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MARCH 1984

FINANCIAL MARKETS REPORT

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The attached note reports on developments in the foreign exchange and domestic financial markets during the period banking and calendar February.

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SUMMARY OF THE MARKETS IN BANKING AND CALENDAR FEBRUARY

(18 January to 29 February 1984 inclusive)

- The dollar fell sharply against most major currencies in February as concerns about the inflationary and balance of payments effects of high US budget deficits turned market sentiment. Sterling benefited from renewed fears over Middle East oil supplies, as well as the weaker dollar, rising in effective terms (though falling a little against the deutschemark).

- The money markets were bullish in the face of sterling's good showing but a number of adverse factors caused the gilts market to hold back.

- The FT index rose to a record high of 840.5 on 25 January but closed February some 4.1 points down on its 18 January level. The new FTSE 100-share index was launched, with a base date of 3 January.

- Total net issues by UK listed companies in calendar February were £41 million, which along with January represents a quiet start to 1984.

HF3/EF1 Divisions

8 March 1984

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Introduction

1. On the foreign exchange markets the dollar weakened sharply. Sterling strengthened against the dollar and in effective terms, but lost some ground against a generally firmer deutschemark. The money markets were bullish in the face of sterlings good showing, with a firm downwards trend in rates developing by the end of the period. The Gilts market was strong through the second half of calendar January, but fell into a deep sleep for most of February. The equity market's growth of recent months was also arrested during February, with relatively little activity on the capital issues front.

FOREIGN EXCHANGE MARKETS

Spot Sterling

2. Sterling was largely on the sidelines in the second half of January, trading fairly steadily against Continental currencies, while continuing to fluctuate against an erratic dollar. After closing at $1.4074, DM 3.9618 and 82.0 on 18 January, sterling ended the month on a slightly softer tone, $1.4033, DM 3.9513 and 81.8, after some heavy commercial selling on the 31st.

	$/£	DM/£	£ Effective
1 February (open)	1.4062	3.9359	81.7

3. Sterling began February firmer against a sharply weaker dollar, but failed to match gains made by the Continental currencies, in anticipation of a large commercial selling order against deutschemarks overhanging the market.

	$/£	DM/£	£ Effective
10 February (close)	1.4144	3.8740	81.4

4. During the period leading up to the 10th sterling traded generally softer, encountering widespread commercial selling on the 7th which also included the first part of the expected large commercial selling order against deutschemarks. Sterling's weaker tone against the Continental currencies persisted on the 8th, but a weakening of the dollar in New York later that day lifted the pound to a high point of $1.4205. However, the rate subsequently eased to a low £$1.4110 and a closing effective of 81.4 (its lowest closing level since last April) on the 10th following reports that OPEC might allow Nigeria to increase its output quota and sell at below official prices.

	$/£	DM/£	£ Effective
21 February (close)	1.4474	3.9102	82.7

5. Sterling traded within a narrow range in the early part of the period between 11 and 21 February, but some sizeable commercial demand towards the close on 14th pushed the pound up to $1.4220, DM 3.8899 and 81.8. However, after rising to $1.4407 on the 15th, as the dollar weakened sharply, sterling began to ease, more so against European currencies following the completion of the final stage of the large commercial operation initiated earlier in the month. By the close sterling had eased to DM 3.8630, with the effective rate unchanged on the previous day's close. However, rumours on the 17th that Iran might try to close the Straits of Hormuz, boosted sterling to a sharply firmer close of $1.4500, DM 3.8918 and 82.5. Renewed fears about oil supplies from the Persian Gulf caused a further sharp rise on the 21st with sterling touching highs of 82.8, $1.4550 and DM 3.92 1/8 during the day.

29 February (close)	1.4915	3.8690	83.5

6. Persistent market sentiment towards a lower dollar and concern about the possible disruption to Middle East oil supplies continued to be the main factors underlying sterling's firmer tone in the period leading up to the end of the month. Rumours early on the 25th, subsequently denied, that Iraq had attacked the Iranian Kharg Island terminal, bolstered sterling to a high point of $1.49½ and a noon effective of 83.5. As the dollar dropped sharply on the 29th, in reaction to the worse than expected US January trade deficit, sterling rose to the $1.49½ level but was restrained from moving higher by some fairly heavy professional selling which emerged around the same time as the release of the UK January trade figures (£129 million current account deficit after a surplus of £568 in December). The main reason behind the selling however, was thought to be the absence of fresh news from the Middle East in previous days.

The dollar

7. The dollar traded erratically during the second half of January reflecting general uncertainty about the pace of the US recovery and the prospects of reducing high US budgets deficits. After closing at DM 2.7890 on the 18th, the dollar subsequently fluctuated between this level and DM 2.83 before closing the month at DM 2.8157.

8. Increasing uncertainty about the prospects for the dollar and emerging signs that investment funds were being switched from the US to European markets caused the dollar to ease sharply to below DM 2.76 at the start of February. However, subsequent release of the December FOMC minutes indicated that the Fed had voted in favour of a slight tightening of monetary policy, and with renewed tensions in Lebanon drawing attention to safe haven considerations, the dollar staged a brief recovery. But remarks by Volcker about the US budget and trade deficits caused a sharp decline (DM 2.7305 on the 9th) which was temporarily interrupted by rumours on the 10th that the Soviet leader Andropov had died.

However, profit-taking followed the official confirmation and the dollar resumed its eaiser tone. Failure to react to strong US economic indicators on the 14th and rumours, quickly denied, that President Reagan had died caused the dollar to fall sharply, closing in London the following day at DM 2.6907. The revised US Q4 GNP figures (+4.9 per cent from 4.5 per cent) and a $2½ billion rise in US M1 steadied the dollar on the 17th before news of escalating Middle East hostilities temporarily boosted it to high of DM 2.71½ on the 21st. But persistent bearish sentiment stemming from growing concern over the inflationary and balance of payments effects of high US budget deficits caused a series of sharp falls thereafter. The announcement of a record $9.47 billion US trade deficit in January caused the dollar to dip to low of 2.5875 on the 29th resulting in a loss of around 26 pfennigs since it reached a 10 year high of DM 2.85 on 10 January and its lowest closing level since last October.

Other currencies

9. Within the EMS the Belgian franc remained firmly established as the weakest currency, despite increases in their discount and Lombard rates by 1 per cent to 11 per cent and 12 per cent respectively. The deutschemark rose to the top of the narrow band which was fully stretched for most of the month, as pressures mounted on other currencies. The Yen traded largely on the sidelines throughout February, benefiting little from the weaker dollar.

THE DOMESTIC MARKETS

Money Markets

10. The markets continued the quiet period begun in January until well into banking February. However, as the end of calendar February approached, a strengthening in sterling against the US dollar prompted speculation that a fall in clearing banks base rates might be imminent.

11. Money rates had started banking February at $9^3/8$ and $9^{15}/16$ for 3 and 12 month Interbank rates respectively but by 2 March they had fallen to $9^1/16$ and $9^5/16$ which dealers said discounted an 8½ per cent base rate. Eligible bill rates have remained close to the Bank's dealing rates throughout due to large market shortages effectively making the bank the market maker in the money market.

12. Money market shortages averaged £430 million during banking February with new assistance totalling £1450 million during the month bringing the total stock of market assistance outstanding to £11,447 million, a little down on the peak of about 11.6 billion in

mid-calendar February. The main influences taking money out of the market were funding, which accounted for £1.2 billion and £200 million of seasonal surpluses in the CGBR. A decrease in the note issue returned £315 million to the market.

The Gilts Market

13. The gilts market was not in very buoyant form for much of the period under review. Gross sales amounted to £1.2 billion in the six weeks between January 19 and 29 February inclusive, over half of which was sold before the announcement of 9¾ per cent Exchequer 1998 on Friday 3 February. The rest of calendar February saw about £100 million of new sales alongside payment of a large call on the 10 per cent Treasury Convertible 1990.

14. Banking February began on January 19 with the £1 billion of the new 10 per cent Treasury 1990, convertible at various points during the next three years into 9½ per cent Conversion stock 2004, fully allotted above the minimum tender price at issue with 20 per cent initial payment (£200 million was also issued to NILO). This success, and the ongoing firmness in the market, led the Authorities to follow this up on Tuesday 24 January with the announcement of three new tranchettes to replenish the Issue Department's Stock - one short, a medium and a 1999 medium-long gilt. By the end of calendar January the latter had sold out with half the 9 per cent Treasury 1992-96 stock also absorbed and by mid-morning on Friday 3 February the whole package was exhausted. At close that afternoon the Authorities announced the issue (by tender at a minimum price of 94½) the following Wednesday of £1 billion of 9¾ per cent Exchequer 1998, technically still a medium though the longest conventional tap stock to the launched for over three years. The market reacted badly to this announcement, exhibiting doubts about the pricing of the new stock and its maturity, which combined to make it look rather aggressive to some commentators.

RECENT GILTS ISSUES

	Stock	Date Announced	Issue Price	Gross Yield to Redemption	£m Total amount
10%	Treasury Convertible 1990	13/1	96	10.90	1200
9½%	Treasury 1988	24/1	95¼	10.82	250
9%	Treasury 1992-96	24/1	93½	10.48	150
9½%	Treasury 1999	24/1	94	10.35	100
9¾%	Exchequer 1998	3/2	94½	10.51	1000

15. The subsequent fall in the gilts market on Monday 6 and Tuesday 7, combined with the gloomy noises from Mr Volcker in the US, conspired to make the minimum price look rather

high by the Wednesday. The Issue Department took up £896 million of the new stock and the market fell into a long and fruitless torpor. Some £433 million of a call on the 10 per cent Treasury Convertible 1990 was received by the Authorities on 13 February.

16. The gilts market was only stirred from its lethargy at twenty minutes past five on the evening of Thursday 23, when the Inland Revenue announced that it had written to the Building Societies Association to say that, following legal advice they proposed to tax building societies' profits from realisations of gilt edged stock as trading income rather than as capital gains. In the next few hours building societies disposed of several hundred pounds worth of low coupon shorts so as to try to avoid the new rules. Prices opened well down on Friday 24, with some shorts £2 or more off. During the day the Bank arranged a £200 million swap of low coupon shorts in exchange for the 9¾ per cent Exchequer 1988, so as to check the fall in prices. By Monday 27, the market had regained its nerve, however, and some cheap buying of low coupons began to occur which has resulted in about a £2 fall in their average price. By the end of the month the market was showing distinctively bullish signs, except at the short low coupon end, and £409 million nominal of the 9¾ per cent Exchequer 1998 was sold in the last two days.

17. Gilt yields (see Annex) firmed a little in the second half of calendar January. They fell by over ¼ at the short end over the first three weeks of calendar February, while remaining fairly steady at the medium and long end. The building societies furore pushed average short yields up by over ¼, but these had fallen back again by the 29 February to close below their levels at the start of the period. Short low-coupon yields, however, have slipped by about ¾ and stayed there. Only long yields rose fairly consistently over the period, closing $^1/8$ up on their mid-January level. From 17 February Mullens (and therefore the Bank) had begun to quote index-linked gilt yields on a new, standard basis. As interest in IGs continued to wane over the period yields rose a little.

Gilts Futures

18. The 20 year gilt futures contract on the LIFFE (London International Financial Futures Exchange) market continued to follow the fortunes of the conventional markets closely with total turnover only around 3024 contracts on average per day underlining the immaturity of the market. The March price started and finished the month at around 109(£) with a minor dip to below 108 on 7-9 February due to the prevailing quietness in the conventional market.

Equity Market

19. Over the period as a whole the 30-share index has fallen by 4.1 to 819.8, having closed at a record high of 840.5 on 25 January.

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20. The FTSE ("footsie") 100-share index has been introduced with a base date of 3 January (1,000.0). This index is not perfectly representative of the whole market, having 18 per cent of its value represented by oil shares. On 19 January the 100-share index stood at 1,058.1; on 29 February it stood at 1,040.3 having recorded a high in the period of 1,075.9 on 27 January.

21. The market began the period encouraged by optimism on economic recovery; the 30-share index closed at a new high of 826.9 on 20 January.

22. The market continued to advance storngly during the following week beginning 23 January with US demand for Bowater, Hawker Siddeley and ICI. The market traded cose to these record levels for the next seven trading sessions until sentiment was unsettled by large falls on Wall Street. On 6 and 7 February the index registered a two-day fall of 32.7 (-4 per cent) to 799.7. By the end of that week the market had steadied with the index closing at 805.4 on 10 February.

23. A firmer tone was seen over the fortnight beginning 13 February with demand for ICI in advance of their figures on 23 February. Clearing banks advanced prior to their dividend season. Commercial Union's poor results on 22 February did not affect insurances generally although life offices reacted nervously on 24 February following the announcement of the new building society tax treatment. On 24 February the index closed at 815.8.

24. The market was subdued for the first three days of the week beginning 27 February with openings reflecting closes on Wall Street. Wednesday, 29 February saw financial sectors weaker with reported concern over possible taxation changes. The index closed at 819.8.

Capital Issues

25. Total net issues by UK listed companies for calendar February were £41 million, compared with £63 million a year ago. Gross issues by industrial and commercial companies were £31 million, which included a £15 million rights issue by Sketchley and £5 million by Ellis and Everard. An £11 million placing of loan stock was the largest of three issues made by financial companies while three overseas bodies also made loan stock issues - Asian Development Bank £22 million (first instalment of an £88 million offer); Province of Quebec £12 million (first instalment of £49 million placing) and Commonwealth of Australia £72 million (last and major tranche of a £96 million offer). There were eleven newcomers to the Unlisted Securities Market, two of which made rights issues, the largest of which, Micro Focus, raised £9 million.

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COVERING SECRET

	Band 1 (0-14 days)	Band 2 (15-33 days)	Band 3 (34-63 days)	Band 4 (64-91 days)
Dealing Rates (unchanged since 4 October)	$9^1/16$	9	$8^{15}/16$	$8^7/8$

Eligible Bill Rates	**Band 1**	**Band 2**	**Band 3**	**Band 4**
January 19	$9^1/16$	9	$8^{15}/16$	$8^7/8$
February 2	$9^1/32$	9	$8^{15}/16$	$8^7/8$
February 17	$9^1/32$	$8^{63}/64$	$8^{59}/64$	$8^{55}/64$
February 29	$9^1/16$	9	$8^{55}/64$	$8^{55}/64$

Interbank rates

	7 days	1 month	3 months	12 months
January 19	9.19	9.25	9.38	9.94
February 12	9.19	9.19	9.38	9.88
February 17	9.19	9.25	9.38	9.81
February 29	9.13	9.19	9.19	9.50
Eurodollar rates				
January 19	9.50	9.56	9.75	10.31
February 2	9.56	9.56	9.75	10.25
February 17	9.75	9.81	10.00	10.63
February 29	9.69	9.75	10.13	10.81

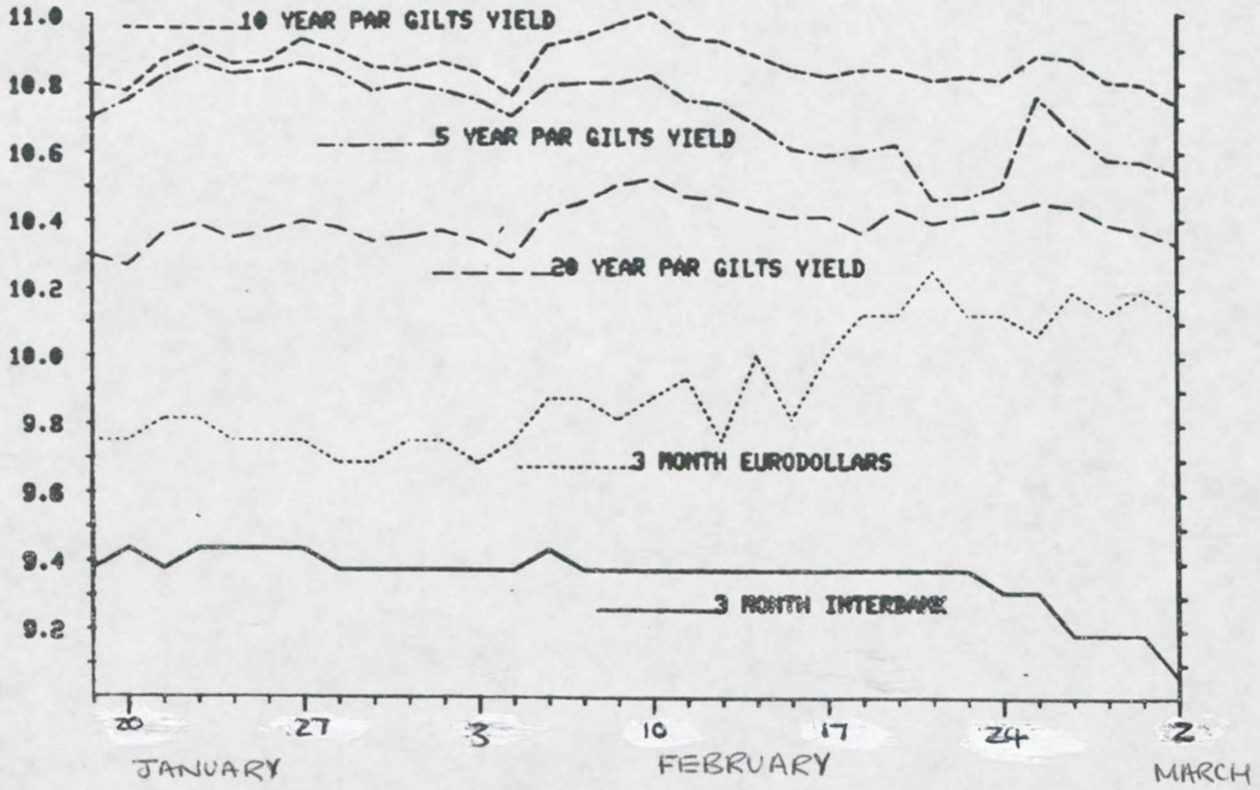
International Comparisons Closest analogies to 3 month interbank rates:

Week ended	USA	Germany	Average 6 leading OECD (barring UK)
January 21	9.25	6.10	10.34
February Feb 4	9.30	6.15	10.31
February Feb 18	9.45	6.03	10.33
February Feb 25	9.65	5.85	10.24

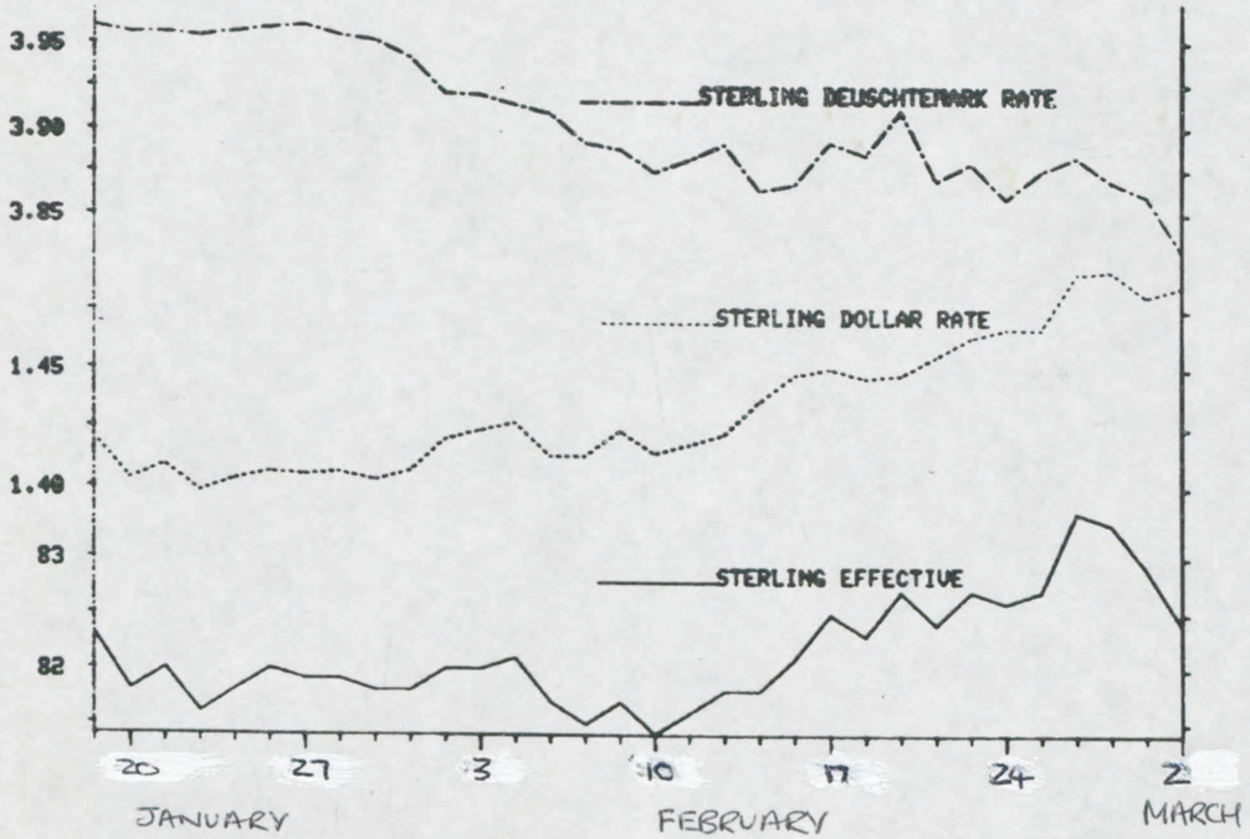
				IG Yields	
Gilt Yield curves	**5 year**	**10 year**	**20 year**	**2% 1988**	**2½% 2011**
January 19	10.733	10.753	10.263	3.80	3.09
February 2	10.779	10.855	10.365	3.91	3.12
February 17	10.586	10.818	10.406	3.89*	3.13*
February 22	10.457	10.807	10.392	3.82*	3.14*
February 27	10.764	10.882	10.453	4.12*	3.20*
February 29	10.580	10.805	10.387	4.24*	3.22*

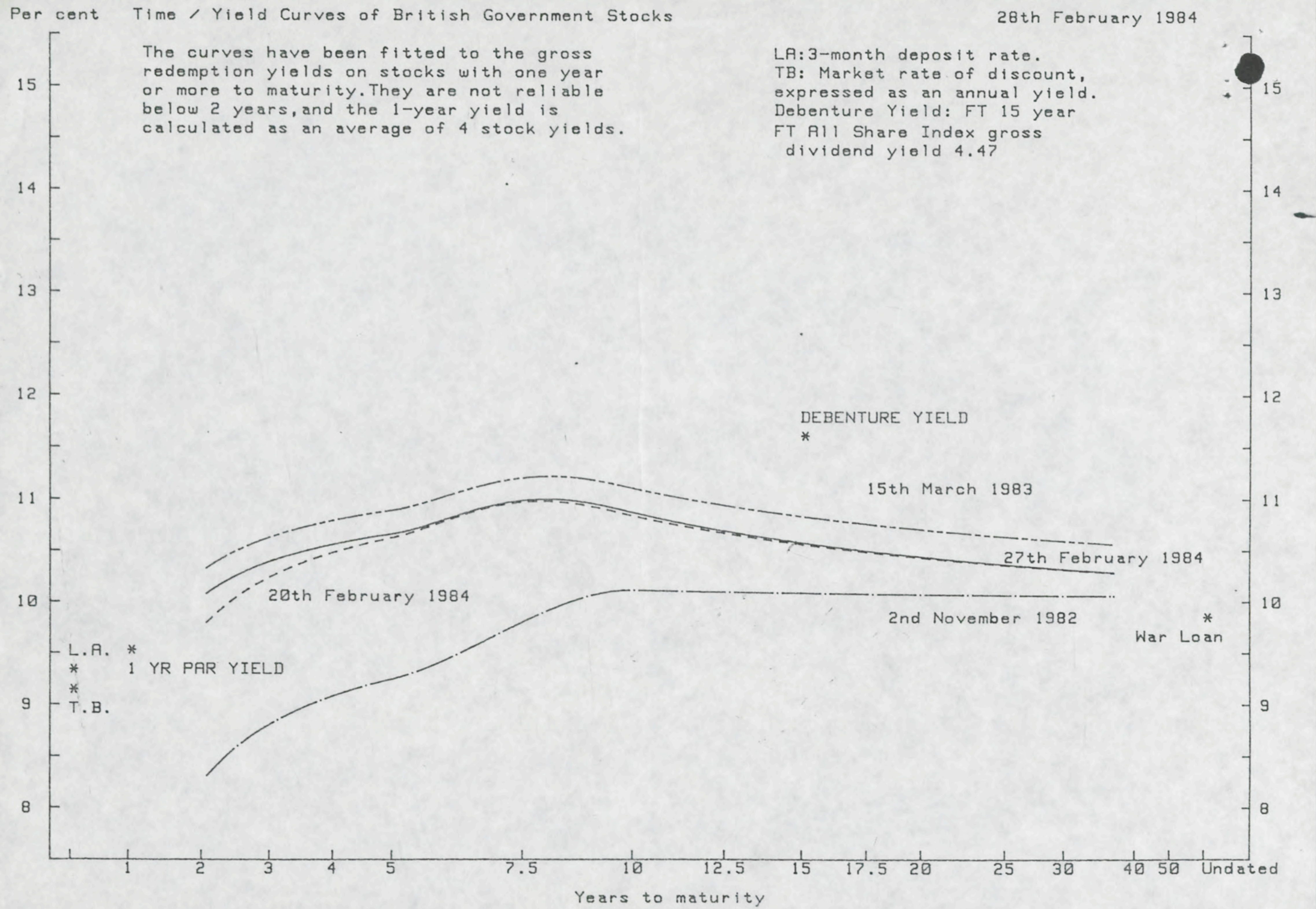
*New Mullens IG Yield method

INTEREST RATES 19 JAN 84 TO 2 MAR 84



EXCHANGE RATE 19 JAN 84 TO 2 MAR 84





Per cent
Time / Yield Curves of British Government Stocks
28th February 1984
The curves have been fitted to the gross redemption yields on stocks with one year or more to maturity. They are not reliable below 2 years, and the 1-year yield is calculated as an average of 4 stock yields.
LA: 3-month deposit rate.
TB: Market rate of discount, expressed as an annual yield.
Debenture Yield: FT 15 year
FT All Share Index gross dividend yield 4.47
DEBENTURE YIELD
15th March 1983
27th February 1984
20th February 1984
2nd November 1982
War Loan
L.A.
1 YR PAR YIELD
T.B.
15
14
13
12
11
10
9
8
1
2
3
4
5
7.5
10
12.5
15
17.5
20
25
30
40
50
Undated
Years to maturity