Operation of monetary policy

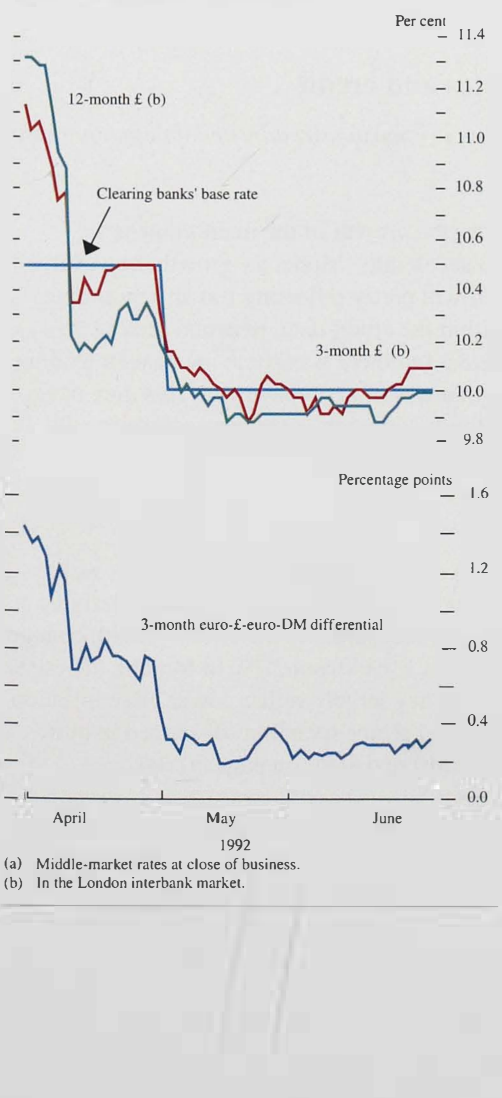
This article covers the post-election period to end-June 1992.

Introduction

Much of the uncertainty over the future course of fiscal and monetary policy which had built up ahead of the general election was removed by the result, and this was reflected in the immediate post-election behaviour of financial markets. But uncertainty still remained over the timing and strength of economic recovery.

Although measured consumer and business confidence rose in the spring, the available evidence on consumer spending and on housing market activity, including that from the monetary aggregates, suggested that any revival in demand soon after the election did little more than offset the fall which had occurred beforehand. Consumption remained depressed by falling asset values and still-high levels of debt and debt service. Although the headline rate of retail price inflation and the growth of average earnings appeared to remain stubbornly high, data on producer prices, input costs and the level of pay settlements indicated that underlying inflation was still falling. Accordingly, the case on domestic grounds for a further reduction of interest rates was clearly established and, as sterling maintained its post-election gains in the ERM, so the Bank was able to signal a further ½% reduction in short-term interest rates in early May.

Short-term interest rates (a)



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

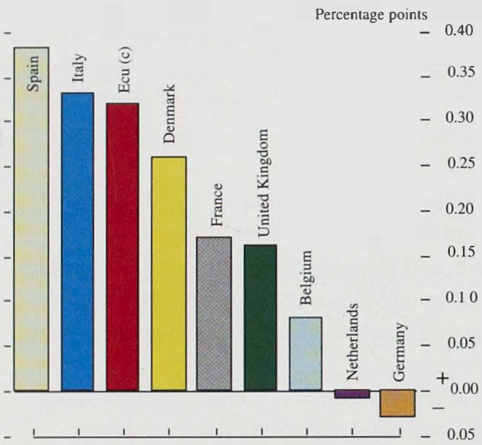
The response of the gilt-edged and money markets to the Danish electorate's unexpected rejection of the Maastricht Treaty in June was muted, in contrast to that in some other ERM countries. This demonstrated the markets' belief that the UK authorities were firmly committed to a counterinflationary policy which did not depend on any move towards monetary union. But, as longer-term prospects for a single currency became more uncertain and the deutschmark strengthened, the scope for a further narrowing of the short-term interest rate differential with Germany was reduced.

In its gilt-edged operations, the Bank took advantage of strong market conditions after the election, to make very significant inroads into the prospective funding needs for the year as a whole. Gross official sales worth £15.2 billion were secured during the quarter while conventional yields retained their downward trend and index-linked yields also fell.

The international financial environment

During the second quarter the dollar reversed its first quarter gains against the yen and the deutschmark. Its weakness against the deutschmark reflected expectations of a further reduction in US interest rates, prompted by concerns over the lack of strength of the US recovery coupled with an apparently benign inflation outlook. Furthermore, although the deutschmark was initially weakened by

Change in ten-year government bond yields (a) following the Danish referendum (b)



(a) Local market standard.
(b) Change between close of business on 2 June and 5 June.
(c) French government.

industrial unrest, rapid money supply growth well in excess of the target range reduced market expectations of an easing of German monetary policy this year and indeed strengthened expectations that there might be further tightening.

The deutschmark and closely related currencies strengthened against the rest of the ERM after the Danish rejection of the Maastricht Treaty and the announcement that a referendum would also be held in France. With doubt thus re-awakened over the EMU process, there was a sharp adjustment in bond yields in those countries for which the ERM and the Treaty's convergence criteria provided an external discipline on domestic policy. Ecu markets also suffered. Of the narrow band member countries, Italian markets moved the most as questions were raised whether the Maastricht criteria would be available to help reinforce incentives to solve existing domestic economic and political difficulties. The Banca d'Italia's advances rate was raised to defend the lira, which came under heavy selling pressure in the following weeks. French money-market rates also rose though more modestly; but the franc was relatively little moved, reflecting the priority given by the French authorities to maintaining the strong franc. Sterling and the peseta lost most against the deutschmark but, with the exchange rate able to absorb the shock, Spanish and UK short-term interest rates rose relatively little.

Monetary aggregates and credit

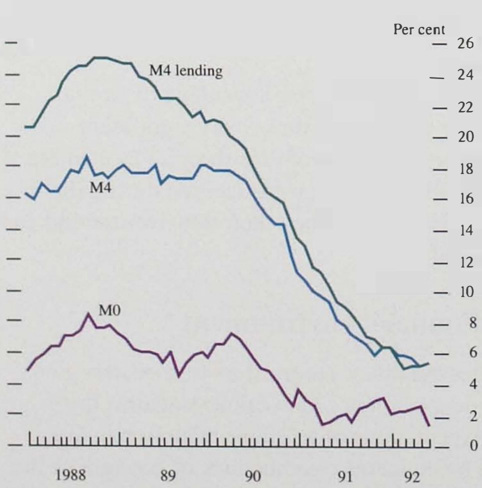
The figures in this section are seasonally adjusted unless otherwise stated.

During the second quarter the growth of the main monetary aggregates continued to decelerate. Monetary growth, however, was lower than credit growth partly reflecting (on an accounting basis) overfunding. Within the credit data, personal sector borrowing remained weak; but there was some increase in lending to corporates after four quarters of net repayment. This may have reflected investment activity, although corporate sector deposits also rose strongly.

Components of money

The twelve-month growth rate of M0 fell to 1.3% in June, well within the lower half of its 0%–4% target range. The underlying growth of narrow money, as measured by the twelve-month change in notes and coin, also fell to 1.3% (from 2.2% in March). These developments in narrow money largely reflect lower price inflation and the weakness of personal sector spending (discussed in more detail in 'The demand for M0 revisited' on page 305).

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



The annual growth rate of M2, which has been on a downward trend since the middle of last year, fell from 6.7% to 4.2% between the first and second quarters. The growth of retail M4 was also particularly weak in the second quarter at only 0.5%. Within this aggregate, banks' retail deposits fell by 0.6% (compared with 1.8% growth in the first quarter) while building societies' retail deposits grew by only 1.4% (compared with 2.2% in the previous quarter).

The weakness of growth in M2 and retail deposits may in part reflect the run-down of deposits following the impact of one-off payments (in the form of increased bonuses and dividends) received

Counterparts to changes in M4

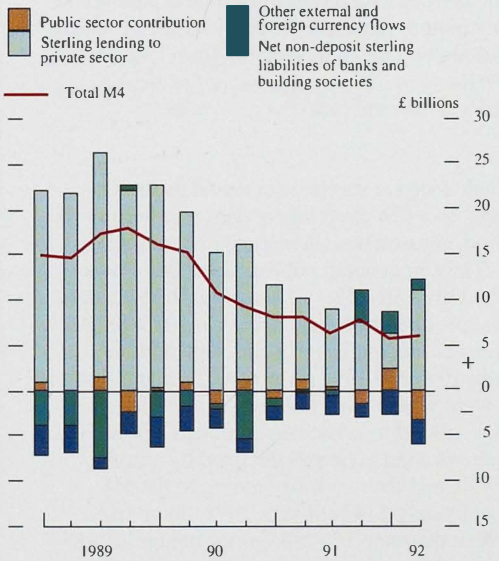


Table A
Sectoral analysis of sterling deposits with, and borrowing from, banks and building societies

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

		1991			1992	
		Year	Q3	Q4	Q1	Q2
	Personal sector					
1	Deposits	23.4	5.5	2.9	8.4	2.6
	of which:					
	Banks	6.1	1.5	0.0	4.3	0.1
	Building societies	17.4	4.0	2.9	4.1	2.5
2	Borrowing	28.5	7.1	6.1	5.8	6.2
	of which:					
	Mortgage	25.4	6.8	5.9	5.6	5.5
	Non-mortgage	2.4	0.6	0.5	0.2	0.1
	Unincorporated businesses, etc	0.6	-0.3	-0.3	0.0	0.6
3	**Net recourse** (=2-1) (a)	**5.1**	**1.6**	**3.2**	**-2.6**	**3.6**
	ICCs					
4	Deposits	6.7	0.6	3.8	-1.2	1.8
5	Borrowing (b)	1.2	-0.2	-0.5	-0.2	1.4
6	**Net recourse** (=5-4) (a)	**-5.5**	**-0.8**	**-4.3**	**1.0**	**-0.4**
	OFIs					
7	Deposits	-1.0	-0.1	0.6	-0.1	1.1
8	Borrowing (b)	6.7	1.9	1.4	-0.9	3.4
9	**Net recourse** (=8-7) (a)	**7.7**	**2.0**	**0.8**	**-0.8**	**2.3**

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

in the first quarter before the general election. Individuals may also have taken up part of the substantial increase in gilt sales over the second quarter and unit trust net sales increased slightly over this period.

M4 grew by 1.2% in the second quarter, taking the annual growth rate down to 5.2%—the lowest since the beginning of 1970. Wholesale deposits grew by 2.3%, compared with 0.1% in the previous quarter. Building societies' wholesale deposits grew by only 2.2% (compared with 5.2% in the previous quarter). Banks' wholesale deposits, however, increased by 2.3%—reflecting the need to fund the increase in lending to businesses, the majority of which tends to be by banks.

Sectoral flow of funds

The public sector remained in deficit in the second quarter, with a seasonally adjusted PSBR of £6.0 billion, compared with £6.6 billion in the previous quarter. Excluding privatisation proceeds, the PSBR increased by £0.1 billion to £7.9 billion. In the same quarter of last year the PSBR was £2.0 billion (£4.4 billion excluding privatisation proceeds).

In the second quarter, government debt sales were exceptionally large—£8.9 billion to the domestic private sector and £0.4 billion to the overseas sector. By contrast the public sector reduced its net debt with banks and building societies by £3.3 billion, having increased it by £2.4 billion in the previous quarter. This turnaround will have served, at least in an accounting sense, to depress M4 growth. If net redemptions of Treasury bills held by the private and overseas sectors of £0.6 billion are also taken into account, there was a total overfund in the second quarter of £3.9 billion.

Allowing for normal seasonal patterns, very little of the PSBR was financed by the overseas sector, and net deposits in foreign currency and from abroad fell by £1 billion in the second quarter. This may reflect higher purchases by the overseas sector of private sector securities.

The PSBR, excluding privatisation proceeds, and the current account provide a good measure of the public and overseas sectors' financial balances. The PSBR excluding privatisation proceeds increased only very slightly in the second quarter, while the current account improved by a similarly small amount. The private sector's financial balance can be calculated from these movements by residual.(1) It implies that the (net) private sector financial surplus may have remained broadly unchanged in the second quarter.

The monetary data show that net recourse to banks and building societies by the private sector was £5.5 billion. If the private sector financial balance was broadly unchanged, then the sector as a whole must have purchased a significant quantity of non-bank assets. This may be largely accounted for by the private sector's substantial purchases of gilts during the second quarter.

Industrial and commercial companies (ICCs) made net recourse of £0.4 billion. ICCs' deposits with and borrowing from banks and

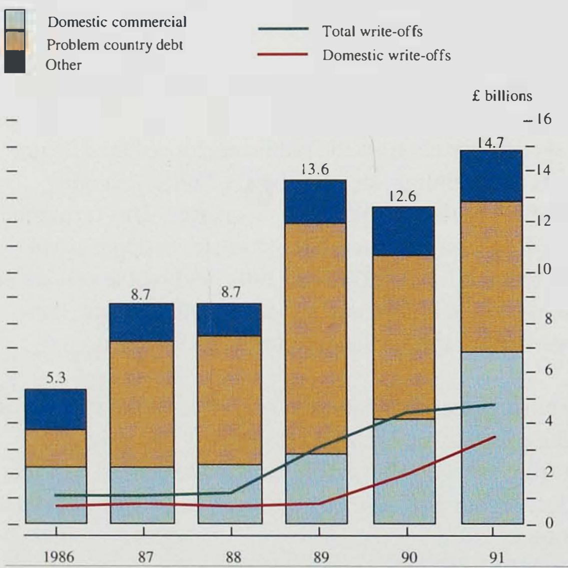
(1) This indirect estimate is subject to the statistical balancing item being broadly unchanged between quarters.

Provisions and write-offs

Like banks in other countries, banks in the United Kingdom have added substantially in recent years to their provisions against bad and doubtful debts. For example, large British banks(1) increased their stock of provisions from £5.3 billion to £14.7 billion between 1986 and 1991, or from 1.6% to 3.1% of assets. Increased provisioning has reduced profits considerably; over the five years to end-1991, pre-tax profits before provisions were £36.2 billion, reducing to £11.7 billion after provisions.

The chart illustrates this growth in provisions outstanding. The first large increases were made against loans to countries experiencing debt servicing and repayment difficulties. During 1987, large British banks increased their provisions against such problem country loans to £5.0 billion, 30.5% of exposure. There was a further substantial increase in such provisioning in 1989, bringing cover to around 60%, an overall proportion which has since been broadly maintained.

Provisions and write-offs: large British banks



More recently, large British banks have experienced a sizable increase in provisions outstanding against domestic loans; the amount has risen from £2.2 billion in 1987 (1.6% of lending) to £6.8 billion in 1991 (3.4%), with services, property and construction the worst affected sectors. Small and medium-sized companies have been especially vulnerable in the last year or so, and there have also been losses in personal lending. Smaller banks specialising in domestic lending have suffered too.

As the chart also shows, large British banks' write-offs did not immediately increase with provisioning. However, international write-offs rose from low levels to £2.2 billion in 1989 and £2.4 billion in 1990, largely owing to write-offs of problem country debt through participation in debt-reduction schemes or in the emerging secondary markets in such debt; this generally involves selling or swapping debt at a discount, with the discount being written off. Domestic write-offs increased sharply from under £1 billion a year in 1986–89 to £2.0 billion in 1990 and £3.5 billion in 1991.

Providing against loans does not affect lending statistics. Banks report their outstanding loans to the Bank of England gross of provisions, which correctly represents their continuing claims on borrowers. *Write-offs* do affect the statistics, because when banks write off debt they reduce both provisions and claims outstanding. For example, a bank will write off a domestic loan when the claim is beyond realistic prospect of recovery; similarly, where a bank swaps or transfers debt at a value below book value, the discount is treated as a write-off. In writing off debt, a bank in effect regards the claim as beyond recovery or, if the debt is sold, relinquishes the claim; the reporting treatment therefore accurately reflects banks' realistic claims.

Statistics for lending *flows* are generally derived from changes in the amounts outstanding. As these flows should measure net new lending in any period, write-offs of previous loans, which reduce the stock of lending indistinguishably from repayments, artificially depress the flow. *Write-offs (but not provisions) therefore potentially distort the statistics for lending flows.*

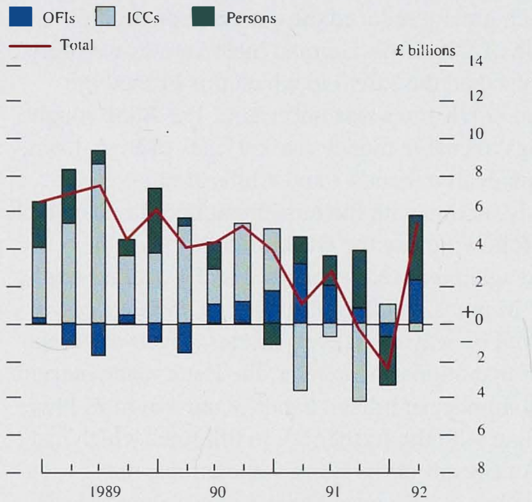
At present, the Bank does not routinely collect data on write-offs, although, in a few cases where particular write-offs have been identified, adjustments (increases) to lending flows have been made. Thus, in general, published lending flows have been depressed by write-offs. As the large British banks' write-offs suggest, this distortion was modest in 1986–88, but significant for overseas lending in 1989 and 1990 and for domestic lending in 1990 and 1991. Moreover, lending flows in these latter years were weak; even after removal of the estimated distortion caused by write-offs, outlined below, UK banks' claims on developing countries declined by around £4 billion in 1989/90, and their sterling lending to the M4 private sector grew by only £14 billion in 1991, down from £45 billion in 1990 and around £60 billion per annum in 1988 and 1989.

The Bank has now used published data and other information provided by banks to make more comprehensive write-off adjustments to lending flows from 1986 to date. These adjustments (estimated total write-offs for all banks' UK offices) add under £1 billion a year to the flows in 1986–88; about £2.5 billion in 1989, £4.5 billion in 1990, and £5 billion in 1991. They have been allocated to individual economic sectors, notably overseas in 1989 and 1990 (about £4.5 billion over these two years), industrial and commercial companies in 1991 (about £3 billion), and the personal sector in 1991 (roughly £1 billion on consumer credit and £0.5 billion on loans to unincorporated businesses). These adjustments are believed to be broadly accurate on an annual basis but have been placed in individual months and quarters in the main by averaging the annual figure. They were introduced when the end-May banking figures were published in June.

It should be noted that the write-offs adjustment to lending flows is only one of several that are necessary in calculating flows from changes in levels; others allow for population and classification changes and other valuation adjustments. Arrangements for reporting of write-offs and other valuation changes to take effect next year are described in the article on page 314. These figures will be used to adjust lending flows in 1993 and thereafter; in the meantime, further estimated adjustments are being made for 1992.

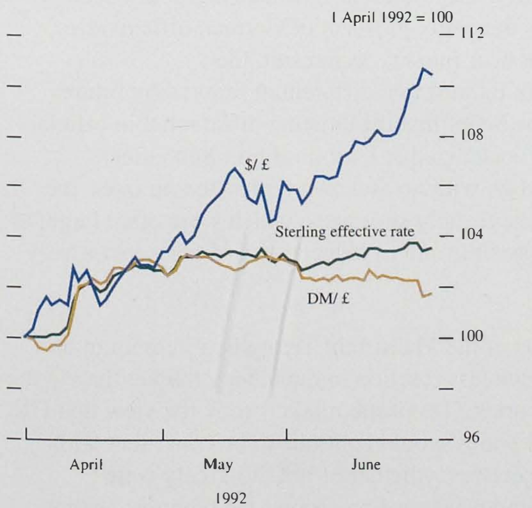
(1) Barclays, Lloyds, Midland and National Westminster together with Bank of Scotland, the Royal Bank of Scotland, Standard Chartered and the TSB. All data for these banks are consolidated, and taken from published sources—either the *Bank of England Banking Act Report 1991/92*, the British Bankers' Association *Annual Abstract of Banking Statistics* May 1992, or reports and accounts. Calendar year-end information except for Bank of Scotland (end-February), the Royal Bank of Scotland (end-September) and the TSB (end-October).

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.

Exchange rates



building societies both rose over the quarter: while deposits rose by £1.8 billion, borrowing increased by £1.4 billion (reversing the trend seen in the four previous quarters). The increase in deposits may partly reflect an increase in capital issues in the quarter (net sterling capital issues were £2.5 billion), which may have been placed on deposit before being used to finance investment or to reduce debt.

The net recourse to banks and building societies of the personal sector, including individuals and unincorporated businesses, increased substantially over the quarter—that of individuals was £2.0 billion and that of unincorporated businesses £1.6 billion. In both cases this was mainly related to the weakness of deposit flows.

Individuals' deposits rose by only £3.6 billion and unincorporated businesses ran down their deposits. Although, like individuals, unincorporated businesses' deposits grew exceptionally strongly in the first quarter, the decline in the second quarter may reflect increased financial pressure on this sector. Their borrowing, however, increased slightly after three consecutive quarters of net repayment.

Lending by banks and building societies for house purchase and consumption grew by only 1.9% and 0.2% respectively. Weak growth in house purchase lending confirms the subdued picture given by housing market price and transactions data. Within the depressed total of mortgage lending, the banks appear to have gained market share. The weak growth in lending for consumption is also consistent with the current weakness in retail spending.

OFIs made net recourse to banks and building societies of £2.3 billion over the quarter. This can be explained partly by a strong rise in lending of £3.4 billion (its strongest growth since the second quarter of 1990). Within the total, leasing companies and securities dealers were particularly active borrowers.

Official operations in gilt-edged and money markets

The figures in this section are not seasonally adjusted.

Following the election, sterling rallied strongly along with gilts and equities, and money-market rates fell sharply. Three-month interbank rates fell by $^{7}/_{16}$%, to $10^{11}/_{32}$%, between 9 and 10 April and the interbank yield curve regained a shallow downward slope. Despite the stronger exchange rate, the UK authorities chose not to cut short-term interest rates immediately. The markets interpreted the Bank's money-market operations—including the offering of a one-month repo on 13 April—as signalling the authorities' intention first to assess the evidence on developments in the economy after the election. Press reports of increased high street spending and of enquiries at estate agents over the Easter weekend helped money-market rates to firm, despite sterling's continued appreciation in the ERM. Moreover, following the release of worse than expected German money supply data on 23 April, three-month interbank rates again reached $10^{1}/_{2}$%, as lingering hopes of a cut in base rates all but vanished. At the end of the month bidding to renew interbank deposits even caused interbank rates to move briefly above $10^{1}/_{2}$%.

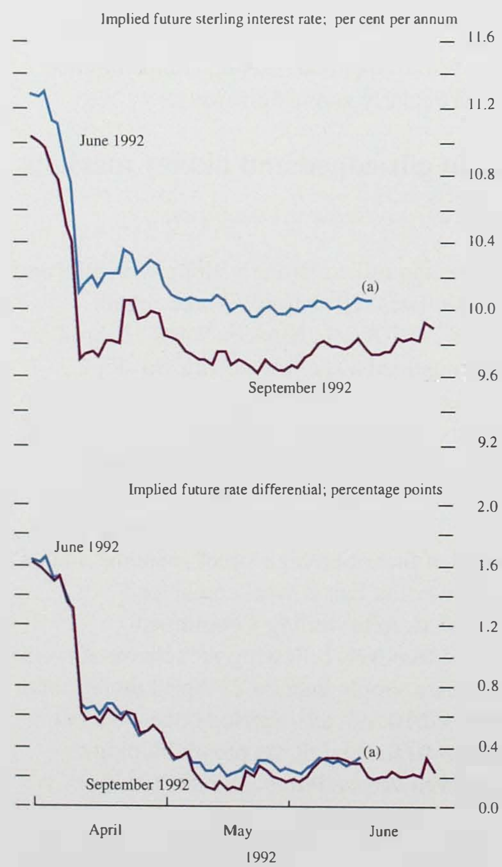
By late April, however, it was apparent to the authorities that, notwithstanding any post-election surge in spending, the case on domestic grounds for a reduction of short-term interest rates still remained. At the same time, sterling's post-election strength had been sustained, which greatly reduced the external constraint. However, the margin of UK above German interest rates was only around 75 basis points, and the extent to which this limited the scope for a reduction in UK rates was uncertain. The Bank sought through its operations to enable money-market rates to edge down. On 29 April the Bank dealt in bands 3 and 4 bills at rates $\frac{1}{32}$% lower than previously, in line with the movement in bill rates which had occurred. The following day the Bank offered a short (eight-day) repo and again reduced its bands 3 and 4 dealing rates by $\frac{1}{32}$% each. On 1 May the whole of the forecast shortage of £2 billion was relieved by way of an even shorter (seven-day) repo in the early round of operations. Moreover, the Bank made outright purchases of a small number of bills in bands 3 and 4 at rates lower than previously, in line with the further fall in bill rates which had by then occurred. As a result of the Bank's operations, the possibility of a reduction in base rates began to enter the market's expectations and this did not unsettle the foreign exchange market. The issue of a tranche of a short-dated gilt-edged stock on 1 May, together with weekend press comment, served to enhance expectations of a rate cut, so that in the early round of operations on 5 May the Bank was offered bills in bands 1 and 2 at rates $\frac{1}{2}$% lower than those previously prevailing; and the Bank accepted the offers. Clearing banks' base lending rates were reduced in line, to 10%. Interbank rates did not fully reflect this fall, however, with the three-month rate closing at $10\frac{5}{32}$% on 5 May, reflecting unease over the reaction of the foreign exchange market and some expectation that German rates might be raised again, perhaps at the Bundesbank Council meeting on 21 May.

With sterling's renewed appreciation, however, to above DM 2.94 in the following days, UK rates gradually eased, further encouraged by press comment that it might be possible to 'decouple' from Germany by allowing UK rates to fall below German rates. As a result, money-market rates fell more fully in line with base rates of 10% and the differential between three-month UK and German euro-rates fell to less than 20 basis points by mid-May, its narrowest since 1981.

On balance, however, the market came to the view that, while it was unlikely that German money-market rates would rise in the short-term (and, even if they did, that UK rates might not need to follow), neither was there any prospect of German official rates being reduced in the near future. As a result, the sterling-deutschmark interest rate differential implied by futures markets reflected the belief that the existing differential in official rates would remain unchanged at least until mid-September. During the rest of May, with no downward pressure on rates, the Bank was able to relieve daily shortages, which were often large, as early in the day as possible and to reduce upward pressure on very short interbank rates.

The Danish rejection of the Maastricht Treaty by referendum on 2 June provoked much less reaction in the money market than in the foreign exchange market. Domestic markets took the view that UK monetary and fiscal policy would continue to be consistent with anti-inflationary objectives, whether or not the Treaty were implemented. Sterling weakened by around $1\frac{1}{2}$ pfennigs against the deutschmark to DM 2.9149 by 5 June and moved further down

Three-month sterling and euro-deutschmark futures contracts



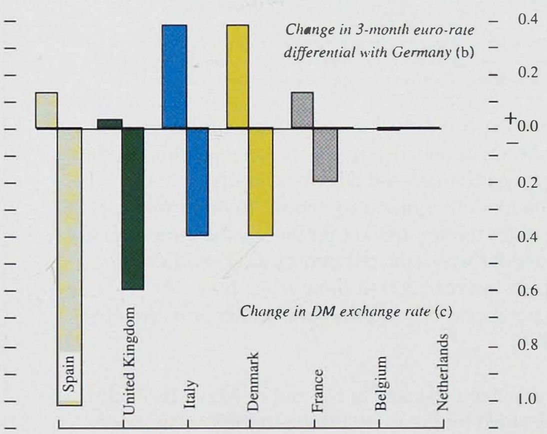
(a) The June sterling contract expired on 17 June, and the deutschmark contract on 15 June.

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

	Interest rates(b) (per cent per annum)					Gilt yields(c) (per cent per annum)				Exchange rates		
	Sterling interbank rates				£-DM euro-rate differential	Conventionals			Index-Linked			
Date, 1992	1 month	3 months	6 months	12 months	3 months	Short	Medium	Long	Long	ERI	$/£	DM/£
9 April	10 5/8	10 25/32	10 13/16	10 7/8	1.1563	9.99	9.77	9.52	4.53	90.3	1.7472	2.8553
13 April	10 1/2	10 11/32	10 1/4	10 5/32	0.6875	9.35	9.14	9.02	4.45	91.7	1.7627	2.9102
1 May	10 7/16	10 5/16	10 5/16	10 3/16	0.5000	9.25	9.14	8.99	4.37	92.4	1.7830	2.9295
5 May	10 5/32	10 5/32	10 1/8	10 1/8	0.3125	9.29	9.20	9.05	4.36	92.2	1.7825	2.9221
29 May	10 1/32	10 1/32	9 31/32	9 29/32	0.3438	9.06	8.93	8.77	4.20	92.9	1.8312	2.9382
2 June	9 29/32	9 31/32	9 15/16	9 29/32	0.2188	9.08	8.96	8.79	4.20	92.7	1.8247	2.9314
5 June	9 15/16	9 31/32	9 31/32	9 15/16	0.2500	9.18	9.11	8.97	4.23	92.5	1.8335	2.9149
30 June	10 1/16	10 3/32	10 3/32	10	0.3125	9.26	9.17	8.97	4.25	93.1	1.9030	2.8992

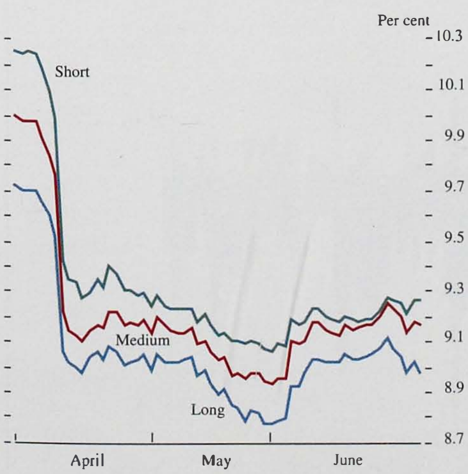
(a) Close of business rates in London.
(b) Middle-market rates.
(c) Gross redemption yield. Representative stocks: short—10 1/2% Exchequer 1997; medium—9 3/4% Treasury 2002; long—9% Treasury 2008; index-linked—2 1/2% Index-Linked Treasury 2024 (real yield assuming 5% inflation).

Changes in interest and exchanges rates following the Danish referendum (a)



(a) Change between close of business on 2 June and 5 June.
(b) Percentage points.
(c) Per cent; depreciation is negative.

Yields (a) on representative conventional gilt-edged stocks



(a) Gross redemption yield. Representative stocks: short—10 1/2% Exchequer 1997; medium—9 3/4% Treasury 2002; long—9% Treasury 2008.

within the ERM; this could, however, be attributed partly to the effect on sterling of the dollar's weakness, as well as to concerns over the effect of greater uncertainty over the path to EMU. Moreover, being in the wide band, sterling had greater scope to respond to any such pressures by moving down within the band than had currencies in the narrow band, where an interest rate response was necessary after a smaller depreciation. Thereafter, sterling steadied against the deutschmark, even though sterling interest rates did not rise by as much as those of other ERM currencies, and despite the weakening dollar.

The deutschmark's immediate strengthening after the 'no' vote pushed back money-market expectations of a further reduction in sterling interest rates, which was then seen to be more dependent on the path of German rates. The September short sterling futures price therefore fell along with German futures prices (implying higher rates) following the release on 23 June of disappointing German money supply data for May. In the final days of June sterling, which had moved to the bottom of the ERM in mid-June, began to weaken against the deutschmark, falling below DM 2.90 for the first time since the general election. Although it benefited along with the deutschmark and other currencies from the dollar's sharp weakening, sterling met resistance from profit-taking at around $/£1.90 and therefore lost ground against the deutschmark, further weakened by renewed political debate over the Maastricht Treaty. It ended the quarter at DM 2.8992.

The weight of demand for gilts after the election was such that, even after the sales on election night itself and despite the announcement on 10 April of an auction of ultra-long-dated stock (maturing between 2015 and 2020) to be held on 29 April, a further £800 million tranche of stock issued early on 13 April was exhausted immediately. Yields continued to fall, 10-year yields reaching an immediate post-election low of 9.1% on 15 April, 67 basis points lower than at the close of business on election day. Given the speed of the market movement and the weight of official sales made, however, the market settled back thereafter. The announcement on 21 April that the auction would be of £2.5 billion of 8 3/4% Treasury 2017—a new 25-year benchmark—was well-received. The auction itself, on 29 April, was 1.82 times covered with an average yield of 9.02% and the market traded up strongly after the result was announced.

The cash position of the money market

In the second quarter, the slowdown in government revenue resulted in a large rise in the CGBR from £2.7 billion in the first quarter to £10.7 billion (see the table). Part of this rise was seasonal, since corporation tax revenues typically are lower in the second quarter than in the first. Compared with the same period last year, however, the increase was almost entirely accounted for by higher outlays (including lower privatisation receipts). The size of the CGBR and PSBR together with the heavy concentration of gilt maturities during the quarter was such that, despite heavy gilt sales and increased flows into National Savings, there was an underfund of £0.6 billion. This underfund was, nevertheless, much less than is normal at this time of year; in seasonally adjusted terms, heavy net gilt sales resulted in an overfund of £3.9 billion. With other government borrowing from, and debt sales to, banks and building societies amounting to £2.2 billion there was an overall net drain on bankers' balances during the quarter of some £2 billion.

Influences on the cash position of the money market

£ billions; *not seasonally adjusted*
Increase in bankers' balances (+)

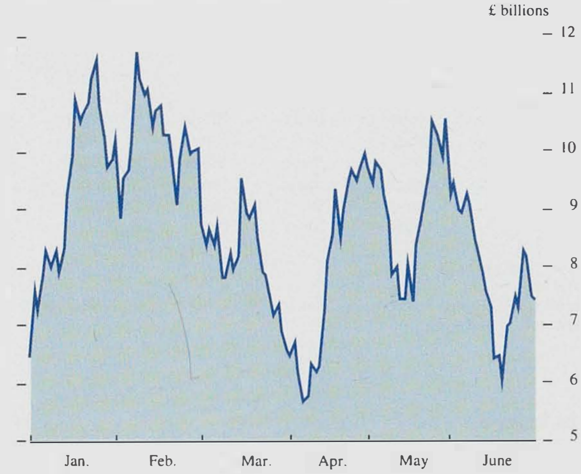
	1991 Q2	1992 Q2	April	May	June
Factors affecting the market's cash position					
CGBR (+)	+6.6	+10.7	+3.0	+3.3	+4.4
of which, on-lending to local authorities and public corporations	*+0.2*	*+0.3*	*+0.2*	—	—
Net sales (-) of central government debt (a)	-3.1	*-11.7*	-4.8	-3.9	-3.1
of which: Gilt-edged	*-2.5*	*-10.2*	*-4.3*	*-3.3*	*-2.6*
National savings	*-0.6*	*-1.5*	*-0.5*	*-0.6*	*-0.5*
CTDs	—	*+0.1*	—	—	—
Currency circulation (increase -)	+0.1	-0.4	-0.6	-0.7	+0.8
Reserves etc	+0.9	—	—	+0.1	—
Other	-0.4	-0.6	—	-0.6	—
Total (A)	**+4.0**	**-2.0**	**-2.4**	**-1.7**	**+2.1**
Offsetting official operations					
Net increase (+) in Bank's commercial bills (b)	-2.3	+0.8	+1.4	+1.5	-2.1
Net increase (-) in sterling Treasury bills in market (c)	-3.3	+1.3	-0.6	+0.7	+1.2
Other	+1.6	+0.1	+1.8	-0.6	-1.0
Total (B)	**-4.0**	**+2.2**	**+2.6**	**+1.5**	**-1.9**
Change in bankers' operational balances at the Bank (A+B)	—	+0.2	+0.2	-0.2	+0.2

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

Gross gilt sales, at £13.0 billion, amounted to nearly three quarters of those made in the whole of 1991/92. The heavy concentration of sales immediately after the election meant that inflows to the central government greatly exceeded outflows at that time and resulted in a sharp rise in the stock of money-market assistance, to nearly £10 billion by mid-April (see Chart 1). This increase was not fully unwound until mid-June when the pace of gilts sales slowed and other exchequer flows moved in the market's favour.

Gilt sales made on 10 April contributed to a shortage on 13 April of nearly £2.8 billion (see Chart 2). The largest daily shortages which occurred during the quarter thereafter reflected the rolling over of the assistance given to relieve this shortage, together with flows associated with gilt sales made at the auctions, held in April and June. The auction stocks were, however, issued on a partly-paid basis and the effect on the money market was minimised by the choice of payment dates to coincide with days otherwise expected to be in surplus.

Chart 1
Stock of money-market assistance (a)



(a) Bank of England holdings of commercial and local authority bills outright and on a repurchase basis; its holdings of gilt-edged stock, sterling Treasury bills, export and shipbuilding credit-related paper on a repurchase basis; and market advances.

The higher than expected stock of assistance tended to make for higher daily shortages and also made it more difficult to relieve those shortages, particularly on days when bills were not available to the market in maturing repos. In order to offset the unnecessarily tight money-market pressures, the three-month Treasury bill tender was reduced, first by £200 million on 15 May and by a further £200 million on 12 June. At £200 million per week, this left the total tender at its smallest since May 1989.

The stock of assistance peaked at the end of May. Its decline thereafter was aided by the smaller take-up of Treasury bills. Throughout the quarter the Bank also continued to invite offers of bills in the longer maturity bands on occasion in order to slow down the rate at which the stock of assistance rolled over; and regularly offered to buy bills for future resale, thereby enabling the use of longer maturity paper in the Bank's daily operations.

Chart 2
Daily shortages in the money market

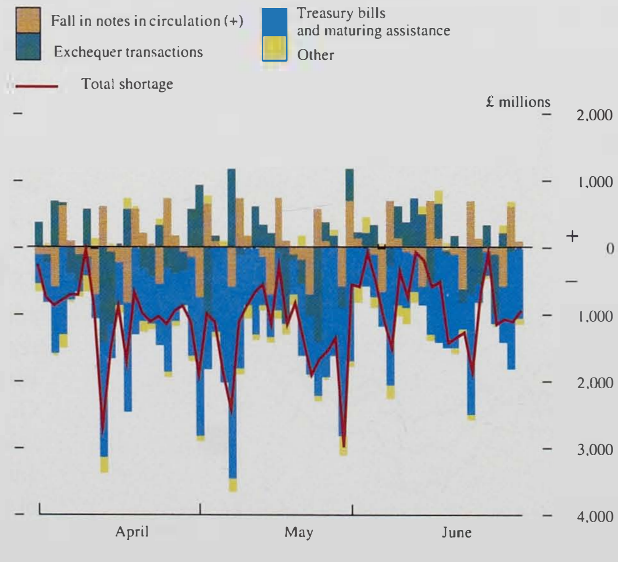


Table C
Issues of gilt-edged stock

Stock	Amount issued (£ millions)	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
9¾% Treasury 2002	200	13.4.92	13.4.92	To CRND					
10% Treasury 2003 'B'	800	13.4.92	13.4.92	To Bank	106.6250	Partly paid (b)	9.05	9.04	13.4.92
8¾% Treasury 2017	2,500	21.4.92	30.4.92	Auction	97.3750 (c)	Partly paid (d)	9.02	9.02 (e)	30.4.92
8¼% Treasury 1993	100	1.5.92	1.5.92	To CRND					
8½% Treasury 1994	100	1.5.92	1.5.92	To CRND					
8¾% Treasury 1997 'D'	800	1.5.92	1.5.92	To Bank	98.2500	Partly paid (f)	9.18	9.13	7.5.92
8¾% Treasury 1997	200	1.5.92	1.5.92	To CRND					
2½% Index-Linked 2013	200	1.5.92	1.5.92	To Bank	109.1250	In full	4.47 (g)	4.47 (g)	5.5.92
2½% Index-Linked 2011	100	8.5.92	8.5.92	To Bank	134.0625	In full	4.44 (g)	4.43 (g)	11.5.92
2½% Index-Linked 2016	100	8.5.92	8.5.92	To Bank	117.5000	In full	4.38 (g)	4.38 (g)	11.5.92
9% Treasury 1994	100	15.5.92	15.5.92	To Bank	99.7188	In full	9.11	9.08	18.5.92
9¾% Treasury 2002	250	15.5.92	15.5.92	To Bank	104.5313	In full	9.06	9.04	18.5.92
9½% Conversion 2005	250	15.5.92	15.5.92	To Bank	103.5938	In full	9.02	9.00	18.5.92
9½% Conversion 2005	100	15.5.92	15.5.92	To CRND					
9% Treasury 2008	250	15.5.92	15.5.92	To Bank	100.5625	In full	8.93	8.91	18.5.92
9% Treasury 2008	100	15.5.92	15.5.92	To CRND					
2½% Index-Linked 2013	150	20.5.92	20.5.92	To Bank	112.6250	In full	4.35 (g)	4.34 (g)	22.5.92
2½% Index-Linked 2020	150	20.5.92	20.5.92	To Bank	115.3750	In full	4.30 (g)	4.28 (g)	28.5.92
9% Conversion 2000 'C'	800	22.5.92	22.5.92	To Bank	100.7500	Partly paid (h)	8.87	9.05	5.6.92
9% Conversion 2000 'C'	200	22.5.92	22.5.92	To CRND					
6¾% Treasury 1995-1998	100	2.6.92	2.6.92	To Bank	93.0625	In full	8.25	8.47	3.7.92
4⅛% Index-Linked 2030	500	12.6.92	12.6.92	To Bank	100.0000	In full	4.13 (g)	4.18 (g)	26.6.92
9% Treasury 2012 'A'	2,750	16.6.92	25.6.92	Auction	98.9688 (c)	Partly paid (i)	9.11 (e)	9.11	25.6.92

(a) Gross redemption yield, per cent.
(b) With £20% payable on issue, £40% payable on 11/5 and balance on 8/6.
(c) Lowest accepted price for competitive bids.
(d) With £27.375% payable on issue, £40% payable on 26/5 and balance on 22/6.
(e) At lowest accepted price for competitive bids.
(f) With £25% payable on issue, £40% payable on 18/5 and balance on 8/6.
(g) Real yield, calculated on the basis of 5% annual rate of increase in the retail price index.
(h) With £40% payable on issue and balance on 6/7.
(i) With £33.96875% payable on issue, £35% payable on 20/7 and balance on 25/8.

Table D
Redemptions of gilt-edged stock, 1992 Q2

Stock	Date redeemed	Nominal amount outstanding at redemption (£ million)
8% Treasury 1992	13 April	1,550
10½% Conversion 1992	7 May	1,288
3% Treasury 1992	11 June	500

Table E
Official transactions in gilt-edged stocks

£ billions: *not seasonally adjusted*

	1991/2	1992 April	May	June
Gross official sales (+) (a)	+18.1	+5.6	+4.3	+3.1
Redemptions and net official purchases of stock within a year of maturity(-)	-6.1	-1.2	-1.0	-0.5
Net official sales (b)	+12.0	+4.3	+3.3	+2.6
of which, net purchases by:				
Non-funding sector	+0.9	+0.7	+0.2	+1.0
Banks (b)	+0.9	+0.4	+0.4	+0.3
Building societies	—	+0.3	-0.2	+0.5
Funding sector	+11.0	+3.7	+3.1	+1.7
Overseas sector	+6.3	+0.5	+0.4	+0.7
M4 private sector	+4.7	+3.2	+2.7	+0.9

(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.

Although official sales on a record scale had been made in April, favourable market conditions allowed continued funding without undue market disturbance. Further funding was secured through the issue of tap stocks. An £800 million tranche of 8¾% Treasury 1997 was issued on 1 May and, in conjuction with official money-market operations, taken as a signal of an imminent cut in base rates. More than half the stock was sold before the base rate cut on 5 May and the remainder by 7 May. On 15 May, a package of £850 million of four tranchettes of conventional stocks was announced and, following news of the German steelworkers' pay settlement which helped to diminish expectations of a further tightening of German monetary policy, prices rose further, enabling all four tranchettes to be exhausted on 18 May in pre-opening mini-tenders. A further £800 million tranche of stock was issued on 22 May but the market was set back by the release of disappointing trade data so that much of the stock was not immediately sold.

The index-linked sector was also active during May, having been quiet since the election. Tranchettes issued on 1 and 8 May were all exhausted on the next trading day, while two further tranchettes of £150 million were issued on 20 May. In response to identified demand by domestic institutional investors for a long-dated index-linked stock, a new stock maturing in 2030 was created on 12 June, the first completely new index-linked stock since 1988, with a coupon of 4⅛%, in line with the current yield on other stocks in the sector.

The post-election rally in conventionals ran through April and May but faltered following the Danish referendum on the Maastricht Treaty which caused some switching into German government bonds. Gilts were not as heavily sold as many other EC government bonds, however, and were helped by Ministerial statements that the

UK policy course would continue unchanged. But the announcement of the next auction, to be held on 24 June, of £2.75 billion of 9% Treasury 2012 set the market back, being rather bigger in size than expected. The auction itself was 1.6 times covered, satisfactory given the larger amount of stock on offer. Taking into account further instalments on partly-paid stocks issued during the quarter, sales worth some £15.2 billion were secured in the second quarter.