

## Financial review

### Introduction

The review describes developments in various markets, mainly during the period May to July.

Until the announcement of a package comprising fiscal and monetary measures on 8th June (see below and page 344), the markets were affected by uncertainties: action by the authorities was widely expected, and it was increasingly felt that a sustainable level had not been established for interest rates. The announcement of the measures brought an immediate response in the gilt-edged market and led to heavy sales of gilt-edged stocks by the authorities.

Sterling traded quietly, rising by almost 6% against the dollar but by only about 2% in terms of the effective exchange rate index.

The review contains the usual sections on international banking and the euro-currency markets (page 354), oil money movements (page 355) and the commodity markets (page 356). It concludes with a brief account of the draft legislation on deposit-taking institutions (page 356).

### The money market

In the first part of the period, continuing unease over the domestic fiscal and monetary situation, combined with rising US interest rates, led to successive rises in minimum lending rate, from 7½% to 10% by 8th June. For the remainder of the three months, money-market rates were kept up by a shortage of liquidity and further rises in US interest rates.

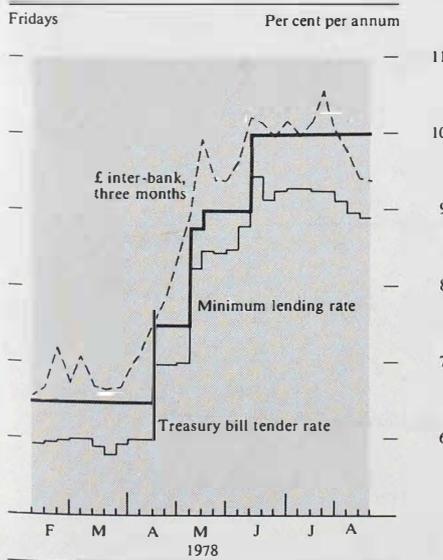
Day-to-day conditions in the market during May were mixed, but fairly comfortable: help was required from the Bank on most days, and was usually given by the purchase of Treasury or local authority bills, but there were several days when Treasury bills were sold by the Bank to absorb a surplus. At the beginning of the month, as explained in the June *Bulletin* (page 172), domestic money rates generally were standing well above their normal relationship with Treasury bill and minimum lending rates, and on the 4th the Bank lent to a number of discount houses for a week at minimum lending rate, making it clear that the authorities would not seek to prevent the restoration of a more normal relationship. Minimum lending rate went up in accordance with the formula after the Treasury bill tender on the following day, from 7½% to 8¼%, and to 9% a week later.

On 25th May, the Bank announced that minimum lending rate would, in future, be set by administrative decision rather than by the formula relating it to the Treasury bill tender rate (see the June *Bulletin*, pages 166 and 173). The rate was initially fixed at its existing level of 9%. It was raised to 10%, however, on Thursday, 8th June, as part of a larger package of measures, embracing also a proposed surcharge on employers' national insurance contributions and the reintroduction of the supplementary special deposits scheme, which together were intended to keep the public sector borrowing requirement within the announced limit of £8½ billion and to put the growth of the money stock on a path consistent with the target range announced at the time of the Budget (see pages 340 and 344).

In the first week of June, the market continued to be fairly quiet, but the very large sales of gilt-edged stocks which followed the measures on the 8th (with the subsequent calls on partly-paid stocks) caused exceptionally tight conditions, and for the rest of the period there were only three days when the market did not require assistance. The Bank purchased large amounts of Treasury, local authority and commercial bills (some for resale at fixed later dates) and there was large and frequent lending, mostly overnight, at minimum lending rate. In these circumstances, on 15th June, the Bank announced that the rate of call for special deposits from banks and deposit-taking finance houses was to be temporarily reduced from 3% of eligible liabilities to 1½%, with effect from 19th June; it was to be

### Short-term interest rates in London

Interest rates rose steeply between April and early June; from the end of July, there was some falling back.



restored to 2% on 3rd July and to 3% on 24th July, but the 24th July recall was later postponed until 11th September. Conditions in the money market, however, remained very tight, as did the banks' reserve asset positions, and on 27th July a further temporary reduction of 1% in the rate of call for special deposits was announced, with effect from 31st July, to be restored on 26th September. All these moves were simply technical smoothing operations undertaken in the course of the Bank's management of the money markets and did not indicate any change of monetary policy: their purpose was to relieve the pressure on the money markets and on the reserve asset positions of the banks, and thus prevent unnecessarily sharp fluctuations in short-term interest rates.[1]

Even so, conditions in the market in June and July were reflected in a rise in short-term money-market rates, which reached a peak around 20th July, when seven-day money cost as much as 11%–12% and three-month money over 10½%. The release of special deposits on 31st July, however, had the effect of bringing rates down and by early August they were below 10%.

In the second week of May, clearing banks' base rates were raised from 7½% to 9%, and deposit rates from 4% to 6%. After the measures of 8th June, base rates were raised further, to 10%; deposit rates also rose—some to 6½% and others to 7%.

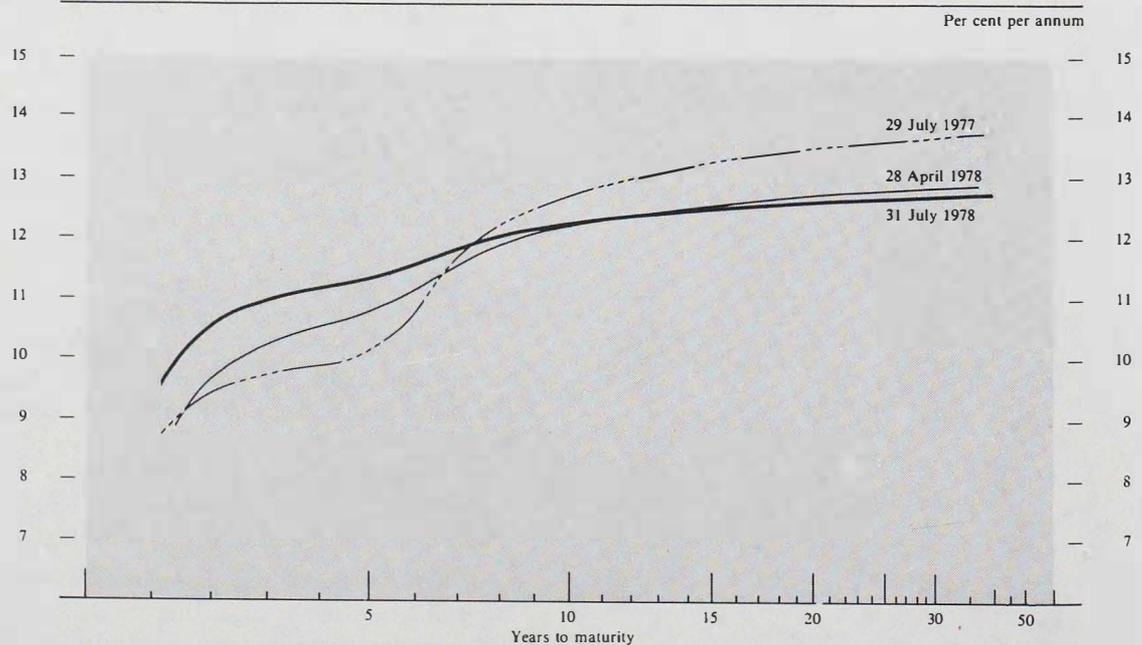
## Capital markets

### *The gilt-edged market*

In the gilt-edged market, yields on short-dated stocks rose during the period but those on long-dated fell back slightly. There was a sharp fall in turnover during May, particularly in short-dated stocks; in June there was an even sharper rise, amounting to about 70% overall, which was widespread among maturities, though again more marked at the short end; in July, turnover once more fell back.

### Time/yield curves of British government stocks<sup>[a]</sup>

*There was some flattening of the yield curve during May to July.*



[a] The lines measure the nominal rate of interest which a stock at each maturity should bear if issued at par. The curve runs from the shortest-dated stock with a life of more than one year to the longest-dated stock. A revision to the construction of these curves was described in the June 1976 *Bulletin* (page 212). The relevant computer program is available from the Economic Intelligence Department of the Bank at the address given on the reverse of the contents page.

[1] On 14th August, £207 million special deposits were released to the London and Scottish clearing banks out of their total of £288 million. This was in accordance with an undertaking given by the Chancellor of the Exchequer in December 1976 to release special deposits if these banks' positions in relation to the supplementary special deposits scheme were prejudiced by their commitment to find fixed-rate finance above 20% of non-interest-bearing sterling sight deposits under the then sterling fixed-rate export and home shipbuilding credit arrangements (see the March *Bulletin*, page 61).

Net official sales of gilt-edged stocks were quite substantial in the month to mid-May, particularly at the beginning of that period, the market thereafter being affected by a number of uncertainties. There was doubt whether the size of the Government's funding programme, as presented in the Budget and as affected by subsequent amendments, was consistent with the target for the monetary aggregates, which were in themselves causing concern; the market was also affected by the weakening of sterling that took place in April, and by rising US interest rates. Higher UK interest rates were expected, and although minimum lending rate went up to 9% early in May it was soon questioned whether this would be enough.

A new short-dated stock, a second tranche of £800 million 9¼% Exchequer Stock 1982 at £94.75 per cent, was issued on 18th May, the previous short-dated tap stock having been exhausted on 19th April. Initial sales were small, but a substantial amount of this stock was sold in the fourth week of May after a new price of £93.50 was established. At the same time, sizable demand developed for the long-dated tap stock, 12% Exchequer Stock 1998; and for Variable Rate Treasury Stock 1982—the second of the two variable rate stocks issued in the summer of 1977—which was exhausted on 25th May. The market then became quiet again, but the tone had already begun to improve before the announcement of the measures of 8th June boosted the market and led to very heavy official sales of stock. The long-dated tap stock, 12% Exchequer Stock 1998, was exhausted on the 9th, and a new stock, £1,000 million 12% Exchequer Stock 2013–2017 at £96.00 per cent, was announced on the same date, for issue on the 15th.[1] This was the first new stock maturing in the twenty-first century to be made available since official supplies of 7¾% Treasury Loan 2012–2015 were exhausted in January 1973, and it was designed to meet the need of life assurance companies and pension funds for an asset to match their long-term obligations. The market continued to be extremely buoyant, with some speculative buying developing. The short-dated tap stock, 9¼% Exchequer Stock 1982, was exhausted on the next working day, Monday the 12th, and a replacement (technically medium-dated) was announced on the same day for issue on the 16th, £800 million 10% Exchequer Stock 1983 at £95.00 per cent.[2] This helped to moderate the excessive enthusiasm which, if it had been allowed to continue, could have led to a sharp reaction in the gilt-edged market—sharper than that which in the event occurred. Even so the very long-dated stock was well subscribed, but subscriptions to the short-dated stock were very small.

There followed a period of adjustment, as it came to be realised that yields were not going to fall sharply and some of the stock recently purchased was resold into firmer hands. In fact, yields rose: on top of some disinvestment by short-term holders of both long and short-dated stocks, renewed doubts about pay restraint and inflation, together with political uncertainties, had a disturbing effect at the long end of the market, while the short end was affected by tightness in the money market resulting from the exceptionally large official gilt-edged sales and by worries about rising US interest rates. The short end of the market was further affected by the prospect of sales by banks and building societies as they came under liquidity pressure.

By early in July, yields had risen again to the levels prevailing before the measures of 8th June. Thereafter, they tended to decline under the influence of better trade and money stock figures and the authorities were able to resume sales of stock; the long tap stock, 12% Exchequer Stock 2013–2017, was exhausted on 24th July. An issue of £800 million 12% Exchequer Stock 1999–2002 at £96.00 per cent, to be made on 2nd August, was announced on 28th July.[3]

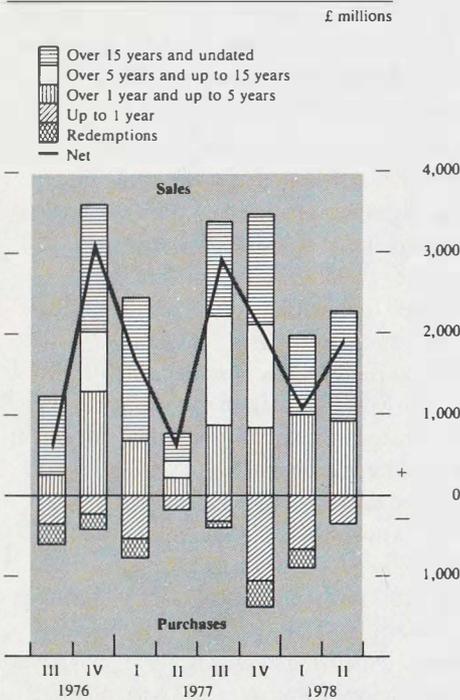
[1] £15 per cent was payable on application, £30 per cent on 27th June and £51 per cent on 14th July.

[2] £15 per cent was payable on application, £30 per cent on 7th July and £50 per cent on 28th July. A further £100 million of this stock was reserved for the National Debt Commissioners for public funds under their management.

[3] £15 per cent was payable on application, £40 on 22nd August and £41 on 18th September.

## Official transactions in gilt-edged stocks by maturity [a]

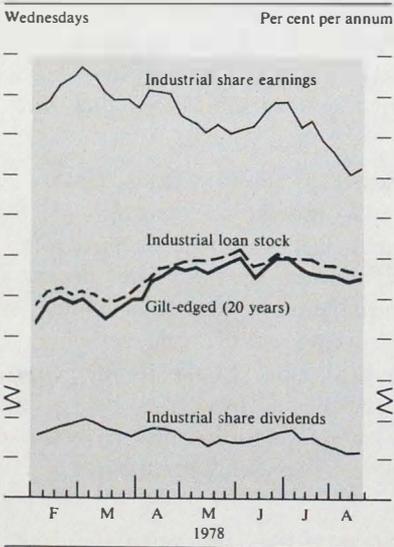
In the June quarter, net sales of stock by the authorities rose to over £1,900 million.



[a] Components are on occasion too small to be shown separately.

## Security yields

Yields on debentures and long-dated gilt-edged were steadier during May to July than during the previous three months.



During the June quarter, the authorities sold £1,920 million net of stock, mostly in the month of June. [1] Net sales of long-dated stocks amounted to £1,365 million and of stocks within one to five years of maturity to £910 million. Purchases of stocks within one year of maturity totalled £355 million.

## Other markets

The flow of stock issues by local authorities picked up during the period. The amount raised by such issues and by bonds over the three months was £315 million gross, or about £100 million net of redemptions, and included some variable rate stocks and bonds. [1]

Turnover in the debenture market was a little lower in May to July than in the preceding three months; yields were little changed on balance. Redemptions by companies once again exceeded new money raised by way of loan capital and preference shares.

Notwithstanding the economic and political uncertainties, prices in the equity market remained firm. The FT-Actuaries industrial (500) share price index, which stood at 225 at the end of April, finished the period strongly at 243. Turnover, which had been low in the previous three months, picked up.

New money raised by issues of equity capital rose to about £405 million, compared with £115 million in the previous period, but of this sum nearly £270 million was raised by British Leyland Limited by a rights issue, virtually the whole of which was taken up by the National Enterprise Board.

Net sales of unit trust units fell back to £70 million after the very sharp increase of the previous three months but were still £43 million higher than in the corresponding three months of 1977.

## Foreign exchange and gold markets

### Summary

Trading in sterling was much quieter between May and July than during the previous three months. Moving broadly in sympathy with other currencies, the pound rose against the dollar by something under 6% over the period. The increase in the effective exchange rate index, however, was considerably smaller, at around 2%—from 61.4 to 62.5. Intervention was mainly confined to smoothing operations, although the Bank on occasions during May intervened in the short-dated swap market in order to raise the cost to non-residents of borrowing sterling by swap transactions, and thereby protect the spot rate from resultant selling pressure. [2] The recovery in the US dollar proved short-lived, and selling pressure predominated from the middle of May onwards, particularly against the yen, which rose very fast during June and July.

### Sterling

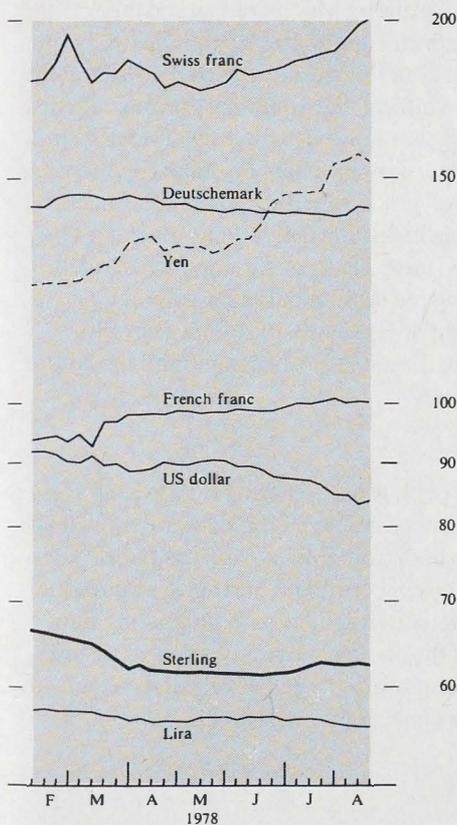
Although its scale was much reduced, selling pressure on sterling continued from April into May as the dollar strengthened generally. The rise in minimum lending rate, signalled on the 4th, had only a temporary effect on sterling, and offering of pounds was particularly heavy after the publication of the April wholesale price index on the 8th, and on the 9th after the Government's defeat in the House of Commons on the opposition amendment to the Finance Bill. The April trade figures, published on the 15th, were well received, but their effect was only temporary, and the rate reached \$1.8050, the low point for the month, on the 17th. After the dollar had peaked in the middle of the month, sterling began to trade more comfortably in quiet markets and ended the month at \$1.8284 compared with \$1.8267 at the end of April. The effective index was unchanged on balance at 61.4.

[1] The figures relate to cash raised and for partly-paid stocks, therefore, incorporate only instalments actually paid.  
[2] For a fuller explanation of these operations, see the footnote on page 430 of the December 1976 Bulletin.

## Indices of effective exchange rates

*Sterling's effective exchange rate strengthened somewhat during July; the dollar weakened from late May, particularly against the yen.*

Logarithmic scale 21 December 1971 = 100  
Fridays



Sterling was again offered during the first few days of June, especially on the 5th. The monetary measures announced on the 8th had little immediate effect on the pound but neither did the deterioration in the trade figures announced on the 14th. A firmer tendency gradually developed in the second half of the month as the dollar weakened, and the sterling/dollar rate closed at \$1.8605 with the effective index 61.5.

The weakness of the dollar continued in early July, but in contrast to the previous month sterling tended to appreciate against other currencies as well. The sterling/dollar rate reached \$1.8971 on the 10th following a report of an oil discovery in a new area of the North Sea, but fell away afterwards as the dollar recovered somewhat, although the effective index was maintained. Buying pressure resumed in the third week of the month, when sterling was among the pacemakers against a generally weaker dollar, and the effective index reached 63.1 on the 24th, when the dollar rate was \$1.9350. The TUC General Council's rejection of the 5% pay proposal prompted heavy offering of sterling on the 26th, and the pound fell by 0.8% in effective terms that day. Only part of this ground was recovered as the dollar fell further, and the sterling/dollar rate ended the month at \$1.9300, with the effective index 62.5.

Over the three months, the reserves fell on balance by \$303 million to \$16,735 million. The proceeds of the Government's bond issue in New York amounted to \$345 million. Repayments of public sector borrowings under the exchange cover scheme, net of new borrowings, amounted to \$233 million, and \$31 million of UK indebtedness to the International Monetary Fund (IMF) was discharged through the use of sterling in drawings by other countries.

### US dollar

The first half of May saw a continuation of the dollar's recovery, spurred by the outcome of the OPEC meeting and by a feeling that priority in US policy-making had shifted towards reducing inflation. Against the deutschemark, the rate had risen 3% by the 17th. However, a relapse ensued, prompted by continued concern about the prospects for the US balance of payments, and fears that, despite the Administration's efforts, inflation was accelerating; by the end of May most of the earlier gains had been wiped out. The dollar was more stable against European currencies in the first half of June, and was assisted by a statement from the Treasury Under Secretary that the US authorities were prepared to intervene in the exchange markets, if necessary in large amounts, to counter disorderly conditions; but it fell again towards the end of the month on doubts about the future tightness of monetary policy in the United States. The dollar remained weak early in July against European currencies generally, and, contrary to some expectations, derived only temporary benefit from the successive summit meetings at Bremen and Bonn. Despite large-scale central bank resistance, the dollar weakened sharply, notably against the yen and sterling, during the third week of July, and fell below Yen 200 for the first time on the 21st. After this barrier had been breached the dollar fell more freely against the yen, and it went through Yen 190 on the 28th.

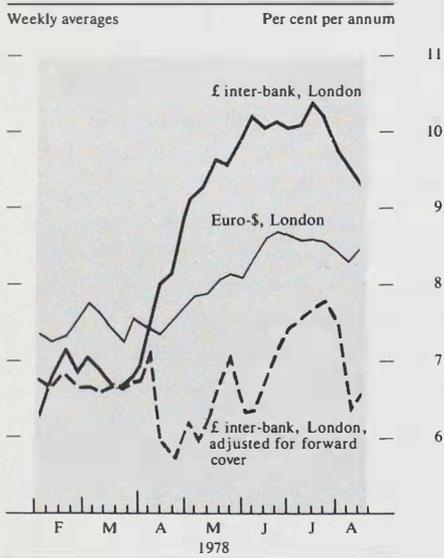
### Other currencies

The mid-point of the 'snake' appreciated by nearly 1% against the dollar over the three months. Towards the end of May and in early June, modest intervention was required to keep the Danish krone (at the top) and the Belgian franc (at the bottom) within the required margins. At the end of June, pressure on the 'snake' re-emerged, this time with the deutschemark at the top of the arrangement, as has become normal during periods of dollar weakness, and the Belgian franc at the bottom. The pressure persisted throughout July and substantial intervention was required.

Despite official discouragement to non-resident purchasers, the Swiss franc appreciated against the 'snake' currencies, and rose from DM 1.0708 at the end of April to DM 1.1737 at the end of July.

## UK and US three-month interest rates

*Sterling interest rates rose much faster than euro-dollar rates between April and mid-July, but then fell back.*



Following speculation that it might be included in a new European currency arrangement, the French franc enjoyed a period of notable strength at the end of June and in July. Against the dollar, it appreciated by 5½% over the three months.

The yen appreciated by 18½% against the dollar over the period (nearly all during June and July).

### Interest rates and differentials

Sterling interest rates tended to rise during May and June, and the three-month inter-bank rate rose from 8  $\frac{7}{16}$ % to 10  $\frac{3}{16}$ % over the two months. After a peak of 10  $\frac{11}{16}$ % on 20th July the rate fell back to 9  $\frac{7}{8}$ % at the end of that month. The uncovered differential in sterling's favour widened from ¾% to about 1  $\frac{1}{2}$ % during May, but showed hardly any net change in June and July. The three months' forward premium on dollars increased early in May and reached a peak of 4¼% on the 10th. After falling back to end the month at 2  $\frac{3}{8}$ %, it rose again in the first half of June, touching 4  $\frac{1}{8}$ % on the 14th. Thereafter it subsided fairly gently and it stood at 2  $\frac{3}{8}$ % at the end of July. The three months' covered differential against sterling narrowed from 1  $\frac{1}{8}$ % to a low point of 1  $\frac{3}{8}$ % at the end of May, but with some further weakness in sterling it widened to 2  $\frac{3}{16}$ % on 16th June before falling back to 1  $\frac{5}{8}$ % at the end of July.

### Gold

The price of gold rose by \$13.30 per fine ounce during May to \$184.15, a generally bullish attitude to the metal being reinforced by rumours that the supply of gold to the market (both from IMF auctions and from other sources) would be reduced, and by concern about the future value of the US dollar. Trading was much quieter during June and early in July, but despite the seasonal slackness of the market, the persistent weakness of the US dollar led to a very fast rise towards the end of July, and on the 28th the price exceeded \$200 per fine ounce for the first time.

## International banking and euro-currency markets

At the time of going to press, the Bank for International Settlements (BIS) figures for international bank activity[1] in the first quarter of 1978 had not been published. There are some provisional indications, however, that the market continued to expand rapidly; indeed the underlying growth may have been faster than in the previous three months (when the gross external assets of reporting banks rose by some \$25 billion, after adjustment for distortions caused by exchange rate fluctuations and for the seasonal build-up of inter-bank positions).

The volume of newly-announced medium-term euro-credits amounted to almost \$14½ billion in the second quarter, after \$12¼ billion in the previous three months.[2] The total of nearly \$27 billion in the first half of 1978 is only some \$10 billion less than that recorded in the whole year 1977. These credits were widely spread among broad economic groupings of countries: credits for the non-oil developing countries during the first half of 1978 totalled nearly \$11 billion, only a little less than in the whole of 1977—Brazil, Mexico, the Philippines and South Korea were the main borrowers within this group; credits for the oil-exporting countries (particularly Algeria, Venezuela and Iran) accounted for \$5 billion, compared with \$7¼ billion in 1977; those for the OECD countries amounted to \$9½ billion (over \$15 billion in 1977). Not all such announcements represented new borrowing, since a number of borrowers were restructuring or refinancing loans early in order to benefit from lower spreads[3] and lengthening maturities (see footnote[2]).

[1] Defined as the domestic and foreign currency business of banks in the Group of Ten countries and Switzerland, and of branches of US banks in certain off-shore centres.

[2] The Bank of England record medium-term euro-credits with maturities of three years or more on the date of announcement, but such credits show up in the BIS figures only when they are taken up and only to the extent that they are not replacing maturing debt. Foreign and international bond issues (see next paragraph) are recorded by the Bank of England on completion.

[3] The 'spread' is the amount by which the interest rate is to exceed LIBOR.

## UK banks' liabilities and assets by customer<sup>[a]</sup>

The underlying growth of the London euro-currency market was probably slightly slower in the second quarter of 1978 than in the first (see text).

	1977			1978	
	30 June	30 Sept.	31 Dec.	31 Mar.	30 June [b]
Foreign currency liabilities of UK banks to:					
Other UK banks	48.4	50.1	51.2	55.2	57.0
Other UK residents	6.8	6.6	7.1	7.3	8.6
Overseas central monetary institutions	37.0	38.9	41.0	42.0	42.3
Other banks overseas	97.3	100.7	108.6	109.7	110.5
Other non-residents	22.2	23.5	24.5	26.3	27.9
Other liabilities[c]	1.6	1.5	1.5	1.8	1.8
<b>Total liabilities</b>	<b>213.3</b>	<b>221.3</b>	<b>233.9</b>	<b>242.3</b>	<b>248.1</b>
Foreign currency assets of UK banks with:					
Other UK banks	48.5	51.3	53.2	56.4	56.9
Other UK residents	18.4	18.3	19.0	19.2	19.5
Banks overseas	107.1	110.2	116.6	118.6	121.9
Other non-residents	38.3	39.8	43.3	46.2	48.3
Other assets[c]	2.4	2.5	2.8	2.9	3.4
<b>Total assets</b>	<b>214.7</b>	<b>222.1</b>	<b>234.9</b>	<b>243.3</b>	<b>250.0</b>

[a] Figures differ from those in Table 6 in the statistical annex (see additional notes to Tables 20 and 21).

[b] Provisional.

[c] Mainly capital and other internal funds denominated in foreign currencies.

## UK banks' liabilities and claims by country or area

In the first half of 1978, oil-exporting countries' outstanding net deposits continued to fall.

	1977			1978	
	30 June	30 Sept.	31 Dec.	31 Mar.	30 June [a]
United States	- 6.7	- 5.7	- 6.1	-10.2	- 8.9
Canada	- 1.6	- 1.4	- 1.3	- 2.0	- 1.0
European Economic Community	+ 3.9	+ 6.4	+ 7.1	+ 8.9	+ 9.5
Other Western Europe	-11.4	-12.4	-13.6	-14.6	-16.4
Eastern Europe	+ 6.9	+ 7.3	+ 7.0	+ 7.3	+ 8.3
Japan	+10.8	+ 9.9	+ 9.9	+ 9.9	+ 8.9
Oil-exporting countries[b]	-23.7	-23.8	-22.7	-21.6	-19.0
Countries engaged in off-shore banking	+10.0	+10.2	+ 8.6	+ 7.4	+ 7.2
Other countries	+ 0.8	- 2.3	- 1.1	+ 2.9	+ 0.9
	-11.0	-11.8	-12.2	-12.0	-10.5

[a] Provisional.

[b] Listed in the footnote to Table 19 in the statistical annex.

## Maturity structure of UK banks' net foreign currency position

Net liabilities at less than eight days rose by \$2 billion between mid-February and mid-May 1978.

	1978	
	mid-Feb.	mid-May
Less than 8 days[a]	-13.0	-15.0
	- 9.5	-11.5
8 days to less than 3 months	-18.5	-18.9
3 months to less than 1 year	- 7.2	- 7.3
Net borrowing up to 1 year	-38.7	-41.2
Net lending at 1 year and over	+38.8	+41.4
	+ 0.1	+ 0.2

[a] Figures in *italics* include all holdings of London dollar certificates of deposit, regardless of maturity, as these are immediately realisable assets for the holding bank.

There was also a surge in new foreign and international bond issues in the second quarter (\$8 $\frac{3}{4}$  billion, after \$7 $\frac{1}{4}$  billion in the first quarter). This largely reflected some revival of issuing activity in the international dollar sector and in the market for foreign dollar bonds in New York.

Provisional figures suggest that the underlying growth of the London euro-currency market slowed down slightly in the second quarter. The recorded gross foreign currency liabilities of reporting institutions rose by \$5 $\frac{3}{4}$  billion; after adjustment for the statistical effects of currency valuation changes, the underlying increase was of the order of \$6 $\frac{1}{2}$  billion. This compares with a rise of something over \$7 billion in the previous three months (after adjustment not only for currency valuation changes but also for the unwinding of end-year positions with banks in the United Kingdom and overseas which had been built up in the final weeks of 1977).

Provisional figures for the banks' external positions suggest that the Eastern European countries, which took \$1 billion net from the London market, were the major borrowers during the quarter. In addition, the oil-exporting countries reduced their net deposits in London by \$2 $\frac{1}{2}$  billion, and the United States and Canada withdrew \$1 $\frac{1}{4}$  billion and \$1 billion respectively. On the other hand, countries of 'other Western Europe' supplied \$1 $\frac{3}{4}$  billion net of new funds and Japan reduced its net borrowing from London by \$1 billion.

A quarterly maturity analysis of the foreign currency liabilities and assets of reporting institutions was completed as at 17th May (see Table 21 in the statistical annex). Gross foreign currency liabilities rose by some \$2 billion, or some \$3 billion after adjustment for currency valuation changes, compared with an adjusted increase of about \$4 billion in the previous three months. Net liabilities at up to one year rose by \$2 $\frac{1}{2}$  billion: the major part of this was in net liabilities at less than eight days, which went up by \$2 billion, an increase attributable almost wholly to the American, Japanese and other overseas banks.

A maturity analysis of institutions' issues and holdings of US dollar certificates of deposit (and small amounts of other negotiable paper) is included in the additional notes to Table 21 in the annex. In the period to mid-May, outstanding issues fell by over \$300 million.

## Oil money movements[1]

Total estimated oil revenues of oil-exporting countries were even lower in the second quarter than in the first. The volume of exports recovered only gradually after declining in January and there was some further shading of prices. With the volume of Middle Eastern exports dropping in May and June, revenues could remain depressed in the third quarter.

Oil exporters' net borrowings[2] were apparently slightly lower in the second quarter than in the first and, despite the very sharp decline in revenues, imports of goods and services have continued to increase. It is estimated, after taking into account significant downward revisions for the first quarter, that the cash surplus available for investment abroad, for government loans and for additions to financial reserves fell sharply again in the first half-year (see table).

Sterling holdings were little changed in either of the first two quarters of 1978 but foreign currency deposits with UK banks fell in both quarters.

Total investment in the United States of some \$2 billion in the first quarter was largely offset by disinvestment, particularly in Treasury bonds and notes and Treasury bills, in the second.

The estimate for bank deposits in other countries is even more tentative than usual and is based on the assumption that much of the disinvestment from the United Kingdom and the United States has been accompanied by increased placements in other centres. It is likely to be revised as more

[1] Tables for this section are shown overleaf.

[2] See footnote [a] to the second table overleaf.

## Estimated oil revenues of exporting countries

Oil revenues in the second quarter were much lower than in the first.

\$ billions				
1976	1977	1978		
Year	Year	1st qtr	2nd qtr	1st half
113.2	129.1	31.9	29.1	61.0

## Estimated deployment of oil exporters' surpluses<sup>(a)</sup>

In the first half of 1978 there was a further sharp fall in the total surplus.

	1976		1977		1978
	Year	Year	1st half	2nd half	1st half [b]
<b>United Kingdom</b>					
British government stocks	0.2	—	- 0.2	0.2	- 0.2
Treasury bills	- 1.2	- 0.2	- 0.1	- 0.1	0.2
Sterling deposits	- 1.4	0.3	0.5	- 0.2	- 0.2
Other sterling investments[c]	0.5	0.4	0.2	0.2	0.1
British government foreign currency bonds	—	0.2	0.2	—	—
Foreign currency deposits	5.6	3.4	3.4	—	- 1.0
Other foreign currency borrowing	0.8	—	—	—	—
	4.5	4.1	4.0	0.1	- 1.1
<b>United States</b>					
Treasury bonds and notes	- 4.2	4.3	2.0	2.3	- 0.8
Treasury bills	- 1.0	- 0.8	0.5	- 1.3	- 0.8
Bank deposits	1.6	0.4	—	0.4	- 0.2
Other[c]	7.2	5.3	2.9	2.4	2.3
	12.0	9.2	5.4	3.8	0.5
<b>Other countries</b>					
Bank deposits	6.5	7.5	4.5	3.0	4.0
Special bilateral facilities and other investments[c][d]	12.2	12.4	6.8	5.6	3.0
	18.7	19.9	11.3	8.6	7.0
<b>International organisations</b>	2.0	0.3	0.2	0.1	—
<b>Total</b>	<b>37.2</b>	<b>33.5</b>	<b>20.9</b>	<b>12.6</b>	<b>6.4</b>

[a] This table excludes liabilities arising from net borrowing and inward direct investment and also, on the assets side, changes in credit given for oil exports. A table reconciling the figures with the estimates for current account surpluses is given below.

[b] Provisional.

[c] Includes holdings of equities, property, etc.

[d] Includes loans to less developed countries.

## Reconciliation between 'deployment' table and current account surpluses

	1975	1976	1977[a]
Current account surpluses	31	36	34
Net borrowing	3	7	7
Oil sector capital transactions[b]	1	- 6	- 2
Cash surpluses available for investment	35	37	39
'Deployment' table estimates	35	37	34
Errors and omissions	—	—	5

[a] The figures for 1977 are likely to be revised as fuller information becomes available.

[b] Includes credit given for oil exports and oil companies' investment/disinvestment in oil-exporting countries.

information becomes available. The indications are that some further diversification into currencies other than the US dollar continued in both the first and second quarters.

## Commodity markets

During May to July, trading remained generally light. Over the three months, prices of most foodstuffs were depressed, while industrial raw materials were generally more buoyant than in preceding months. *The Economist* sterling all-items index fell 8%, partly reflecting the appreciation of sterling against other currencies.

In the terminal markets, the decline in coffee prices which had resumed during January to April was reversed in May owing to fears of the onset of a Brazilian frost, and prices rose sharply. In June and July, however, the fears were allayed, and towards the end of the period prices were at their lowest for more than two years. Cocoa prices also eased, following a higher estimate of this season's supply. In the sugar market, the London Daily Price fell during July to the lowest since late 1972.

On the London Metal Exchange (LME), all prices moved upwards over the period. Cash copper rose substantially during May following the disruption of production in Zaire, but fell back as fears of a prolonged and serious reduction of supplies were dispelled. Copper prices were nevertheless higher at the end of the period, partly owing to further declines in LME stocks, to below 500,000 tonnes for the first time since the end of 1975.

## Draft legislation on deposit-taking institutions

On 25th July the Government issued a White Paper (Cmnd 7303) containing a draft bill providing for the authorisation and supervision by the Bank of banks and other deposit-taking institutions not already subject to statutory regulation. The draft bill, which embodies and develops proposals originally announced in August 1976,[1] was published in this form to allow for further consultations with interested parties. The Government remain committed to legislation as soon as Parliamentary time permits.

The draft Banking Bill will fulfil the United Kingdom's obligation as a member of the EEC to introduce a system of prior authorisation for credit institutions and will ensure that all such institutions are made subject to adequate supervision while leaving substantially unchanged the Bank's well-established approach to the supervision of banks. Banks will be recognised as such under the legislation, and other deposit-taking institutions will be licensed.[2] The Bank will make an annual report to the Chancellor of the Exchequer, who will lay it before Parliament, on the exercise of their functions under the statute and the principles on which they act in interpreting and applying the criteria for the grant and withdrawal of deposit-taking authority. The proposed legislation includes provisions for regulating the use of banking names and descriptions—which as a general rule will be confined to recognised banks—and for controlling advertisements for deposits.

In addition, it will set up a deposit protection scheme, to which both recognised banks and licensed institutions will contribute, to provide a limited measure of protection to depositors of sterling with any institution covered by the legislation in the event of its failure. The scheme will be administered by the Bank through a separate legal entity, the Deposit Protection Board, on which contributory institutions will be represented.

[1] *The Licensing and Supervision of Deposit-taking Institutions* (Cmnd 6584). See the September 1976 *Bulletin*, page 306.

[2] With certain exceptions, notably building societies and trustee savings banks, which are regulated in other ways.