stock was reserved for the National Debt Commissioners. Further gains by sterling the following day helped the market to bounce back, reinforced by rumours of Japanese buying, and the new stock was exhausted on 11 March.

The Chancellor's £4 billion PSBR forecast for 1987/88 was lower than had been generally expected, and the market responded with a surge in prices. Even though the cut in base rates following the Budget was limited to ½%, the bullish tone continued, with yields falling below 9% on 18 March.

Concerns ahead of the release of the February trade figures and reports of Japanese selling prior to their year-end (end-March) prompted profit-taking during the penultimate week of March. In the event, the trade figures were better than expected, but evidence of political uncertainty in the polls, weaker sterling and worries regarding trade relations led to a difficult and volatile end-March for the gilt-edged market. Index-linked were at one stage better, however, and the authorities took the opportunity to announce tranchettes of £150 million of 2½% Index-Linked Treasury 2011 and £100 million of 2½% Index-Linked Treasury 2024 on Friday 27 March.

Over the period from the beginning of January to the end of March, yields on conventional 5-year stocks fell by 1.4% to 9.1%, those on 10-year stocks by 1.2% to 9.3%, and those on 20-year stocks by 0.7% to 9%. The real yield on 2% Index-Linked Treasury 1990 fell by 1.2% to 2.4%, whilst that on 2½% Index-Linked Treasury 2020 fell by 0.4% to 3.3% (both calculated on the assumption of 5% inflation, and before tax). Thus the yield curve for British government stocks, which had been downward-sloping at the end of December, flattened considerably with the general fall in yields during the period, and long yields exceeded those on short-dated stock at end-March.

During the period under review turnover in the gilt-edged market continued its post-Big Bang rise. Turnover with outside-market customers rose from an average of £1.2 billion per day in the four months from June to October to £1.4 billion per day in the two months following Big Bang, and to £2.3 billion per day in the first quarter of 1987; in March the figure exceeded £3 billion. Additionally, turnover between gilt-edged market makers, many of whom were classified as outside-market customers before 27 October, also averaged over £2¼ billion per day in January to March. In total, therefore, average daily turnover increased roughly fourfold from the period immediately prior to Big Bang. The turnover in gilts futures contracts traded on the London International Financial Futures Exchange also continued to rise rapidly in the aftermath of Big Bang. In the first ten months of 1986, daily turnover in the long gilt contract averaged about 7,000 contracts; this increased to 12,000 contracts in November and December, and to about 25,000 contracts in January to March.

Other capital markets

The more optimistic tone in the equity market which followed the successful flotation of British Gas in early December continued virtually uninterrupted until the end of March, when it was halted by fears of a deterioration in international trade relations. The FT-Actuaries all-share index increased from 835.5 at the end of December to a peak of 1026.6 on 24 March, before falling to 1000 at the end of March. This represented a rise of 20% during the period. While prices in London moved broadly in line with those in New York and Tokyo, the London market was also influenced by increasingly optimistic assessments of domestic economic prospects and by expectations of cuts in interest rates. The CBI surveys in February and March showed that manufacturing companies were more confident about the outlook for orders than at any time since the 1970s, and better-than-expected unemployment and trade figures for February reinforced the optimistic economic mood, as did the cuts in bank base rates in March, with expectations that the continuing strength of sterling would permit further cuts. The market began to falter towards the end of March, however, on fears of the adoption of protectionist measures by the United States and the United Kingdom against Japanese goods and services and on nervousness about possible rises in US interest rates.

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

	1986		1987
Banking months	Q3	Q4	Q1
UK private sector			
Loan capital and preference shares	+ 443	+ 40	− 889
Equity capital	+2,279	+2,301	+1,441
Unit trusts	+1,033	+1,743	+1,726
Issues on the unlisted securities market	+ 82	+ 145	+ 76
Local authorities			
Stocks	—	− 25	—
Bonds	− 68	− 49	− 25
Overseas	+ 39	+ 104	—

Issues of equity by UK companies amounted to £1.4 billion in the first quarter, compared with an average of nearly £2.5 billion in the previous two quarters. The largest issues were vendor placings for £621 million by the Argyll Group and for £162 million by Tarmac; a rights issue for £169 million by the Cookson Group; a rights issue for £113 million by Siebe; and a placing for £96 million by British Land.

The eurosterling market was very active in the first three months of 1987, with falling interest rates giving a strong incentive to fixed-rate issues. Fifty-one issues were announced for some £3.5 billion, of which £3.2 billion was in the form of

Table Q
Amounts raised by sterling bond issues
£ millions

	Eurosterling			Domestic issues	
	Fixed-rate (including equity-related)		FRNS		
	UK borrowers(a)	Overseas borrowers		UK borrowers	Overseas borrowers
1987					
Jan.	110	550	50	—	—
Feb.	455	510	100	55	—
Mar.	838	715	200	10	—
Total	**1,403**	**1,775**	**350**	**65**	—

(a) Of which, £828 million were equity-related.

fixed-rate issues (including £828 million of equity-related bonds). About a half of the total of issues in the quarter were made by UK borrowers. In the sterling FRN market the first mortgage pass-through bonds were issued. These represent the direct ownership of a pool of domestic mortgages where repayments from homeowners are 'passed through' to make interest and principal payments to bondholders. There were just three issues for £65 million in the domestic fixed-rate market.

During the first quarter, UK borrowers made issues of £1 billion in the international bond markets in currencies other than sterling, £0.3 billion less than in the final quarter of 1986 (including issues by foreign subsidiaries with a parental guarantee). Using their new powers under the Building Societies Act, building societies raised £300 million through issues of foreign currency bonds, with the proceeds swapped into sterling. Issues for banks, however, fell back sharply with the lower level of activity in the FRN market. Three issues were made in deutschemarks, including one of DM300 million for Royal Insurance. Other issues included one of $150 million for Guaranteed Export Finance, a vehicle set up to refinance ECGD-guaranteed loans.

Sterling commercial paper

There was further growth in the sterling commercial paper market during the first quarter of 1987. Over the period as a whole, gross issues totalled £2,027 million as compared with £2,218 million of issues between May—when the market opened—and December last year. Redemptions during the first quarter of 1987 amounted to £1,618 million, and the total value of paper outstanding increased by £409 million to £936 million. By the end of March, fifty-five programmes had been notified to the Bank. Paper had actually been issued under thirty-six of these programmes.