Operation of monetary policy

This article covers the period from January to 10 April 1992.

Introduction

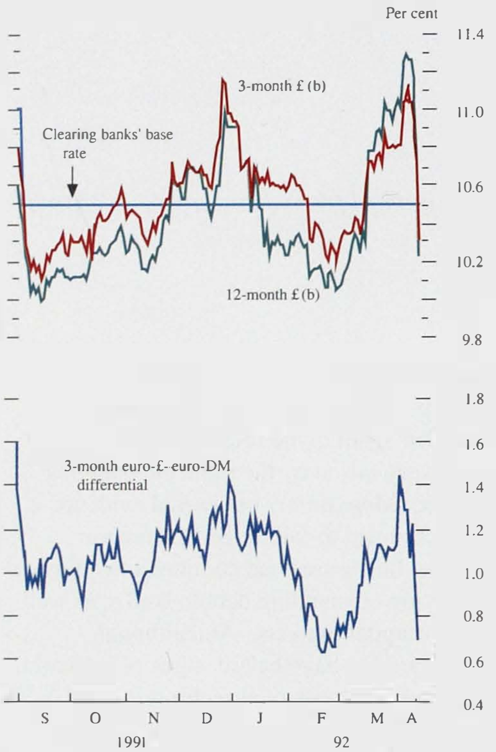
Monetary policy was conducted against a background of considerable economic and political uncertainty. It became apparent that output had fallen again in the fourth quarter, disappointing hopes of recovery raised by the more encouraging indicators in the late summer. More timely but partial evidence suggested that output had continued to fall in the first quarter. Monetary data confirmed that businesses had continued to adjust to weaker demand, again repaying outstanding debt to banks, as well as reducing their recourse to capital markets. And although consumer retrenchment appeared to have halted, signs of increased spending were tentative at best. The personal sector remained highly indebted, with its net debt to banks and building societies almost as great as ever in relation to disposable income. This, along with uncertain employment prospects, deterred expenditure. Uncertainty before the general election over future disposable income and capital allowances may have further deterred spending decisions by consumers and businesses. But that obstacle to expenditure has now been removed.

Rising unemployment and weak demand continued to constrain wage and cost pressures but headline measures of inflation generally showed little further decline during the quarter. Further progress was needed, particularly in non-traded sectors, before UK inflation could converge on the best performance of our ERM partners.

Market uncertainty centred on the Budget and the general election. Changing views over the likely course of fiscal and monetary policy precipitated sharp movements in gilt-edged and money markets as well as in the equity market. By contrast, sterling was relatively stable, gaining support close to its lower wide band limit. It had weakened within the ERM after the rise in interest rates in all other ERM countries in December and, because of domestic uncertainties, failed to benefit as it might have done during the quarter from the dollar's appreciation and the deutschmark's general weakening. With sterling close to its lower limit, a further reduction of UK interest rates, even if justified by the prolongation of the recession, would have risked sterling's position in the ERM and might have had to be reversed at short notice.

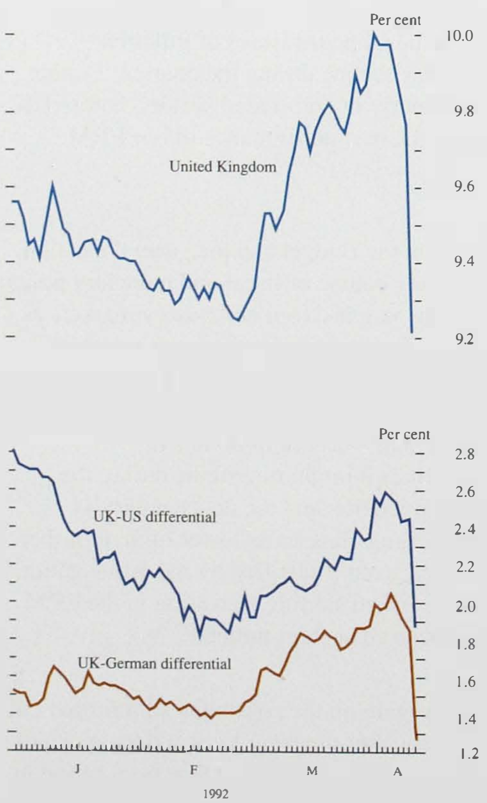
The money market focussed again on the possibility of a further cut in official interest rates shortly after the New Year and for much of the quarter thereafter. Expectations of a cut had first been raised in September after the reduction of base lending rates to $10\frac{1}{2}\%$ but had fallen back after sterling's weakening in November and the interest rate rises in other ERM countries in December.

Short-term interest rates (a)



(a) Middle-market rates at close of business.
(b) In the London interbank market.

Benchmark 10-year government bond yields (a)



(a) Gross redemption yield.

The Bank maintained money-market dealing rates in line with prevailing base lending rates of $10^1/_2\%$ throughout the quarter. In its daily operations it did not feel it necessary to discourage the downward movement in period market rates when it occurred, which reflected the market's view that interest rates could be reduced without endangering sterling's position in the ERM. On the other hand a rise in interest rates was undesirable on domestic grounds. When, at the beginning and end of the quarter, there was upward pressure on market rates, the Bank was able to reduce this as sterling found market support around its lower limit.

The PSBR announced in the Budget for 1991/92 was higher than forecast in the Autumn Statement, largely reflecting the unexpected length of the recession. Despite the higher funding requirement for 1991/92 which was announced in the Budget, gilt sales made between January and March were more than sufficient to ensure that the funding requirement was met. The scale of the funding requirement for the fiscal year 1992/93 was larger than had been previously implied by the Autumn Statement PSBR forecast and resulted in a sharp adjustment in gilt yields, which continued during the election campaign. However, immediately after the election, the market rallied strongly, along with equities, and nearly £5 billion of funding for the current financial year had been secured by 10 April.

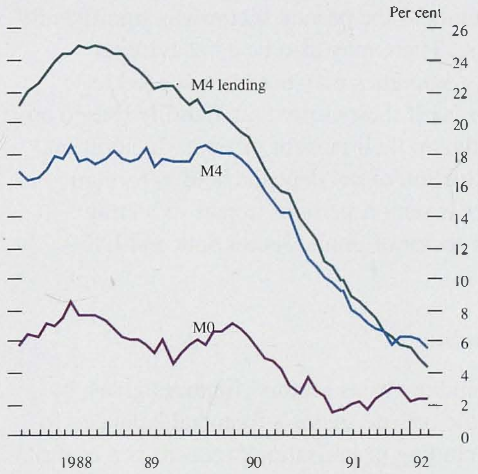
Overseas market developments

The dollar quickly reversed its December loss against the deutschmark in the New Year as it appeared unlikely that the German-US short-term interest rate differential would widen further: in the United States there were signs that the pace of recovery might be quickening while in Germany, the more moderate tone of wage negotiations suggested that rates had probably peaked. Furthermore, forecasts of German growth were reduced during the quarter and data showed German GNP to have fallen for two consecutive quarters. However, expectations of a cut in German official rates were deferred as monetary growth in Germany continued above its target range during the quarter and wage claims remained high.

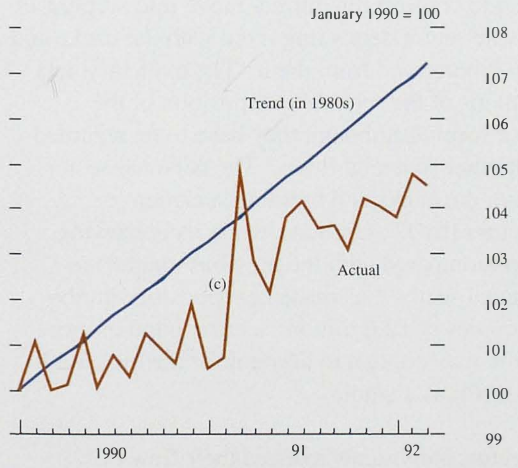
US government bond yields fell sharply after the discount rate cut in December, the 10-year yield to below 7%. But the fiscal package presented in January and evidence of stronger economic recovery caused inflation expectations and yields to rise during the quarter. In Germany, the yield curve became further inverted after the increase in Lombard and discount rates in December and the 10-year yield fell below 8%. But, as the expected fall in inflation and reduction of interest rates were deferred during the quarter, yields rose again.

The peseta remained the strongest currency in the ERM reflecting its high yield: 3-month euro-peseta rates were around 2% above euro-sterling rates and 3% above euro-deutschmark rates during the quarter. The official 10-day repo rate was reduced by 25 basis points on 25 February to ease upward pressure on the peseta; but it moved only a little from its limit after the cut, indicating the extent to which the constraint of the wide band limited its strength. The Portuguese escudo's entry into the ERM on 6 April caused little disturbance and, although it rose towards the top of the wide band, it did not replace the peseta.

Twelve-month growth rates of M0, M4 and M4 lending



Notes and coin velocity: (a) **trend and actual** (b)



(a) Ratio of the value of retail sales to notes and coin.
(b) The slope of these lines represents the growth of notes and coin velocity.
(c) Affected by prospective VAT changes, March 1991.

Monetary aggregates and credit

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

In the first quarter of 1992, growth in the main monetary and credit aggregates fell further. This slowdown appears to reflect depressed expenditure by the corporate and personal sectors, accentuated perhaps by uncertainty prior to the general election.

Components of money

After a weak recovery during the autumn, the level of narrow money had hardly changed since November. The modest growth of notes and coin during the first quarter (1.7% at an annualised rate) largely represented an unwinding of the erratically low December outturn. The narrow money data are broadly in line with the available expenditure figures on the personal sector—the value of retail sales grew by 0.8% over the quarter.

In fact, as shown in the chart opposite, the growth rate of expenditure, measured by retail sales, in relation to notes and coin has been below its long-run trend. This may reflect especially weak growth of spending on less essential items (such as consumer durables) which are less likely to be bought with cash.

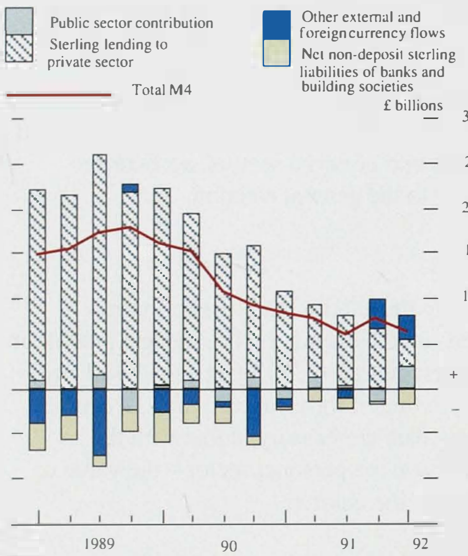
The fall in the twelve-month growth of M2 (to 6.7%) in the first quarter was possibly accentuated by the effect of TESSAs and other special factors; growth of M2 in early 1991 was particularly strong, as persons switched into TESSAs (within M2) from accounts outside M2. This has now fallen out of the twelve-month growth rate, because the effect of persons switching further funds into TESSAs in early 1992 was almost certainly lower. Retail M4 has not been materially affected by the introduction of TESSAs; its twelve-month growth rate continued to decline.

The growth of wholesale M4 has varied much more than that of retail M4 because most of the banks' and building societies' marginal funding takes a wholesale form. As the growth of their balance sheets has slowed over the past three years, they have had less need to bid for funds and wholesale M4 has decelerated very markedly. Its twelve-month growth rate is now well below that of retail M4. When M4 as a whole grew a little faster in the fourth quarter of last year, wholesale M4 accelerated much more and, in the first quarter, when M4 slowed, wholesale M4 slowed much more.

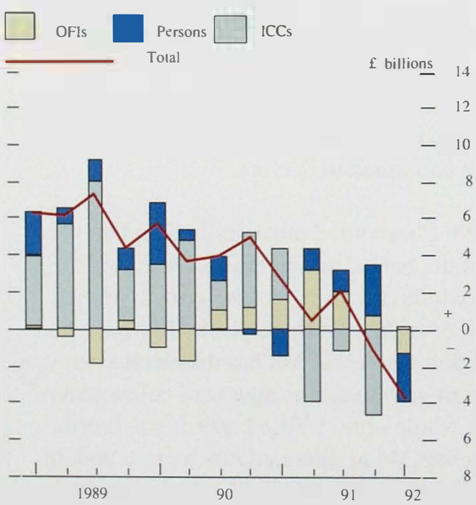
Public sector and external counterparts

In the first quarter, the (seasonally adjusted) PSBR rose to £6.4 billion, or £7.6 billion excluding privatisation proceeds, taking the borrowing requirement to £13.9 billion for the 1991/92 financial year as a whole. In the first quarter, £1.7 billion of the PSBR was financed by net sales of government debt to the domestic private sector and £2.1 billion was financed in foreign currency and from abroad. This left £2.3 billion to be borrowed net from the banks and building societies (the public sector's 'contribution to the growth of M4'). Net redemptions of Treasury bills (£0.3 billion) from the domestic non-monetary and overseas sectors account for the difference between this and an underfund (seasonally adjusted) of £2.0 billion, which took the total for the financial year to an

Counterparts to changes in M4



Private sector net sterling borrowing from banks and building societies (a)



(a) Changes in the stock of borrowing less the change in the stock of deposits. Net borrowing is positive, net additions to deposits are negative.

overfund of £0.2 billion. The policy aim of fully-funding over the year as a whole was thus achieved.

The expansionary public sector contribution partly explains in an accounting sense why lending to the private sector was significantly lower than deposit inflows. There may also be a behavioural connection; for example, companies may not have needed to borrow to pay corporation tax if their current tax liability (based on past profits) was low relative to their current income. In addition, there was a substantial reduction of net deposits held in foreign currency and by the overseas sector, perhaps in part reflecting purchases by the overseas sector of public sector debt and UK company securities.

Sectoral deposits and lending

Knowledge of the public and overseas sectors' finances gives, by residual, an indication of the private sector's financial balance. In this context, the PSBR excluding privatisation proceeds is a useful measure of the public sector's finances. This measure increased by approximately £2½ billion in the first quarter of 1992 over the last quarter of 1991. Quarter-on-quarter, the current account deficit deteriorated by about £1½ billion. These movements suggest that the (net) financial surplus of the private sector increased a little further in the first quarter.(1)

The monetary data tend to confirm this further move into surplus, in that they show the private sector depositing more with the banks and building societies than it borrowed from them. The monetary data also offer some indications of the sectoral composition of the increased private sector surplus, although they have to be regarded in the wider context of other financial flows. The personal sector built up its deposits with the banks and building societies substantially in the quarter (by £7.3 billion), while its borrowing flows fell by £1 billion (compared with the previous quarter) to £4.7 billion. The personal sector thus made net deposits with the banks and building societies of £2.6 billion: a turnaround of more than £5 billion and more than enough to account for the increased surplus of the private sector as a whole.

Within the personal sector, individuals reduced their flow of borrowing by £0.6 billion, reflecting the continued weakness of the real economy, and also made greater additions to their deposits with banks and building societies. This would be consistent with a similar or slightly higher *household* saving ratio, unless funds had been switched from other assets.

Unincorporated businesses, also part of the personal sector, substantially cut their net recourse over the quarter. Their behaviour suggests continued financial adjustment in the face of the recession. This adjustment is probably less well advanced for unincorporated businesses and other small firms without access to the capital markets than is the case for larger companies which were able to recapitalise last year.

Industrial and commercial companies (ICCs) drew funds from the banks and building societies having made large net placements in the previous quarter. This may signal a slowdown in retrenchment by the company sector, as companies reduced slightly the deposits

(1) This indirect estimate is, of course, subject to the statistical balancing item being broadly unchanged between quarters.

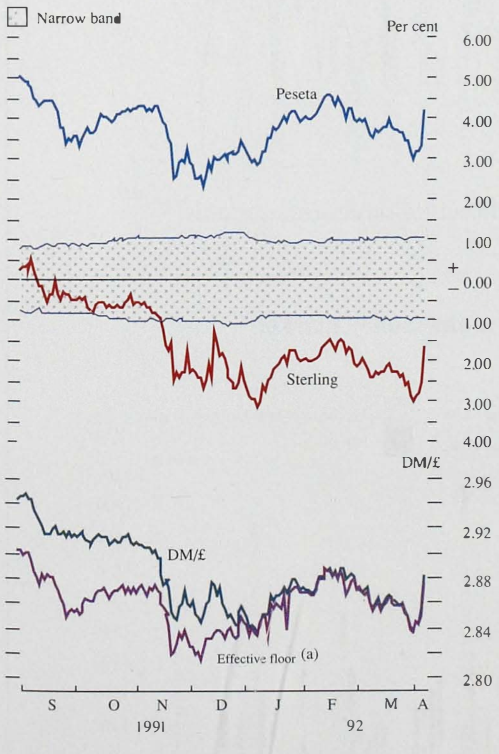
Table A
Sectoral analysis of sterling deposits with, and borrowing from, banks and building societies (a)

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

		1991				1992
		Year	Q2	Q3	Q4	Q1
	Personal sector					
1	Deposits	23.5	6.5	5.5	3.0	7.3
	of which:					
	Banks	6.1	1.5	1.5	0.1	3.0
	Building societies	17.4	4.9	4.0	2.9	4.3
2	Borrowing	27.1	7.6	6.7	5.7	4.7
	Individuals	26.8	6.9	7.1	6.1	5.5
	of which:					
	Mortgage	25.4	6.4	6.8	5.9	5.6
	Non-mortgage	1.4	0.5	0.3	0.2	-0.2
	Unincorporated businesses, etc	0.3	0.7	-0.4	-0.4	-0.8
3	**Net recourse** (=2-1)(b)	**3.6**	**1.1**	**1.2**	**2.7**	**-2.6**
	ICCs					
4	Deposits	6.3	2.6	0.5	3.6	-0.2
5	Borrowing (c)	-0.8	-1.4	-0.7	-1.0	—
6	**Net recourse** (=5-4)(b)	**-7.0**	**4.0**	**-1.2**	**-4.6**	**0.2**
	OFIs					
7	Deposits	-0.9	-1.6	-0.1	0.5	0.4
8	Borrowing (c)	6.6	1.7	1.9	1.2	-0.9
9	**Net recourse** (=8-7)(b)	**7.5**	**3.2**	**2.0**	**0.7**	**-1.3**

(a) Totals may not sum due to rounding.
(b) Excludes notes and coin.
(c) Includes Issue Department take-up of commercial bills.

ERM positions



(a) The limit implied by the need for sterling to remain within its bilateral limits with all other ERM currencies.

built up in recent quarters, which were financed through capital issues in anticipation of planned expenditures. This also partly reflected a switch back into bank intermediation, as ICCs' recourse to the capital markets fell (net sterling capital issues by ICCs at £1.9 billion, not seasonally adjusted, were £2.5 billion lower than in the previous quarter). The capital market was a less attractive source of funds as electoral factors depressed stock and bond prices and increased their volatility.

A reduction in net recourse by financial institutions reflected a repayment of borrowing rather than an increase in deposits resulting from a switch out of alternative assets. This represents the first fall in borrowing by financial institutions since the first quarter of 1977. The implications for the real economy of such repayments, which probably reflect an unwinding of some short-term borrowing, are unclear but probably slight.

Official operations in financial markets

The figures in this section are not seasonally adjusted.

Sterling began the quarter steady at around DM 2.85, but only around $^1/_2$ pfennig above its effective floor. In the money market, although the technical pressures on short rates which occurred at the end of the year had largely subsided, helped by the Bank's operations, period rates remained high reflecting concerns that sterling would come under pressure as the foreign exchange market returned to normal working after the New Year. Interest rates, although high enough to support sterling, did not put pressure on banks' base lending rates. In the event, sterling did weaken, in the absence of positive economic news, and on 13 January reached its weakest against the deutschmark since joining the ERM.

During this period in January, the Bank's money-market operations reduced upward pressure on short market rates, by relieving shortages early in the day, inviting offers of bills in all maturity bands, for future resale or for outright purchase. The money market was encouraged by the Bank's stance and the easing of pressure on sterling following the reduction of some mortgage lending rates, which was seen as helpful to the housing market and activity more generally. Sterling further benefited from the effect on the deutschmark of industrial unrest in Germany. As a result, the money market became satisfied that the existing differential with German interest rates could be sustained and it grew accustomed to sterling's position close to its lower limit.

Money-market rates therefore eased in mid-January: 6 and 12-month rates fell to below $10^1/_2$%, and the yield curve regained its downward slope. The Bank's operations became slightly less accommodating than they had been, with offers of bills in bands 3 and 4 invited less frequently, depending on the size of the shortage. This kept shorter interbank rates firm, so allowing less scope for period rates to ease rapidly with possibly adverse effects on the exchange rate.

Sterling opened above DM 2.87 on 23 January, for the first time since December, helped by the weaker deutschmark and stronger dollar, and moved away from its effective floor. This, and the announcement on 23 January of the date of the Budget, both increased the belief that a reduction of official interest rates might

The cash position of the money market

The first quarter is a large tax-gathering period, with corporation tax and large income tax payments due in January. This usually causes a drain on bankers' balances which has to be offset by official operations, and which results in a seasonal rise in the stock of money-market assistance.

The effect of the recession, however, increased public expenditure and depressed revenue to a much greater extent than envisaged in the Autumn Statement. Privatisation proceeds [(1)] of £1 billion were also lower than in the recent past. The result was two offsetting influences on the market's cash position. There was a CGBR of some £2.7 billion (compared with a debt repayment of £2.5 billion a year earlier) which resulted in a flow to the market, but this was more than offset by increased net sales of debt (excluding Treasury bills), which amounted to £4 billion. The net effect of other factors, including an underlying fall in the reserves, was a flow to the market.

Size of the Treasury bill tender, from 1990

£ millions

Period beginning	63 days	91 days	182 days	Total
End-1989	**—**	**300**	**100**	**400**
1990				
2 February	—	500	200	700
28 September	200	250	200	650
30 November	—	250	200	450
1991				
15 February	—	350	200	550
19 April	—	500	200	700
10 May	200	500	200	900
12 July	—	500	200	700
2 August	—	300	200	500
6 September	—	300	100	400
1992				
14 February	—	500	100	600

As a result, on average there was a small net flow to the money market of around £9 million per day. More than offsetting this, however, was the amount of maturing assistance, which contributed to daily shortages which averaged £1.1 billion.

As a result of the concentration of tax payments early in the quarter, the stock of assistance rose rapidly to a peak of £11.7 billion on 7 February, when the daily shortage itself peaked at £2.7 billion. The Bank therefore continued to invite bills in the longer maturity bands 3 and 4 on days of large shortage, in order to spread maturing assistance. Thereafter, the stock of assistance declined, to £6.5 billion by the end of March, helped by a record CGBR of £4.7 billion. In anticipation of the usual seasonal decline in the stock of assistance, the size of the Treasury bill tender was increased to £600 million per week, on 14 February.

With the increase in the PSBR to £13.9 billion from £10.8 billion forecast in the Autumn Statement and a small underlying fall in the reserves in the first quarter, the funding requirement for 1991/92 rose to £19.8 billion (taking account of £350 million overfund carried over from 1990/91). Net debt sales during the first quarter resulted in a small overfund of this requirement of £580 million. Net gilt sales of £3.1 billion were made, with purchases of £2 billion by overseas investors, while the National Savings contribution increased markedly to £1.2 billion.

In the FSBR forecast, the PSBR was projected to rise to some £28.1 billion in 1992/93. In accordance with the full fund objective, a programme of auctions will be continued, each for an amount of £2–3 billion (or more if market conditions warrant) which is likely to account for more than half of the gilt funding requirement. By 10 April, a significant part of that requirement had already been met.

Chart 1
Daily shortages in the money market

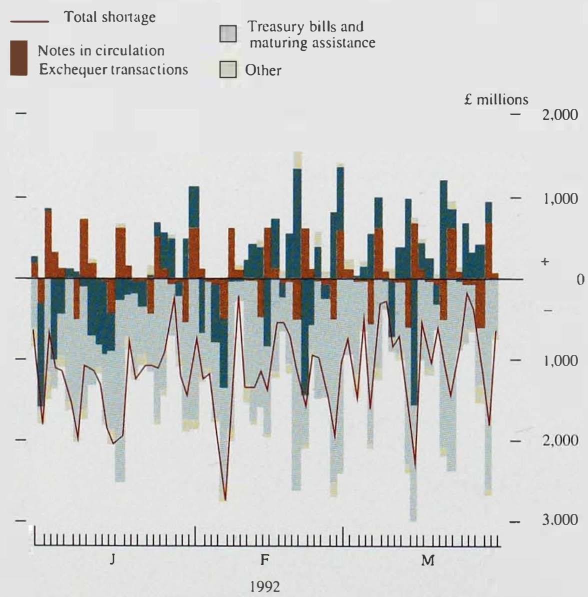
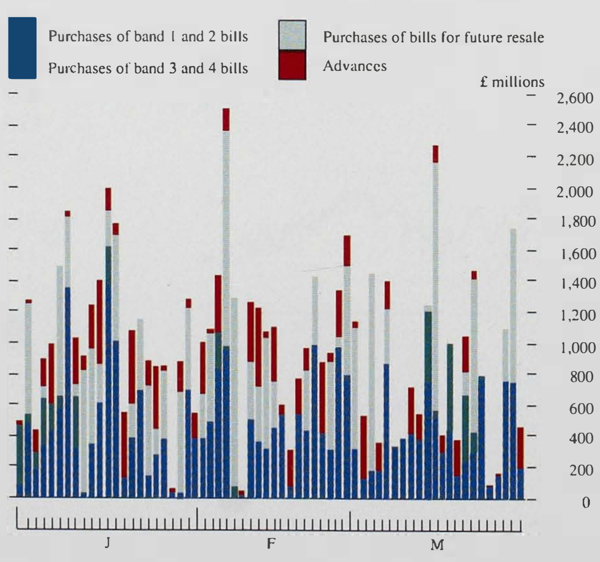


Chart 2
Daily assistance to the money market



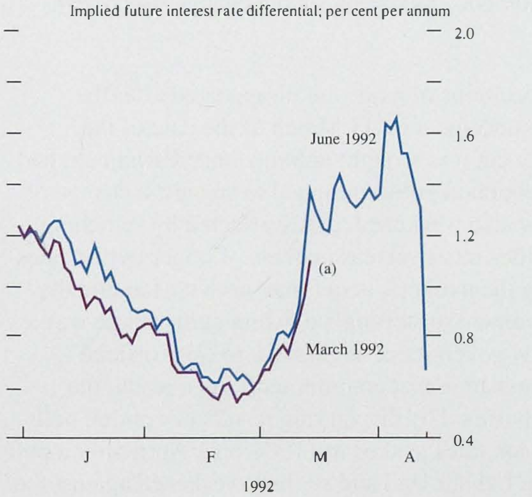
(1) Principally some £800 million in February from the second instalment of the privatisation of National Power and PowerGen.

Table B
Sterling interest rates, gilt yields and exchange rates; selected dates (a)

Date, 1992	Interbank interest rates (b) (per cent per annum)				Gilt yields (c) (per cent per annum) Conventionals			Index-Linked	Exchange rates		
	1 month	3 months	6 months	12 months	Short	Medium	Long	Long	ERI	$/£	DM/£
2 January	10 11/16	10 13/16	10 13/16	10 13/16	9.88	9.56	9.32	4.38	91.6	1.8740	2.8513
13 January	10 21/32	10 11/16	10 5/8	10 5/8	9.82	9.60	9.34	4.30	90.2	1.7980	2.8351
31 January	10 23/32	10 21/32	10 7/16	10 5/16	9.56	9.40	9.18	4.26	90.9	1.7925	2.8779
19 February	10 5/16	10 3/16	10 1/8	10 1/16	9.40	9.33	9.13	4.26	90.7	1.7557	2.8846
26 February	10 3/8	10 1/4	10 5/32	10 1/16	9.34	9.25	9.07	4.26	90.6	1.7450	2.8854
10 March	10 1/2	10 13/32	10 3/8	10 5/16	9.61	9.54	9.33	4.33	90.1	1.7187	2.8697
1 April	10 3/4	11 1/8	11 9/32	11 5/16	10.25	10.00	9.72	4.56	90.0	1.7245	2.8515
10 April	10 9/16	10 11/32	10 1/4	10 7/32	9.43	9.22	9.06	4.46	91.2	1.7725	2.8803

(a) Close of business rates in London.
(b) Middle-market rates.
(c) For representative stocks: short—10 1/2% Exchequer 1997; medium—9¾% Treasury 2002; long - 9% Treasury 2008; index-linked—2½% Index-Linked Treasury 2024 (5% inflation assumed).

Three-month sterling and euro-deutschmark futures contracts



(a) The March contracts expired on 18 March.

be possible and focussed attention on the timing, possibly to coincide with the Budget on 10 March. However, markets recognised that a cut would depend on sterling's position in the ERM and that, under these circumstances, it would probably depend on a prior reduction of German rates. Therefore, when data were released showing German money supply growth in December above its target range, the expected timing of a German rate cut was deferred and the decline in domestic 6 and 12-month rates halted and indeed partially reversed. Although sterling gained against the deutschmark, money-market expectations of a reduction in UK interest rates were further set back by the German steelworkers' pay settlement at the beginning of February, which suggested that German rates would stay high for longer.

As sterling had continued to strengthen during this period, the Bank was content for longer market rates to ease. The scope for shorter rates to decline had, however, been limited by large daily shortages. On 7 February the Bank invited offers of bills in all four maturity bands for the first time since 20 January, as well as a repo, as the shortage was forecast to be £2,300 million (heavy customs receipts coincided with the usual increase in the note issue and more than £1,000 million of maturing assistance). A substantial amount of bills was offered by the market in the early round which was accepted in full. In line with market rates, the Bank also established new lower dealing rates in the small quantity of bands 3 and 4 bills which were offered. The market was encouraged by its ability to handle such a sizable shortage. Weekend press comment on the operations, and comment on similar operations on 10 February, sparked some belief that a cut in rates and narrowing of the differential with German rates might be possible before the Budget without harming sterling. As a result, 3-month rates fell below 10½% on 10 February, for the first time since November.

Sterling was weakened by the decline in rates and failed to benefit from the stronger dollar as opinion polls cast uncertainty over the outcome of the election and therefore over future monetary and fiscal policy. As a result the Bank adopted a strictly neutral stance, operating in bands 1 and 2 bills. Rates steadied, but began to fall again as sterling benefited once more from the generally weaker deutschmark. Three-month interbank rates fell below 10¼% as sterling rose through DM 2.88. But, as the peseta also benefited from the weaker deutschmark, the wide band remained stretched and speculation about a possible cut in rates prevented sterling from rising off its floor. During this period, the Bank in its operations sought not to discourage expectations of a rate cut but equally did not signal that the authorities were yet ready to contemplate a cut, particularly as sterling opened sharply lower against the deutschmark on 21 February after an opinion poll had indicated that a change of government was likely after the election. The money market was also disappointed that day, when bills were invited for resale at a date after the Budget, even though this did not in itself preclude a cut on or before Budget day. The money market then came to expect a cut to coincide with the Budget, believing that opportunities to cut had already arisen but had not been taken. The Spanish 10-day repo rate was reduced by 25 basis points on 25 February creating some expectation of a cut in UK rates. The Bank signalled early in the day that its dealing rates would be unchanged. Three-month interbank rates fell briefly below $10^1/_4$% again but rose thereafter, firmed by tighter short dates. Money-market rates rose early in March when sterling lost ground as opinion polls continued to raise the possibility of a change of government; it fell back through DM 2.87 on 5 March, affected by rumours of an opinion poll suggesting such a change was likely.

Money-market expectations of a rate cut disappeared after the Budget and the announcement on 11 March of the date of the general election, as a cut was thought unlikely once Parliament had been dissolved. As opinion polls continued to suggest a change of government, sterling also weakened, partly affected by switching out of gilts and equities into overseas markets. Longer-period rates rose most, reflecting the market's belief that, notwithstanding the main parties' commitment to sterling's existing parity, there was a possibility that a new government might have to raise official interest rates to demonstrate that commitment. As a result, the money market was buffeted by the varying results of opinion polls. Three-month interbank rates peaked at $11^1/_8$% on 1 April after a poll showed a significant Labour lead and sterling weakened against the deutschmark.

Throughout the campaign period, daily money-market shortages were smaller on average than earlier in the year, and this helped to keep short-term market rates low. By relieving as much of the shortages as possible early in the day, the Bank further sought to minimise upwards pressure on rates. Sterling was relatively stable during the campaign, helped by market support close to its limit against the peseta: as it lost ground against the deutschmark, the peseta also moved with it. However, as opinion polls in the final days before the election showed a late swing towards the government, whose commitment to sterling's parity was thought by the markets to be less in need of demonstration, it gained against the deutschmark.

The election result was unexpected and, as it became clear, sterling rallied strongly, buoyed by heavy overseas demand for gilts and equities; it moved sharply away from its lower limit against the peseta and appreciated strongly against the deutschmark. This rise indicated the extent to which it had previously been depressed by political uncertainties. Three-month interbank rates largely mirrored sterling's movements, easing to $10^{25}/_{32}$% by the close on polling day, and shedding nearly $^1/_2$% to $10^{11}/_{32}$% by close on 10 April.

Table C
Official transactions in gilt-edged stocks

£ billion: *not seasonally adjusted*

	1991	1992		
	Apr.–Dec.	Jan.	Feb.	Mar.
Gross official sales (+) (a)	+12.6	+1.6	+2.7	+1.1
Redemptions and net official purchases of stock within a year of maturity (-)	-3.8	-0.6	-1.0	-0.7
Net official sales (b)	+8.8	+1.0	+1.7	+0.4
of which, net purchases by:				
Non-funding sector	*+0.3*	*+0.3*	*+0.3*	—
Banks (b)	*+0.5*	*+0.4*	*+0.3*	*-0.2*
Building societies	*-0.2*	—	—	*+0.1*
Funding sector	*+8.5*	*+0.7*	*+1.4*	*+0.4*
Overseas sector	*+3.9*	*+0.3*	*+0.9*	*+0.8*
M4 private sector	*+4.6*	*+0.3*	*+0.5*	*-0.4*

(a) Gross official sales of gilt-edged stocks are defined as official sales of stock with over one year to maturity net of official purchases 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.

Table D
Issues of gilt-edged stock

Stock	Amount issued (£ million)	Date announced	Date issued	Method of issue	Price at issue (per £100 stock)	Details of payment	Yield(a) at issue	Yield(a) when exhausted	Date exhausted
10¼% Exchequer 1995	150	24/1/92	24/1/92	To CRND					
2½% Index-Linked Treasury 2009	150	24/1/92	24/1/92	To Bank	131.3125	In full	4.28 (b)	4.58 (b)	10/4/92
2½% Index-Linked Treasury 2001	150	24/1/92	24/1/92	To Bank	145.8125	In full	4.21 (b)	4.22 (b)	7/2/92
9¾% Treasury 2002 'C'	1,800	21/1/92	30/1/92	Auction	102.09375 (c)	Part paid (d)	9.43 (e)	9.43	30/1/92
9½% Conversion 2005	250	4/2/92	4/2/92	To Bank	101.4375	In full	9.30	9.29	5/2/92
12¼% Exchequer 1999	150	4/2/92	4/2/92	To Bank	113.4375	In full	9.62	9.60	5/2/92
9½% Treasury 1999	100	4/2/92	4/2/92	To CRND					
9½% Treasury 1999	150	4/2/92	4/2/92	To Bank	101.0	In full	9.30	9.27	5/2/92
9% Treasury 2012	1,500 (f)	7/2/92	7/2/92	To Bank	99.25	Part paid (g)	9.08	9.05	27/2/92
9½% Conversion 2005	100	9/3/92	9/3/92	To Bank	100.625	In full	9.41	9.41	10/3/92
9% Conversion 2000	200	9/3/92	9/3/92	To Bank	97.875	In full	9.38	9.68	18/3/92
9¾% Exchequer 1998	100	9/3/92	9/3/92	To CRND					
9¾% Exchequer 1998	100	9/3/92	9/3/92	To Bank	100.6875	In full	9.58	9.57	10/3/92
8½% Treasury 1994	100	9/3/92	9/3/92	To CRND					
8½% Treasury 1994	100	9/3/92	9/3/92	To Bank	98.25	In full	9.51	9.51	10/3/92
9% Conversion 2011	200	10/4/92	10/4/92	To Bank	98.125	In full	9.21	9.18	10/4/92
8% Treasury 2009	200	10/4/92	10/4/92	To Bank	88.375	In full	9.36	9.35	10/4/92
8½% Treasury 2007	200	10/4/92	10/4/92	To Bank	92.75	In full	9.40	9.39	10/4/92
9½% Conversion 2005	200	10/4/92	10/4/92	To Bank	101.375	In full	9.31	9.30	10/4/92
9¾% Treasury 2002	200	10/4/92	10/4/92	To Bank	102.4375	In full	9.37	9.36	10/4/92
9% Conversion 2000	200	10/4/92	10/4/92	To Bank	97.0	In full	9.54	9.52	10/4/92
10½% Exchequer 1997	200	10/4/92	10/4/92	To Bank	103.625	In full	9.54	9.52	10/4/92
10½% Exchequer 1997	200	10/4/92	10/4/92	To Bank	102.8125	In full	9.75	9.75	10/4/92

(a) Gross redemption yield, per cent.
(b) Real rate of return, assuming 5% inflation.
(c) Lowest accepted price for competitive bids. The non-competitive allotment price was £102.15625%.
(d) For lowest accepted price for competitive bids, £27.09375% payable at issue, £40% on 24/2, and £35% on 26/3.
(e) Yield at lowest accepted price for competitive bids.
(f) Including £250 million reserved for the CRND.
(g) With £50% payable at issue, and £49.25% on 13/4.

Table E
Redemptions of gilt-edged stock

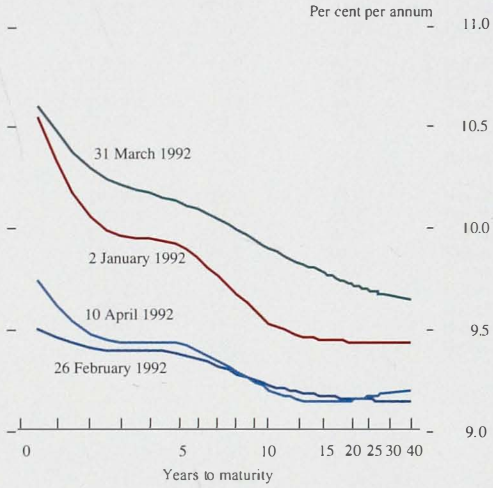
Stock	Date redeemed	Nominal amount outstanding at redemption (£ million)	Amount paid out (£ million)
12¾% Treasury 1992	22/1/92	775	775
10% Treasury 1992	21/2/92	1,600	1,600
2% Index-Linked Treasury 1992	23/3/92	650	889

The aim of gilt-edged operations in the first quarter, on the basis of net official sales to the funding sector of £8½ billion in the first nine months of the fiscal year, was to meet the 1991/92 funding requirement in full and then to anticipate some of the larger requirement for 1992/93.

The gilt-edged market rallied strongly in January, reflecting the attractiveness of bonds in a domestic and international environment of weak or falling activity and subdued inflation. Overseas demand was also encouraged later in January by the removal of pressure on sterling in the ERM. The remainder of the 8½% Treasury 2007 tap, which had been placed with Issue Department on 13 December, ahead of the European rate rises, was sold out on 9 January, on the back of a rally in US and European bond markets. On 10 January, the Bank announced that an auction would be held on 29 January of a medium-dated stock: the last two auctions and the recently exhausted tap were all long-dated stocks, while the interest rate environment was not conducive to issuing short-dated stock. The reduction in mortgage lending rates announced by major building societies and sterling's strengthening led to strong demand, and medium and long yields fell to below their 1991 lows; short yields followed as money-market rates declined. Details of the auction, announced on 21 January, of £1,800 million of 9¾% Treasury 2002, this year's 10-year benchmark, were favourably received. Short positions in the auction stock established by the day of the auction were comparable to those in the previous four auctions. The auction itself was twice covered with an average yield of 9.42% and a tail of only one basis point. The (partly paid) price rose by £6/32 after the auction, following the usual pattern. Index-linked gilts were strong for much of January and a package of tranchettes including £300 million of index-linked gilts was created on 24 January.

By the end of January, and taking into account future payments on the auction stock, a full fund had been achieved on the basis of the Autumn Statement forecast of the PSBR. In February, the Bank took advantage of the continued rally to secure further funding by selling from its holdings when there was demand. On 4 February,

Time/yield curves of British government stocks (a)



(a) Calculated par gross redemption yields on British government stocks.

the market benefitted from switching away from other European bond markets and a £550 million package of tranchettes was issued. All three stocks—£150 million each of 9½% Treasury 1999 and 12¾% Exchequer 1999 and £250 million of 9½% Conversion 2005—were intended to meet specific demand, principally from overseas, and were sold out the following day. Demand for index-linked stocks enabled the 2½% Index-Linked 2001 tranchette, which had been issued on 24 January, to be exhausted on 7 February. The opportunity was also taken to create a new 20-year benchmark stock—9% Treasury Stock 2012—of which £1,250 million was placed in Issue Department and £250 million was reserved for the CRND. A long stock was preferred, since the auction had been of a medium-dated stock and a significant amount of shorts had recently been sold. Substantial sales were made before the market was held back by weakness in the US market in mid-February. By 27 February, long yields had fallen to 9.06%, their lowest since early 1989. But in the first days of March, yields rose again partly influenced by higher private sector forecasts of the PSBR for 1992/93 which was to be announced in the Budget. On 9 March, the day before the Budget, the market rallied sufficiently to enable a £500 million package of conventional stocks to be issued. Two of the stocks were exhausted in a mini-tender the following day. During the Budget Statement yields rose in reaction to the PSBR of £28 billion announced for 1992/93, which was higher than had generally been expected: 10-year yields rose by 10 basis points during the Statement. The market weakened further following the announcement of the general election because of uncertainty, reinforced by opinion polls, over future fiscal and monetary policy. Short yields were also driven higher by money-market rates. The rise was halted by bargain-hunting on 18 March and enabled the reactivation of the 9% Conversion 2000 tranchette, issued on 9 March, which was then exhausted. Yields continued to rise until the week before the general election, on 9 April, when there was some demand as polls showed a late swing to the Conservative Party.

The market stayed open on election night as did the Bank's gilt-edged dealing room, principally to monitor developments and ensure an orderly market. In the event, as the election result became clear, there was substantial demand for gilts which the Bank met, exceptionally, during the night; two packages each of £800 million of tranchettes were announced at 2.30 am and 8.15 am, both of which sold out very quickly. Including sales made on 10 April, gross official sales of some £4 billion were made in the first 10 days of April, a substantial contribution to the funding requirement for this year. Despite the substantial supply, yields fell sharply from the pre-election peak, the 10-year benchmark by nearly 80 basis points to 9.22%.