Operation of monetary policy

This article covers the period from July to early October.

Introduction

The economic and financial indicators released over the third quarter provided unambiguous evidence that the sustained period of tight monetary conditions has slowed activity in the real economy, with the signs becoming progressively clearer and more widespread. As expected, however, adjustment in the real economy has preceded adjustment in inflation.

The tight policy stance, with interest rates maintained at 15% throughout the third quarter, was reinforced by the appreciation of sterling, which was attributable in part to anticipation of ERM entry and, in the immediate aftermath of the Iraqi invasion of Kuwait, to a degree of petro-currency support. Expectations about the timing of ERM entry were an important factor in explaining movements in most UK financial markets over the period. Entry took place in early October when, as discussed in the Assessment, the combination of the slowdown in economic activity and the projected easing of inflation provided an appropriate conjuncture for the United Kingdom to join, with a simultaneous reduction in the general level of interest rates to 14%.

The stance of monetary policy has not been significantly altered by entry into the ERM: the continuing restraint exercised by interest rates at 14% has been reinforced by the contribution to counterinflationary policy stemming from ERM obligations. In the present circumstances, the authorities have continued to indicate that interest rates will not be reduced further until they are sure that it would be safe and prudent to do so.

Monetary aggregates and credit

The figures in this section are seasonally adjusted.

The monetary aggregates continued to decelerate during the third quarter reflecting, in part, the slowing of activity in the real economy.

Components of money

The twelve-month growth rate of M0, which has been on a downward trend since April, was 4.6% in September, within the 1%–5% target range. The twelve-month growth rate of notes and coin slowed from 6.5% in June to 4.8% in September. The progressive moderation in the growth of narrow money partly reflects a similar slowdown in personal sector spending; there is a broad relationship between movements in the value of consumers' expenditure and M0 (Table A).[1]

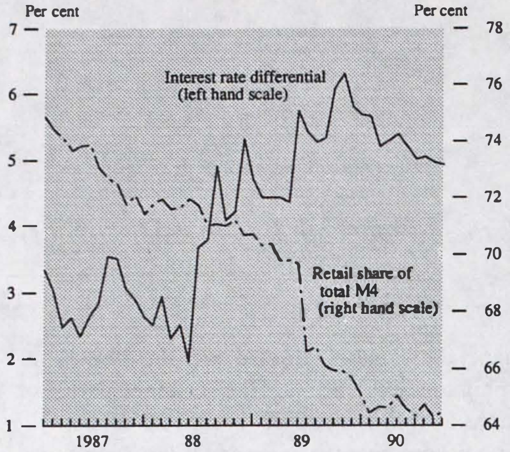
Table A
Growth rates of the monetary aggregates[a]
Percentages; *seasonally adjusted (financial year constrained)*

	12 months to June 90	12 months to Sept. 90	1990 Q2	Q3
M0(b)	6.5	4.6	2.3	—
M2	8.2	7.2	1.5	2.4
M4	16.9	14.6	3.8	2.5
M4 lending	18.7	15.7	3.1	3.0

(a) See the statistical annex to the February 1990 *Bulletin* for definitions.
(b) Data are based on end-month figures, except M0, which is an average of Wednesdays in each month.

(1) See 'The determination of the monetary aggregates' in the August 1990 *Bulletin*, pages 380–83.

Wholesale minus retail deposit rate [(a)] and retail share of total M4 stock



(a) Wholesale deposit rate is 3-month Libor, retail deposit rate is the average instant access deposit rate of the five largest banks and the five largest building societies.

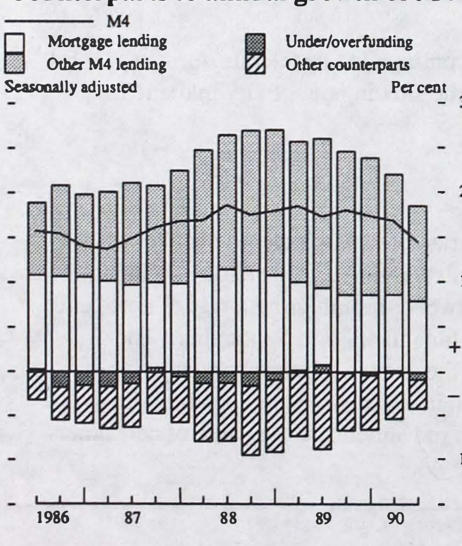
Table B
Counterparts to changes in M4 [(a)]

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

	Counterparts to M4 1990 Q2	Q3	12 months to end-Sept. 90
1 PSDR (-)	5.0	-1.9	-2.2
2 Net purchases (-) of public sector debt by the M4 private sector	-1.8	-0.6	-0.9
of which, central government debt	*-1.3*	*-0.8*	*-0.4*
3 External and foreign currency finance (-) of the publ c sector	—	-0.1	—
4 Public sector contribution (=1+2+3)	3.2	-2.6	-3.1
5 S erl ng lending to the M4 private sector (b)	16.5	16.5	75.9
6 Other external and foreign currency flows	1.2	-0.6	-2.4
7 Net non-deposit sterling liabilities of banks and building societies (-)	-4.3	-2.1	-11.0
8 Total (=5+6+7) =change in M4	**16.5**	**11.3**	**59.3**

(a) See the statistical annex to the February 1990 *Bulletin* for definitions.
(b) Including charges in Issue Department's holdings of private sector commercial bills and promissory notes relating to shipbuilding paper guaranteed by the Department of Trade and Industry.

Counterparts to annual growth of M4



The twelve-month growth rate of M2 fell to 7.2% in September—the smallest increase since the series began in 1983—despite a pick-up in growth during the third quarter. The retail deposits component of M4 grew somewhat faster than M2, because the non-M2 component of retail deposits (mainly building society retail deposits with a residual maturity of over one month) is growing more rapidly than the M2 component.

The growth in M4 resumed a downward trend after flattening off in the second quarter. The rise (2.5%) was the lowest quarterly increase for seven years. The easing in M4 growth was more marked for wholesale than for retail deposits; indeed, for the first time since mid-1988 the proportion of wholesale deposits in total M4 fell. This may have been a consequence of a rise in retail deposit rates relative to wholesale rates, and of companies having met expenditure through a significant rundown in deposits (most of which are wholesale) rather than through new borrowing. The slowdown was more evident for the banks than the building societies, reflecting the banks' greater reliance on company rather than personal deposits.

Counterparts to money

High interest rates, perhaps coupled with increasing caution by the banks and building societies, have restrained borrowing further over the third quarter. Lending by banks and building societies to the M4 private sector grew by 3.0% in the quarter, the lowest increase for nine years, while the twelve-month growth rate, at 15.7%, is the lowest since 1983 (Table A).

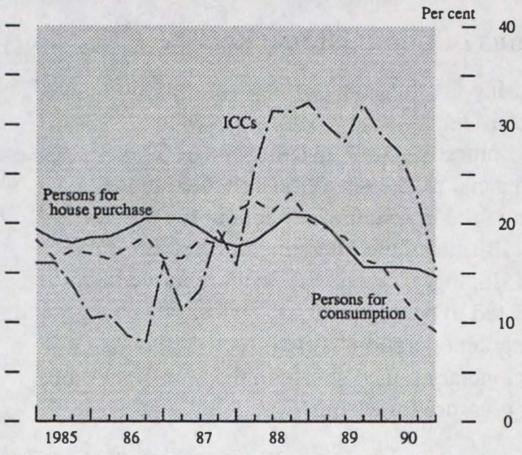
The public sector counterparts to the change in M4 had a contractionary effect of £2.6 billion. The local authority data would be consistent with some recouping of delayed payments of non-domestic rates and the community charge. The public sector debt repayment of £1.9 billion (£0.2 billion excluding privatisation proceeds) compares with a borrowing requirement of £5.0 billion in the previous quarter. Net sales of debt to the M4 private sector were £0.6 billion, £0.4 billion of which consisted of inflows into national savings, attracted by issues of new certificates and rises in interest rates in the summer. Other counterparts had a contractionary influence on M4 (Table B).

Sectoral developments

Following an adjustment in expenditure, the personal sector had moved further into financial surplus in the second quarter (£1.1 billion). This was reflected in a reduction in their net recourse to banks and building societies (Table C). The sector's net recourse rose in the third quarter, but only slightly .

Within these figures, lending for house purchase was subdued, growing by 2.8% in the third quarter. This reduced the twelve-month increase to 14.7%, down from the figure of about 15.5% which had prevailed for the previous four quarters. The principal factor which restrained this lending was high mortgage interest rates. Nevertheless, the centralised mortgage lenders—whose assets are not included in the lending counterpart to M4—appear to have gained market share at the expense of the building societies and particularly the banks.

Twelve-month growth rate of sectoral M4 lending



Lending for consumption increased by 2.1% in the third quarter, a similar rise to those in the last four quarters. The twelve-month growth rate has fallen to 9.1% compared with 16.4% in the same period a year ago.

Compared with the personal sector, there has been little evidence to date that industrial and commercial companies (ICCs) have adjusted in any significant measure to the earlier policy tightening. ICCs' total net recourse to the banks and building societies was £0.5 billion in the third quarter compared with £1.3 billion in the second quarter. However, and partly owing to a sharp decline in the growth of their deposits, sterling net recourse was £4.1billion, the highest figure since that of the third quarter of 1989 (which was very significantly inflated by the need to fund a record level of takeover activity). This pattern of behaviour could presage a correction in the record financial deficit, as suggested by the latest CBI quarterly survey.

The call on water shares may have had a contractionary impact on other financial institutions' M4 deposits in the third quarter. Partly as a result they made net sterling placements of £0.7 billion with the banks and building societies, having drawn a net £1.2 billion in the previous quarter.

Table C
Sectoral analysis of deposits with, and borrowing from, banks and building societies
£ billions; *seasonally adjusted (financial year constrained)*

	1989 Year	Q4	1990 Q1	Q2	Q3
Personal sector					
1 Sterling deposits	39.3	9.6	9.0	10.2	8.6
of which:					
Banks	21.9	5.6	4.9	5.9	3.1
Building societies	17.5	4.0	4.1	4.3	5.5
2 Sterling borrowing	45.8	11.9	12.1	10.1	9.1
of which:					
Individuals:					
Mortgage	31.0	8.8	8.8	8.0	7.0
Non-mortgage	5.5	0.9	0.9	0.9	0.9
Unincorporated businesses, etc	9.3	2.2	2.4	1.2	1.2
3 Net recourse (=2-1)(a)	**6.4**	**2.3**	**3.1**	**-0.1**	**0.5**
ICCs					
4 Deposits	13.6	5.2	6.6	3.5	3.6
of which:					
Sterling	11.5	3.7	4.8	1.8	0.5
Foreign currency	2.1	1.5	1.8	1.6	3.1
5 Borrowing	37.1	6.1	6.8	4.8	4.1
of which:					
Sterling (b)	28.6	4.9	5.7	3.8	4.5
Foreign currency	8.5	1.1	1.1	1.1	-0.4
6 Net recourse (=5-4)(a)	**23.5**	**0.8**	**0.3**	**1.3**	**0.5**
OFIs					
7 Deposits	19.1	4.8	4.6	4.5	3.4
of which:					
Sterling	13.2	2.3	2.3	3.8	2.2
Foreign currency	5.9	2.5	2.3	0.7	1.3
8 Borrowing	21.3	5.5	3.2	1.6	3.8
of which:					
Sterling (b)	13.9	3.9	4.3	2.6	2.9
Foreign currency	7.3	1.7	-1.1	-1.1	0.9
9 Net recourse (=8-7)(a)	**2.2**	**0.8**	**-1.4**	**-3.0**	**0.3**

(a) Excludes notes and coin.
(b) Includes Issue Department take-up of commercial bills.

Market developments

Market developments in the third quarter have to be seen against an unsettled international background, with the effects of the Iraqi invasion of Kuwait on 2 August adding to existing tensions in domestic economies.

Concerns about inflation have been apparent in all major economies. In the United Kingdom, inflation is expected to adjust only with a lag in response to the slowing of economic activity, while in Germany the effects of economic and monetary union have put upward pressure on costs and prices and, through their increased borrowing requirement, on interest rates. Japanese economic activity remained relatively buoyant over the quarter, but interest rates rose in order to bear down upon inflation. The markets were particularly cautious about the state of the US economy, with fears of recession coupled with concern over the state of some financial institutions. These worries, along with an erosion of the yield differential on dollar assets, led to the significant weakening of the dollar over the third quarter.

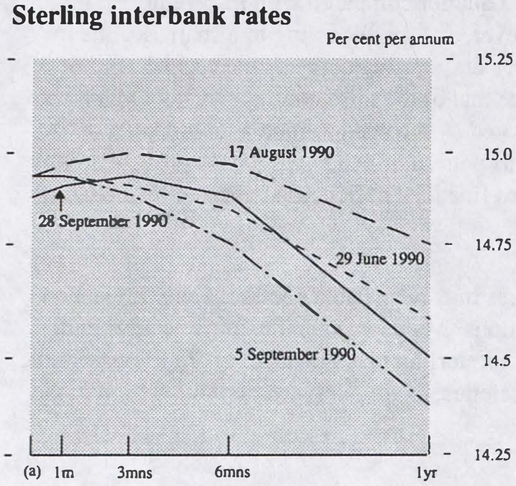
The Iraqi invasion of Kuwait increased international tension and heightened world inflationary pressures as oil prices rose sharply. Bond markets worldwide fell, and stayed fairly subdued for the remainder of the quarter. World equity markets, having already weakened earlier in the year, fell further with the onset of the Gulf crisis, particularly in Japan. The falls in the UK equity market, while less severe than in most other countries, reflected not only the tensions in the Gulf, but also the gathering evidence of weaker corporate results.

The rise in oil prices has also been a factor underlying the weakening in late August of the lira and the peseta within the ERM, which brought those currencies back from their band limits, and thus removed a source of intermittent strain. The United Kingdom's full entry to the ERM has not altered the pattern prevailing since the end of August of all ERM currencies trading comfortably within their band limits.

Official operations in financial markets

Market sentiment during the third quarter was strongly influenced by expectations of ERM entry—expectations to which developments in the domestic economy contributed. The effect of the Gulf crisis on financial markets was most marked in the immediate aftermath of the invasion. Throughout the quarter sterling was generally firm and the interbank interest rate curve remained downward sloping, indicating that future movements in base rates were expected to be downward. Against this background, the Bank's money-market operations were directed towards maintaining a tight monetary policy stance in the face of, at times, considerable market pressure for easing.

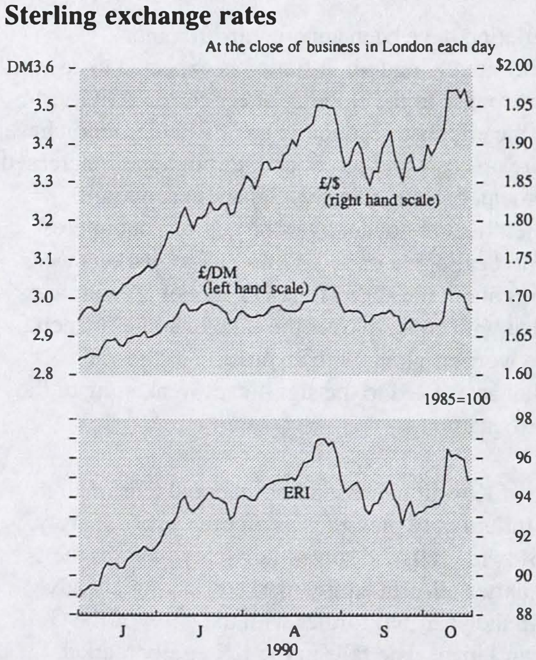
Sterling interbank rates



(a) For one week.

Sterling began the third quarter on a firm note, continuing its steady appreciation since the spring, with positive interest rate differentials in sterling's favour and expectations of early ERM entry continuing to provide support. The pound approached DM 3.00 on 10 July and rose briefly above that level on 18 July—a rise of 8 pfennigs from the beginning of the quarter. Sterling's strength also led to a softening of money-market interest rates in early July, with three-month and twelve-month rates around 14 15/16% and 14 5/8% respectively. Against this background the Bank maintained a tight operational stance, resisting any tendency for rates to ease. Fears that ERM entry might be delayed caused a sharp fall in sterling to DM 2.9290 on 25 July, but the currency recovered as the Chancellor re-emphasised the commitment to entry, and by the end of the month it had recovered to DM 2.9560. Over July as a whole, the effective exchange rate index rose by over 2½%, and sterling appreciated by 5½% against a dollar weakened by concerns over the US domestic economy.

Sterling exchange rates



The invasion of Kuwait at the beginning of August for a time displaced the prospect of ERM entry as the major factor influencing financial markets. Perception of sterling as a 'safe haven' petro-currency led the pound to firm sharply in the days immediately following the invasion, particularly against the weakening dollar but also against ERM currencies. Money-market rates reached their highs of the quarter around 17 August when an escalation of tension in the Gulf led to further rises in oil prices and concerns that their effect on the general price level might delay ERM entry and interest rate cuts. The oil price by this time had risen to over $26 a barrel, some $10 higher than at the beginning of the quarter. Three-month interbank rates were around 15% for several days, while twelve-month rates moved back to 14¾%, some 5/16 of a percentage point above their end-July level. This firming of rates lessened the immediate need for tightness in day-to-day market operations, and the authorities adopted a more neutral stance.

Yields in the gilt-edged market also rose following the invasion on heightened inflationary fears, and the yield curve flattened further as funds moved into short-dated stocks. Yields reached a peak in mid-August, but fell back as fears of imminent hostilities eased. Money-market rates similarly eased later in August, a move to which the strength of sterling and the underlying signs of an economic slowdown contributed, along with renewed market anticipation of ERM entry and cuts in rates later in the year. This

The cash position in the money market

There was a flow of funds into the money market, of £0.6 billion in the third quarter (Table 1). Net government revenue of £0.6 billion was almost exactly offset by net official purchases of government debt, and there was an increase in reserves and other influences.

Table 1
Influences on the cash position of the money market
£ billions; *not seasonally adjusted*
Increases in bankers' balances (+)

	1989 Q3	1990 Q2	1990 Q3	12 months to end-Sept .90
Factors affecting the market's cash position				
CGBR (+)	+0.3	+4.3	-0.6	-4.2
of which, on-lending to local authorities and public corporations	*+1.8*	—	*-0.5*	*-3.7*
Net sales (-) of central government debt (a)	+4.9	+0.3	+0.6	+7.5
of which: Gilt-edged	*+4.3*	*+0.9*	*+0.9*	*+7.7*
National savings	*+0.7*	*-0.4*	*-0.4*	*+0.1*
CTDs	*-0.1*	*-0.3*	—	*-0.3*
Currency circulation (increase -)	-0.3	-0.6	—	-0.8
Reserves etc	-0.7	+0.2	+0.2	-2.7
Other	+0.5	-0.3	+0.4	+0.7
Total (A)	**+4.8**	**+3.9**	**+0.6**	**+0.5**
Offsetting official operations				
Net increase (+) in Bank's commercial bills (b)	-1.1	-1.1	+0.8	+3.4
Net increase (-) in Treasury bills in market (c)	-3.4	-3.2	-0.9	-3.8
Other	-0.4	+0.4	-0.2	+0.2
Total (B)	**-4.9**	**-3.8**	**-0.3**	**-0.2**
Changes in bankers' operational balances at the Bank (=A+B)	-0.1	+0.1	+0.3	+0.3

(a) Other than Treasury bills.
(b) By the Issue and Banking Departments of the Bank of England.
(c) Excluding repurchase transactions with the Bank.

The alternative presentation of these influences (Table 2), shows the main factors to which the net flows in the market may be attributed.[1] Local authorities, which had reduced their net deposits with banks and building societies for three successive quarters, made no significant change to them in the third quarter, leaving the outstanding stock of such deposits at £7.3 billion, some £2.1 billion below the peak in the same quarter a year ago. The other main factor, contributing an inflow of £0.5 billion into the market over the quarter, was net sales of central government debt by banks and building societies; these do not contribute to the 'funding balance', and so are absorbed in official purchases (or offset official funding sales). Over the twelve months to end-September these two factors have been the most significant influences on the market's cash position.

Table 2
Alternative presentation of factors affecting the market's cash position
£ billions; *not seasonally adjusted*
Increase in bankers' balances (+)

	1989 Q3	1990 Q2	1990 Q3	12 months to end-Sept.90
Factors affecting the market's cash position				
Under/overfunding (+/-)	+2.8	+5.9	-0.3	-0.1
Central government net debt sales to banks and building societies(a) (-)	+1.7	+0.3	+0.5	+3.0
Other public sector net borrowing from banks and building societies (-)	+0.5	-1.7	—	-1.9
of which, local authorities' deposits with banks and building societies	*+0.1*	*-1.0*	—	*-2.1*
Currency circulation (-)	-0.3	-0.6	—	-0.8
Other	+0.1	—	+0.4	+0.3
Total	**+4.8**	**+3.9**	**+0.6**	**+0.5**

(a) Other than Treasury bills.

Over the third quarter, money-market influences led to a net inflow of funds to the market, concentrated in the later part of the period (see Table E). Combined with a fall in the level of maturing assistance over the quarter, these influences led to a reduction in the size of the daily cash shortage in September. This was not fully offset by the rising stock of Treasury bills, and the stock of assistance fell back to £4.9 billion at end-September, down £1.3 billion from end-August. This could have contributed to the softness in short rates in September.

The Treasury bill tender

Over the next few months a seasonal drainage of liquidity from the money market is expected, due to a period of large net government receipts —particularly from corporate tax payments. To avoid a resulting unnecessary tightening in the money-market position, the weekly Treasury bill tender was reduced by £50 million on 28 September and bills issued with a 63-day rather than a 91-day maturity (Table 3). If the 63-day bills taken up in subsequent weeks are not renewed on maturity, the rise at that time in the stock of money-market assistance will be correspondingly smaller.

Table 3
Changes in the size of the Treasury bill tender
£ millions

	63 days	91 days	182 days
End-1986	—	100	—
1987			
22 May	—	250	—
29 May	—	400	—
31 July	—	300	—
4 September	—	200	—
2 October	—	100	—
23 October	500	100	—
20 November	—	100	—
1988			
23 September	—	400	—
28 October	400	100	—
25 November	—	100	—
1989			
12 May	—	300	—
19 May	—	500	100
29 September	200	500	100
17 November	—	500	100
24 November	—	300	100
1990			
2 February	—	500	200
28 September	200	250	200

(1) A back run of data from Tables 1 and 2 is presented in Table 9.4 in the *Statistical annex*.

Table D
Sterling interest rates, gilt yields and exchange rates; selected dates [(a)]

Date	Interbank interest rates (per cent per annum)				Gilt yields (b) (per cent per annum)				Exchange rates		
					Conventionals			Index-linked			
	1 month	3 months	6 months	12 months	Short	Medium	Long	Long	ERI	£/$	£/DM
18 July	14 15/16	14 15/16	14 25/32	14 1/2	12.06	11.91	10.89	4.05	94.3	1.8247	2.9892
25 July	14 31/32	14 31/32	14 7/8	14 5/8	12.09	12.00	10.99	4.09	92.9	1.8085	2.9343
2 August	14 31/32	14 31/32	14 27/32	14 15/32	11.87	11.82	10.85	4.00	93.9	1.8412	2.9509
17 August	14 31/32	15	14 31/32	14 3/4	12.29	12.37	11.46	4.00	95.3	1.9155	2.9719
29 August	14 15/16	14 15/16	14 25/32	14 7/16	11.98	12.16	11.29	4.09	96.8	1.9482	3.0298
5 September	14 15/16	14 7/8	14 3/4	14 3/8	11.97	12.14	11.16	4.10	94.7	1.8952	2.9664
28 September	14 29/32	14 15/16	14 7/8	14 1/2	12.06	12.19	11.19	4.14	93.3	1.8705	2.9286

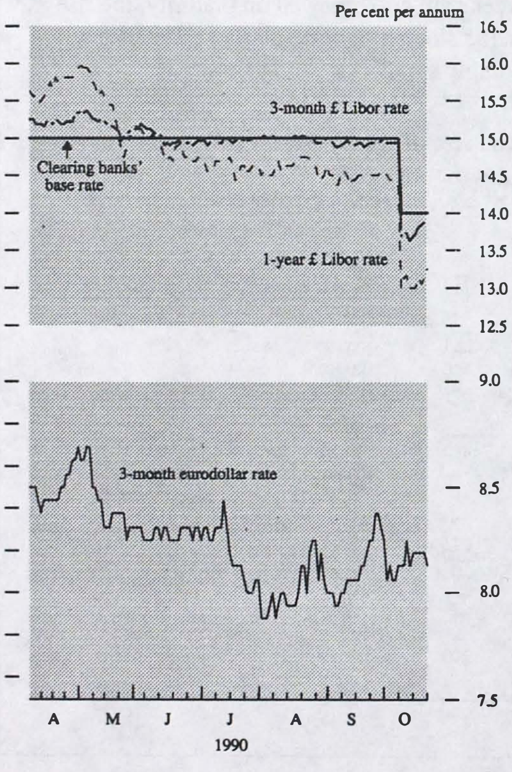
(a) The rates quoted are for close of business on each day.
(b) For representative stocks: short—12% Treasury 1995; medium—12% Exchequer 1998; long—9% Treasury 2008; index-linked—2 1/2% Treasury Index-Linked 2024 (5% inflation assumed).

Table E
Average daily money-market statistics
£ millions; *not seasonally adjusted*
Increases in the market's cash (+)

	1990 June	July	Aug.	Sept.
Average daily figures				
Influences (excluding maturing assistance)	+ 110	- 60	+ 20	+ 90
Maturing assistance (a)	- 760	- 800	- 960	- 760
Surplus (+)/shortage (-) before daily operations	- 650	- 860	- 940	- 680
End-period levels				
Stock of assistance	4,320	6,150	6,230	4,910
Treasury bills outstanding (b)	12,180	12,220	12,450	13,080

(a) Including net issuance of Treasury bills and the level of bankers' balances above or below target from the previous day.
(b) Other than those held outright by the Bank, Bank customers and government accounts but including those purchased by the Bank on a repurchase basis.

Short-term interest rates in London



downward pressure in rates caused the Bank to resume a tighter day-to-day posture in its market management operations, at times inviting offers of bills of band 1 maturity only, or leaving relief of the market shortage until late in the day.

The period high of sterling came around 23 August, when the oil price breached $30 a barrel. Sterling reached $1.9590, its highest level against the dollar for 8½ years, and on 29 August touched DM 3.0335, where it had last been in October 1989. Thereafter, the pound lost some of its petro-currency support as Gulf tensions eased and as higher rates abroad eroded some of its interest rate advantage. These influences continued into early September when profit-taking and rumours that sterling might enter the ERM at a parity rate below DM 3.00 led to further softening, despite the rising oil price.

Early September saw a significant softening of money-market rates as evidence of economic slowdown accumulated. Concerns about the economy moving into recession led to calls for interest rate cuts from several quarters, including the CBI. Smaller daily shortages in the money markets in September also contributed to the softer tone (Table E), and the twelve-month interbank rate fell to 14 5/16%, its lowest since November 1989. On 6 September the Bank conducted 2.30 pm lending at 15% for 7 days, reinforcing the message in public statements by the Chancellor that the policy stance would remain firm. Market rates firmed in consequence and by the end of September the money and gilt-edged markets were generally calm and steady, the official messages that policy was not to be eased having been accepted.

Throughout September sterling was particularly sensitive to any suggestion that ERM entry might be delayed, and its low of the month of DM 2.9037 (21 September) was in response to confusion over official comments which were misinterpreted as implying delay to sterling's entry. By the end of the month belief that membership was less distant and a boost from the better than expected August trade figures had helped sterling to recover ground.

Sterling ended the quarter 1.7% higher in effective terms than its level at the beginning, while at its peak it had been nearly 6% above its end-June point. This was despite oil prices at the end of September hovering around $40 per barrel—the petro-support which sterling received in early August had faded by the end of September. Over the third quarter as a whole, three-month money-market rates moved within a narrow range between 15% and 14 13/16%: the downward slope of the interbank interest rate curve already indicated an expectation that the next movement in rates would be downward, although not imminent.

Despite the various market pressures over the quarter, the gilt-edged market generally traded quietly in a narrow range. Short-term gilt yields rose by only 3/32 of a percentage point between beginning and end-quarter, while long-term yields rose by 3/8 of a percentage point, leaving the yield curve slightly flatter overall, but less so than its mid-August shape. Yields on index-linked gilts softened in the immediate aftermath of the invasion of Kuwait as expectation of higher rates of inflation worldwide boosted demand for stock. However, the market soon settled and remained relatively quiet for the remainder of the quarter. During the third quarter gross official sales of gilt-edged stock were negligible but, including redemptions, there were net official purchases of £0.9 billion (Table F). There were no new issues of stock and official operations were, as previously, directed towards day-to-day market management.

Money-market rates remained generally calm and steady until the announcement on 5 October that the United Kingdom would enter the ERM on 8 October. The simultaneous reduction in the general level of interest rates was effected by announcing on 5 October that a Minimum Lending Rate[1] (MLR) of 14% would apply on 8 October. The announcement was immediately followed by similar reductions in bank base rates. In the immediate aftermath of this announcement of entry, however, money-market rates fell to an extent that indicated expectations of further cuts in official rates. The Bank accordingly acted on 8 October to reinforce the 14% level of rates, by lending at 2.30 pm to the discount houses at MLR.

Since then, the Bank has used its market operations to underline the message that policy is to remain tight, on several occasions relieving the market shortage later in the day or inviting offers of bills of band 1 maturity only, and reinforcing this further by conducting 2.30 pm lending at 14% when a clear public message has been deemed necessary.

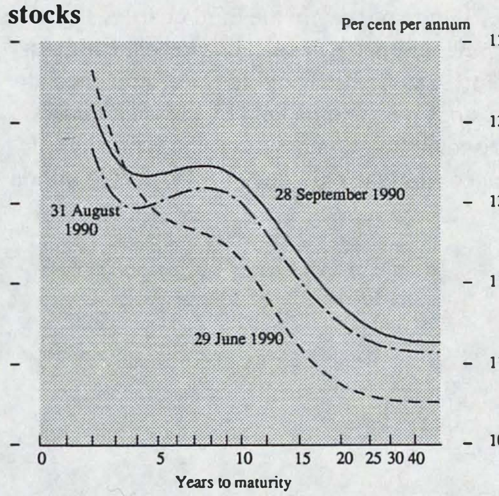
Table F
Official transactions in gilt-edged stocks
£ billions; *not seasonally adjusted*

	1989 Q3	Q4	1990 Q1	Q2	Q3
Gross official sales(a)	-1.2	-1.0	-0.6	+0.2	+0.1
less					
Redemptions and net official purchases of stock within a year of maturity	-3.1	-0.8	-3.4	-1.2	-1.0
Equals net official sales(b)	-4.3	-1.8	-4.1	-0.9	-0.9
of which, net purchases by:					
Banks (b)	*-0.8*	*-0.5*	*-1.3*	*-0.1*	*-0.3*
Building societies	*-0.9*	*+0.1*	*-0.5*	*-0.2*	*-0.2*
Overseas sector	*+0.6*	*-1.1*	*-1.5*	*-0.8*	*-0.6*
M4 private sector	*-3.2*	*-0.3*	*-0.8*	*+0.2*	*+0.2*

(a) Gross official sales of gilt-edged stocks are defined as net official sales of stock with over one year to maturity apart from transactions under purchase and resale agreements.

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

Time/yield curves of British government stocks



Official reserves

The level of reserves was virtually unchanged over the third quarter, at $39 billion (Table G). The moderate underlying rise in August associated with market demand for sterling in the aftermath of the Iraqi invasion was more than offset by the underlying fall at the end of the quarter and the reduction in the valuation of gold and dollars (in ECU terms) arising from the quarterly rollover of the European Monetary Co-operation Fund swap.

Table G
Changes in UK official reserves
$ millions

	1990 June	July	Aug.	Sept.
Changes in reserves	**+80**	**- 172**	**+ 455**	**- 237**
of which:				
Net borrowing (+)/payment (-) of public debt	-35	- 79	+ 89	+ 107
Valuation change on rollover of EMCF swap	—	- 266	—	—
Underlying changes in reserves	+115	+ 173	+ 366	- 344
Level of reserves (end of period)	**39,014**	**38,842**	**39,297**	**39,060**

ECU Treasury bills

The amount of ECU Treasury bills outstanding in the market has risen from ECU 3,400 million at the end of the second quarter to ECU 3,600 million at end-September. At each of the three latest tenders, on 14 August, 11 September and 9 October, the Bank allotted to the market ECU 400 million of the six-month bills and ECU 300 million of both one-month and three-month bills.

On average these tenders were covered 2.9 times, with three-month maturity bills continuing to attract the highest level of cover. The margin by which the average accepted yields has been below the bid

(1) The last occasion on which a Minimum Lending Rate was posted was on 14 January 1985.

Table H
Conversions of gilt-edged stock
Amounts of stock are quoted in £ million nominal

	Stock to be converted from				Stock to be converted into			
		Amounts outstanding				Amounts outstanding		
Date of conversion		before conversion	after conversion	Percentage of stock converted		before conversion	after conversion	Rate of conversion (a)
15/11/1989	9¾% Conversion 2006	702	15	98	9% Treasury 2008	1,800	2,521	£105.00
22/1/1990	12% Exchequer 1999–2002	1,265	105	92	12% Exchequer 1998	2,500	3,659	£99.90
10/2/1990	9¾% Conversion 2001	802	35	96	10% Treasury 2001	1,050	1,806	£98.55
11/4/1990	10% Conversion 2002	591	21	96	9¾% Treasury 2002	1,450	2,030	£101.80
19/5/1990	9% Exchequer 2002	1,190	89	93	9¾% Treasury 2002	2,030	3,071	£94.55
28/7/1990	8½% Treasury 2000	1,200	109	91	9% Conversion 2000	1,554	2,609	£96.70
20/9/1990	10½% Exchequer 2005	1,050	23	98	9½% Conversion 2005	1,881	2,992	£108.25

(a) The nominal amount received of the stock being converted into per £100 nominal of the stock from which the conversion is being made.

rate for ECU-denominated bank deposits remained at around ⅜% for three and six-month maturities and widened slightly to 3⁄16% for the one-month maturity.

Daily turnover by market makers in the third quarter averaged ECU 160 million, down from ECU 240 million in the previous quarter.

Gilt-edged conversions

There were two offers to convert holdings of gilt-edged stocks during the third quarter, with over 90% of the original holdings being converted in each case (Table H). Since the series of conversions began in October 1989, seven such offers had been made by end-September.

Bill turnover

Transactions in eligible bills by discount houses,(1) including sales to the Bank, averaged £1.7 billion per day in the third quarter, slightly below the level in the previous quarter, which had been the highest since reporting started in 1988. Treasury bill turnover remained at £260 million, while the stock outstanding held by discount houses fell back somewhat. Discount house transactions in certificates of deposit were little changed from the previous quarter, at £0.6 billion daily.

(1) Figures for discount houses cover only those money-market dealing counterparties which are authorised under the Banking Act 1987.