CONFIDENTIAL 30.10.80

MR COLEBY
MR FFORDE

Very useful note. 30/10

Copies to Mr George
Mr Gill
Mr Smith o/r
Mrs Drummond

MONEY MARKETS DURING THE WEEK ENDED 29 OCTOBER

Market Conditions

The resumption, for the first time in over two years, of outright purchases of eligible bank bills by the Bank on Wednesday 22nd was followed on Friday by the innovation of asking the houses to attach a rate to their offers of bills. ALC's note of 28 October gives a full account of that day's operations, in which total assistance of 530 was given, comprising outright purchases of Treasury and local authority bills, and eligibles, as well as 2.45 lending, some at 16½%.

Monday-Wednesday this week were characterised by continuous surpluses: a small surplus on target balances over the weekend increased and persisted, as a result of sizeable government disbursements (including disturbingly large swings relative to forecast) and as the emergent surpluses became stuck with the banks. Thus, although we offered to sell Treasury bills to the houses on each of these three days, amounts taken up failed to match the days' surpluses.

Our reminder to the banks on reserve assets appears to have lifted the demand to hold call money onto a somewhat higher plane: houses reported some approaches from banks whom they rarely see, while established customers may be planning a thicker cushion. This, alongside the daily surpluses, put marked downward pressure on call money rates, especially since the houses themselves were reminded about compliance with the x20 requirement and cannot be absolutely sure, when they negotiate call money in the morning, whether they will be offered a reasonable haven for it in public sector debt by us later on. In addition, some houses could be quite quickly pushed against their x30 limits, though the indications are that this has not yet happened to any extent because houses are reluctant buyers of public sector paper, on yield considerations.

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Consequently, some significant parcels of overnight call money were placed at 13½-14%. On the other hand, the clearers were understandably reluctant to have their call money marked down, with 15% being a particular point of resistance. However, yesterday it was reported that at least one clearer had conceded a lower rate. It may be worth noting that this is the first week of a new target averaging month for the clearers: there could be a suspicion that they may not be too worried about holding surpluses for a few days while rates are poor, although it is well understood that they should not deliberately exploit the averaging process.

Talking Points

Friday's events, though initially sparking a little anxiety, have, on reflection, been well received by the market. Most houses seem rather flattered - even surprised - at the speedy and flexible response to conditions which they demonstrated that they could give.

The reserve asset reminder to banks is universally welcomed. The x20 reminder has revealed that the requirement was not uniformly interpreted within the market - some have adhered rigidly on a daily basis while one or two have taken a more relaxed view of matters between reporting days.

Frantic drafting for submissions on methods of monetary control is in progress in many houses.

The admission of Flemmings to the AHC has given rise to one or two tentative enquiries about wider revisions to eligibility, but no one is really expecting anything in the near future.

Following Friday's operations, some people in the market are wondering whether there might be some changes to our formal requirements regarding the proportion of inland finance paper in our bill purchases, although the existing arrangements, including the flexibility which we maintain, are well appreciated.

Inter-bank market

In contrast to call money rates, inter-bank rates remained firm. The main influence was probably our reserve asset reminder: this explanation would be consistent with the increased offers of call money to the houses. Some commentators invoke euro-sterling: on closer inspection, this suggestion seems to be that sterling rates were being dragged up by firmer dollar rates, but such pressure from the dollar would more likely be reflected in the exchange rate. Expectations of a resumption of market shortages and signs of further postponement of any MLR cut kept rates beyond overnight up.

Treasury bill tender

There is some expectation that the pro rata price might move down by 1p or so, thereby locking on to our present dealing rates.

Money Markets Division HO-M
30 October 1980

A R Latter (4710)

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