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13 June 1984

FINANCIAL MARKETS REPORT

Prepared by HF3 and EF(1)

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

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SUMMARY OF THE MARKETS IN BANKING AND CALENDAR MAY

(18 April to 31 May 1984 inclusive)

- The dollar fluctuated sharply as concerns about the stability of US banks and LDC debts reduced the Fed's scope for tightening monetary policy. Although sterling eased to a new record low against the dollar ($1.3707), it traded firmer against Continental currencies and broadly steady in effective terms.

- Following the base rate rise on 9 May the short-term yield curve pointed sharply upwards and by the end of calendar May a further increase in base rates was widely expected.

- Gilt Yields moved up sharply in line with short-term interest rates, seriously reducing the level of activity in the market.

- Equities fell by more than 90 points on the FT 30 Index over the period.

- Capital issues were the highest in 1984 to date, but still well down on last year's record levels.

HF3/EF1 Divisions
13 June 1984

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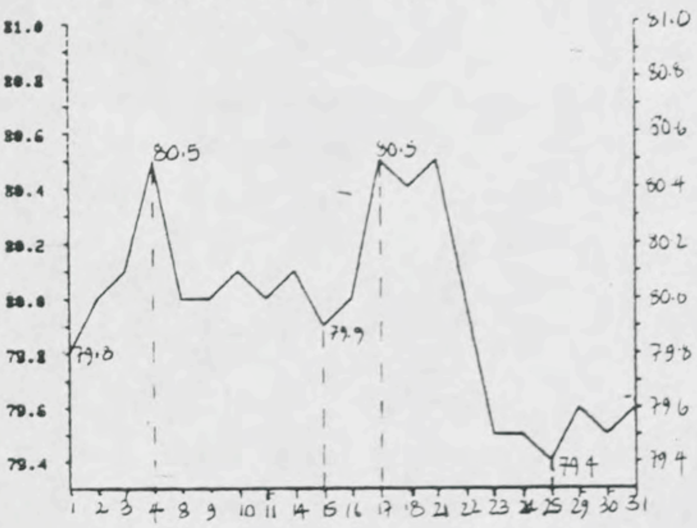
Introduction

1. On the foreign exchange market the dollar traded erratically in May and although sterling drifted lower against the dollar it traded firmly against European currencies and remained broadly steady in effective terms. Short-term interest rates finished the period pointing to a further rise in base rates, which had earlier risen on 9 May. Gilts were reluctant to make a start, with a low level of sales and rising yields. The equity market lost over 90 points on the FT 30 Index over the period. Capital issues were the highest so far in 1984.

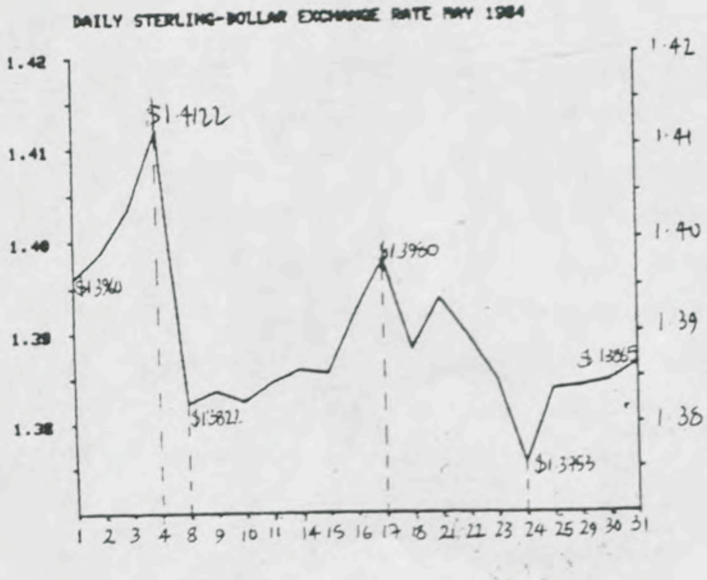
FOREIGN EXCHANGE MARKETS

Spot Sterling

DAILY EFFECTIVE EXCHANGE RATE(STERLING) MAY 1984



DAILY STERLING-DOLLAR EXCHANGE RATE MAY 1984



2. A sharp firming of the dollar in the second half of April on expectations of higher US interest rates caused sterling to move quietly lower, although it strengthened against European currencies and remained steady in effective terms.

3. A gradual firming of interbank sterling rates early on in May focussed attention on the possibility of an increase in base rates and the pound rose to $1.42 in New York on the 3rd. However, a late surge in the dollar on the 4th, reflecting interest rate considerations, caused sterling to fall sharply, though by less than Continental currencies, in New York on the 7th (when London was closed). With interbank rates continuing to edge higher on the 8th sterling showed a firmer tone, but unexpectedly good April money supply figures (£M3: +½%) followed by news of a rise in US prime rates led to a burst of selling and the pound fell quickly to a new all-time low of $1.3785. News of the base rate increases (½ - ¾%) on the 9th was followed by some profit-taking, but the selling was short-lived. Concerns about a possible disruption to Gulf oil supplies and a sharp stengthening in spot oil prices led to some good demand for

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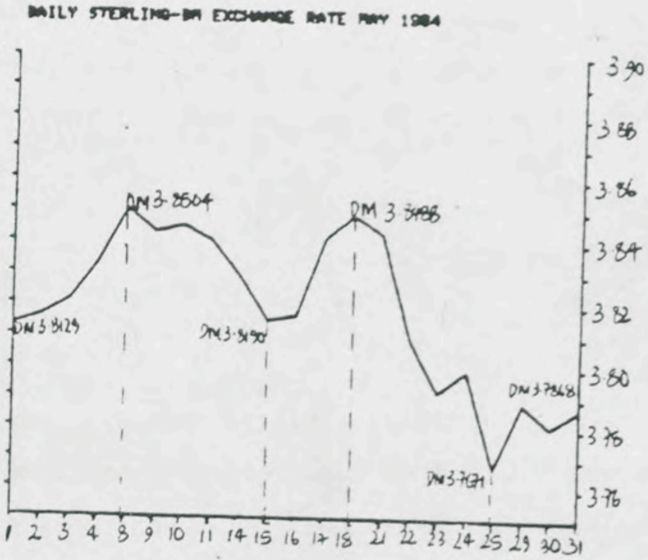
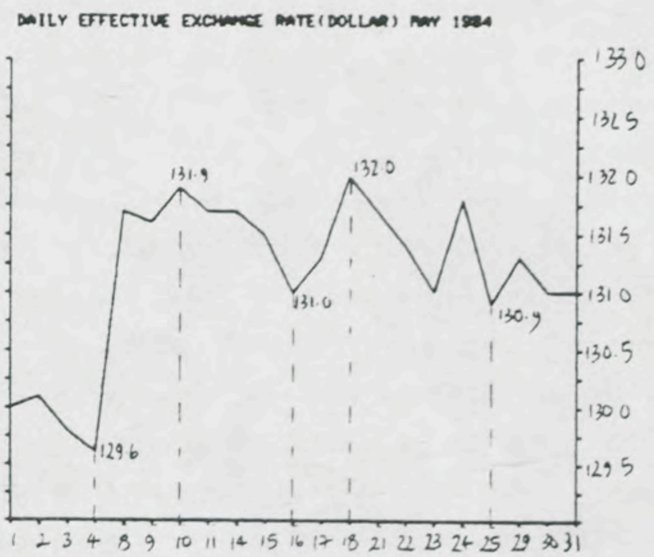


sterling around the middle part of the month. But the absence of further news from the Gulf together with a change in sentiment towards sterling after news of the failure of the NCB's talks with the miners' led to a steady decline in the rate. These factors, which coincided with a general strengthening of the dollar, caused sterling to open on the 24th at a new 13 month low of 79.4 in effective terms with the rate against the dollar falling to an all-time low of S1.3707 in New York later that day. The pound recovered from its lower levels, as the dollar fell sharply, to trade within a relatively narrow range. Publication of the April trade figures on the 29th had very little effect as did the gradual firming of interbank rates and the resulting speculation of a rise in base rates.

The dollar



4. The dollar firmed quiet in the latter part of April supported by expectations of higher US interest rates following stronger than expected US economic data, and concerns about industrial disputes in parts of Europe, particularly in West Germany.

5. After a fairly quiet start to May a forecast by Kaufman predicting "spectacularly higher US interest rates", together with news of a strong rise in US manufacturing employment, triggered a spectacular rise in the dollar in New York on the 7th which was subsequently fuelled by a ½ per cent increase to 12½ per cent in US prime rates. But nervousness over concerted intervention by central banks, coupled with rumours about the liquidity problems of a major US bank caused the dollar to move erratically lower. The

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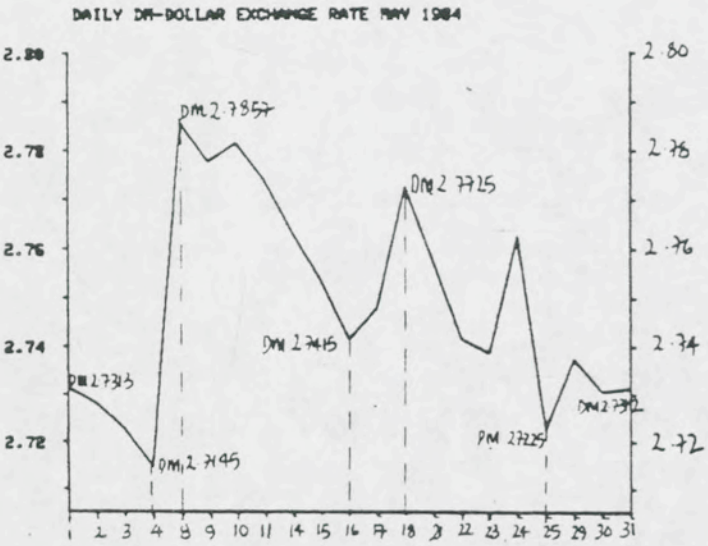

dollar was further depressed by an easing of US interest rates, despite further strong US economic data, as rumours about the financial difficulties of Continental Illinois Bank diminished the likelihood of the Fed tightening policy. The dollar began to recover cautiously around the middle part off the month in response to renewed tensions in the Gulf War. A sharp $4.9 billion rise in US M1 and news that US GNP grew by 8.8 per cent in the first quarter, compared to an earlier estimate of 8.3%, also provided support. Thereafter the dollar traded erratically as concerns about the stability of major US banks and LDC debts - Bolivia's decisions to temporarily suspend repayments - limited the Fed's scope for action. The dollar fell by six pfennigs at one point in New York on the 24th before subsequent assurances by the Fed to provide financial support to US banks in difficulties led to more settled trading. News of a record $12.2 billion US trade deficit in April was absorbed calmly by the markets.

OTHER RELATED DEVELOPMENTS

	EMS Top	EMS Bottom	Spread %	Yen	Gold
18 April (close)	DM	Bfr	1 7/8	224.63	380 ½
1 May (close)	DM	Bfr	1 5/8	227.16	376 ½
11May (close)	Dfln	Bfr	1 5/8	230.25	372 ½
21 May (Close)	Dfln	Bfr	1 5/8	233.05	380 ¾
31 May (Close)	DM	Bfr	1 13/16	231.50	384 ¼

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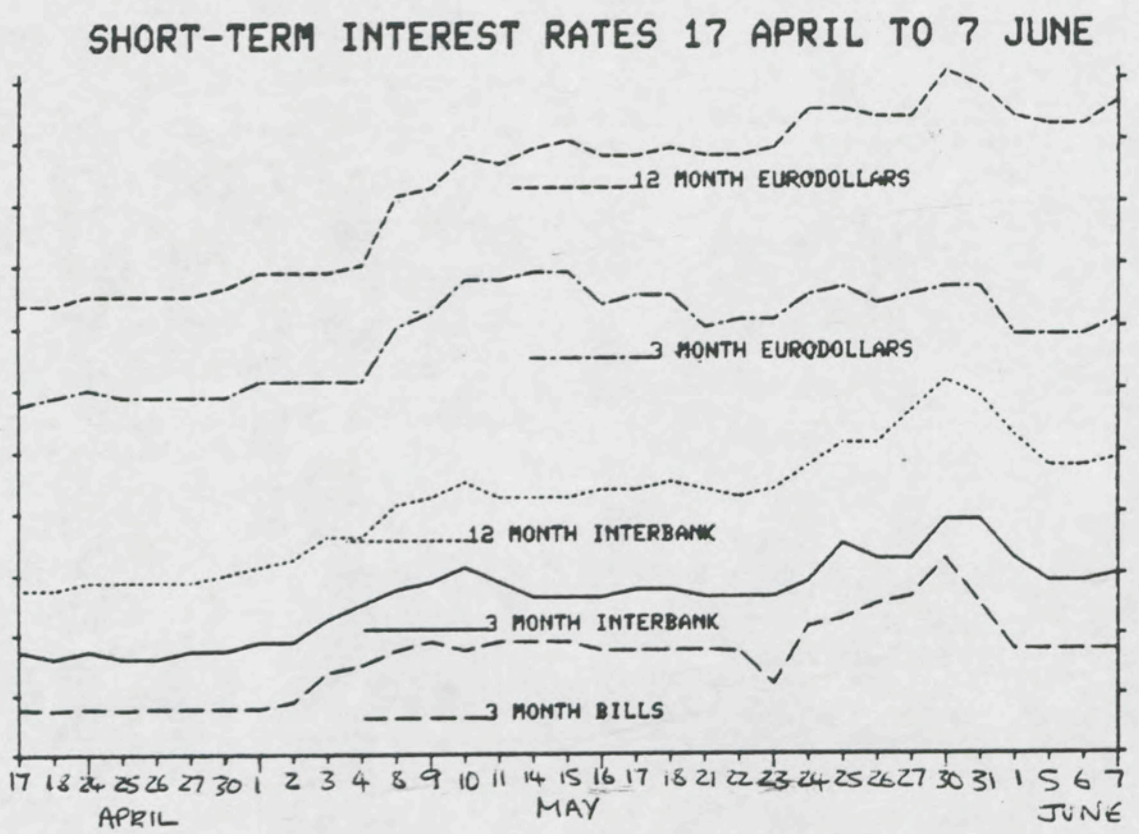
The Domestic Markets

Money markets

6. Money market rates were quiet in the early part of the banking month but towards the beginning of calendar May pressure developed for a rise in base rates as the differential between UK and US 3 month rate grew to over 2 per cent. Base rate rose from 8½ per cent to 9 per cent (and 9¼ per cent for Barclays and Midland) on 7 May and for a while rates settled.

7. However concern about the future course of US rates, the troubles of Continental Illinois and domestic monetary worries (following the announcement of an April PSBR of £2.4 billion) began to force rates upwards again with 3 month interbank touching 10 per cent by end-month and the propsect of a further base rate increase looming on the horizon.



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Bank's dealing rates	**Band 1** (0-14 days)	**Band 2** (15-33 days)	**Band 3** (34-63 days)	**Band 4** (64-91 days)
April 19	$8\frac{9}{16}$	$8\frac{1}{2}$	$8\frac{7}{16}$	$8\frac{3}{8}$
May 10	$9\frac{1}{16}$	9	$8\frac{15}{16}$	$8\frac{7}{8}-\frac{15}{16}$
May 17	$9\frac{1}{16}$	9	$8\frac{15}{16}$	$8\frac{7}{8}$

Interbank rates (X)

	7 days	**1 month**	**3 months**	**12 months**
April 18	8.56	8.63	8.81	9.38
April 27	8.63	8.63	8.88	9.44
May 4	8.44	8.88	9.25	9.81
May 11	8.13	8.88	9.44	10.13
May 18	8.00	8.94	9.38	10.25
May 25	7.31	8.56	9.75	10.56
May 31	8.13	9.06	9.94	11.06

Eurodollar rates (Y)

April 18	10.63	10.63	10.94	10.69
April 27	10.56	10.63	10.94	11.75
May 4	10.44	10.75	11.06	12.00
May 11	11.19	11.31	11.88	12.81
May 18	10.50	10.88	11.75	12.94
May 25	10.38	10.88	11.81	13.25
May 31	10.81	11.00	11.69	13.56

Uncovered Differential (X-Y)

April 18	-2.07	-2.00	-2.13	-1.31
April 27	-1.93	-2.00	-2.06	-2.31
May 4	-2.00	-1.87	-1.81	-2.19
May 11	-3.06	-2.43	-2.44	-2.68
May 18	-2.50	-1.94	-2.37	-2.69
May 25	-3.07	-2.32	-2.06	-2.69
May 31	-2.68	-1.94	-1.75	-2.50

International Comparisons Closest analogies to 3 month interbank rates:

Week ended	USA	Germany	World Basket*	World/UK Differential
April 21	10.35	5.83	9.72	−0·84
April 28	10.50	5.83	9.75	−0·37
May 5	10.55	5.83	9.76	−0·51
May 12	10.95	5.83	9.91	−0·47
May 19	11.50	6.23	10.11	−0·73
May 26	11.05	6.15	9.93	−0·18
June 2	11.30	6.28	10.07	−0·13

* ROSHT World Basket, using US CD rate.

The Gilts Market

8. Gross sales in banking May only amounted to £550 million, well short of the target of £1¼ billion and net sales only came to £300 million. The first two weeks of banking June (up to the end of calendar May) saw a continued poor performance in the gilts market, with gross sales amounting to only £150 million and heavy redemptions leaving the net position minus £700 million, with three weeks of the banking month still to go.

9. The primary reason for this sluggishness in the gilts market was uncertainty about US developments, which caused gilt prices to fall to their lowest levels since September 1983, with daily turnover in banking May down to 880. Only one new stock was issued in the entire period:-

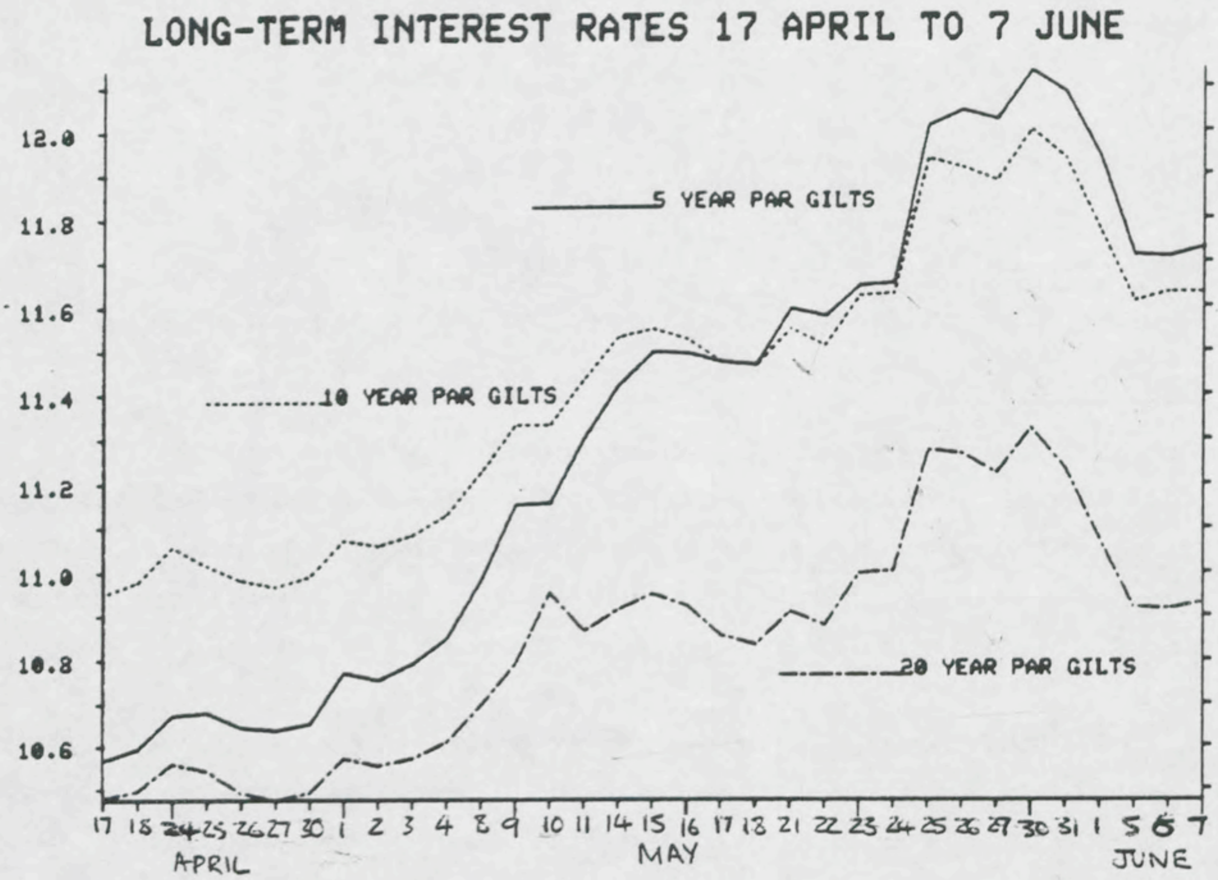
Gilts Issues in Banking and Calendar May

Stock	Date Issued	Issue Price	Gross Yield to Redemption	£m Total amount
9½% Treasury Convertible 1989 (convertible to 9¼ Conversion 2005)	2/5	95½	10.70	1100*

* £100 million allotted to NILO

10. This was undersubscribed at tender on 2 May with £100 million taken up and only another £220 million nominal was sold in a price-cutting sale two weeks later. By the end of the period domestic worries about the miners strike and the next money supply figures were also beginning to adversely affect the market, in addition to US pressures and the international debt crisis.

11. As prices fell gilt yields rose dramatically in the period by anything between one and two per cent, with sharper rises at the short end:-

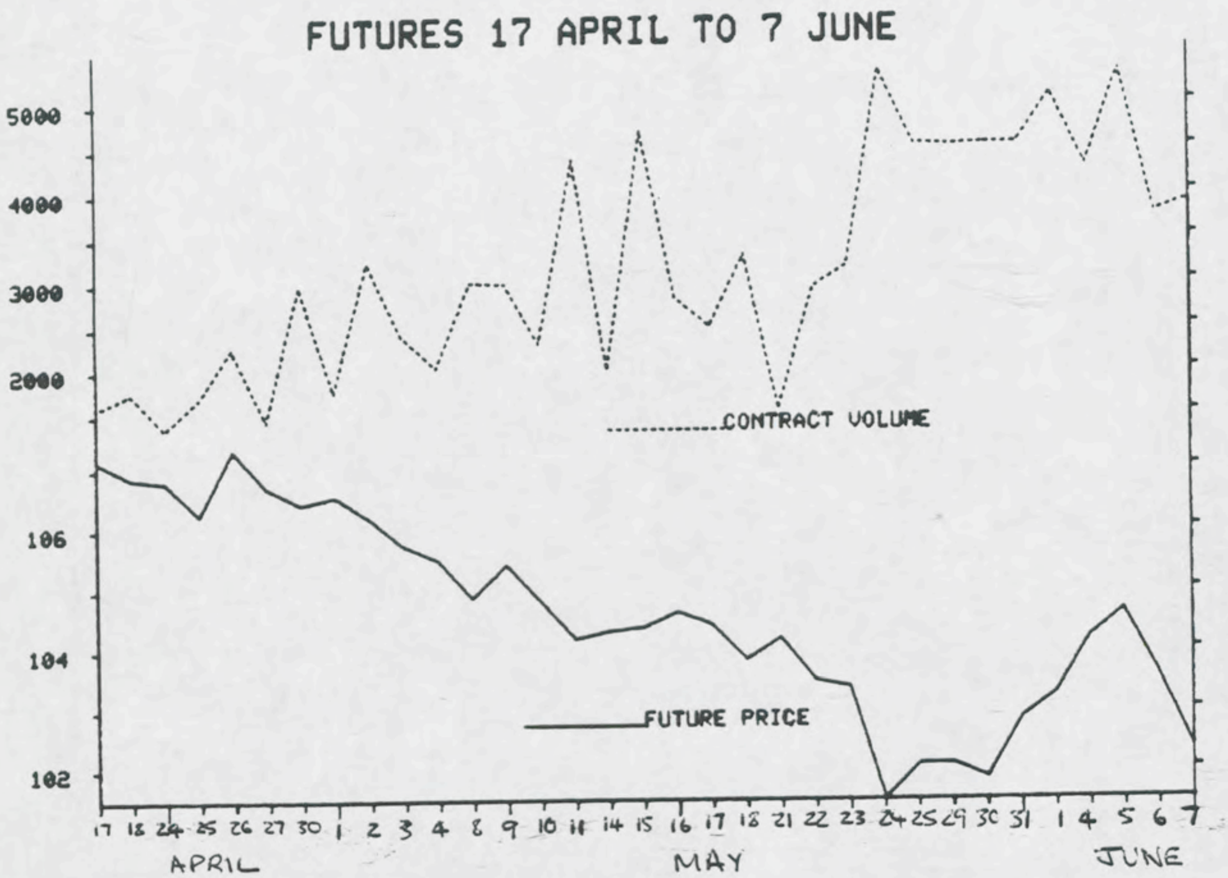


				IG Yields	
Gilt Yield curves	**5 year**	**10 year**	**20 year**	**2% 1988**	**2½% 2011**
April 18	10.594	10.978	10.496	4.40	3.21
April 27	10.637	10.967	10.472	4.50	3.22
May 4	10.849	11.128	10.608	4.42	3.21
May 11	11.302	11.435	10.867	4.14	3.18
May 18	11.468	11.467	10.834	4.63	3.28
May 25	12.010	11.935	11.275	5.01	3.42
May 31	12.136	12.002	11.322	4.97	3.45

Index-linked yields also rose sharply suggesting that inflationary worries were not uppermost.

12. Gilt futures contract volume averaged just over 2,900 during the period under review with trading generally very quiet except for small bursts of activity where volume reached over 500 per day. Contract price followed the cash market closely with the September

contract finishing calendar May only a point above the months lows at 102¾ after dipping at one point to 101½. The June contract had started the month at nearly 107.

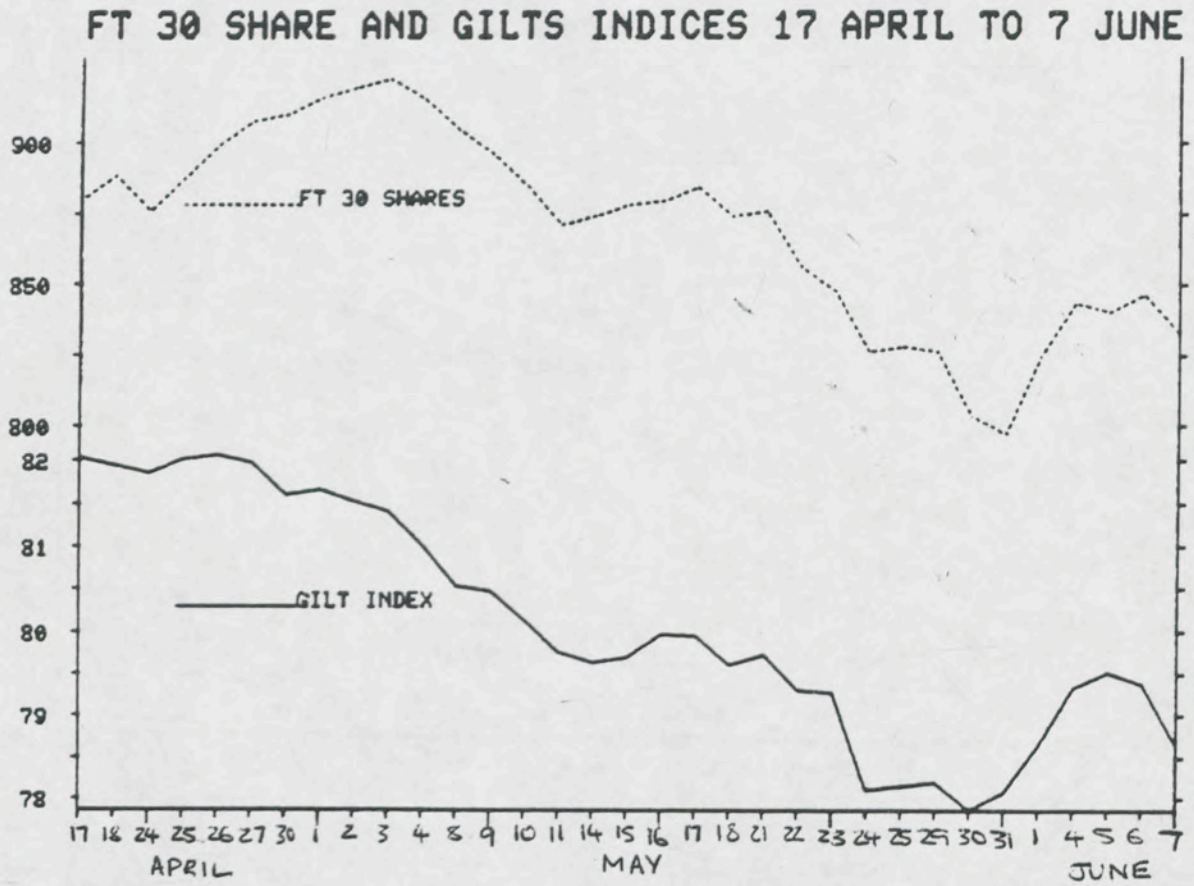


The Equity Market

13. Equities experienced their first sizeable bear market for many months with the FT 30 share index losing 91.7 points between close on 18 April and close on 31 May. Nonetheless, the early weeks of the period saw the market buoyant and the 30 share index closed at all-time high of 922.8 on Thursday, 3 May, helped by an optimistic statement at BP's AGM. But the local elections results the following day began to produce the first signs of faltering in the market. US prime rates increases early in the second week of May then began the serious fall in equity prices, on both sides of the Atlantic. By Friday 11 May the index had lost 51.8 points in the last five trading sessions.

14. There was a slight rally in mid-May, led by news of Mercantile's acquisition of Jessel and Toynbee Discount House and news of British Aerospace's merger discussions with Thorn EMI. But on Thursday 17 May the bear market went ahead again following the Continental Illinois announcement. The final May Bank Holiday did nothing to put fears to

rest and the last few days of the May saw further heavy selling, with greater acrimony in the miners' strike and news of the Bolivian default adding fuel to the flames. On Thursday 31 May the 30 share index closed below 800 at 796.9.



Capital Issues

15. Total new issues by UK listed companies in calendar May were £244 million, the highest monthly return in 1984 to date. Gross issues by industrial and commercial companies were £132 million, which included the final £50 million instalment of a £70 million loan stock placing by MEPC. Gross issues by financial companies were £118 million, including a £30 million package from Save and Prosper Return of Assets Trust, a £43 million rights issue by the Bank of Scotland and a £30 million convertible loan stock placing by Britannia Arrow Holdings. There were no local authority stock issues, but Liverpool Corporation redeemed £10 million stock. Overseas issues saw an £18 million first instalment of a £75 million loan stock placing by Electricite de France and a £15 million first instalement of a £50 million similar issue by the Republic of Trinidad and Tobago.

16. Future prospects continued to look heathy despite the prevailing bear market, with twelve UK companies announcing issues amounting to £127 million, including an offer for sale by tender of £54 million by Reuters Holdings. The Unlisted Securities Market saw new issues totalling £15 million and announcements of future issues of £22 million.