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20/11

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MONEY MARKETS DURING THE WEEK ENDED 19 NOVEMBER

Market Conditions

For the past few days, eyes have been very much on make-up day with the hope that the round-tripping experienced in October would not be repeated. As it transpired, conditions have been easy both on Tuesday and Wednesday and although there were one or two signs that certain rates notably in the Euro-£ market were being 'bid' up, probably as a form of insurance policy against tight conditions on Wednesday, it is unlikely that any round-tripping took place yesterday. In fact with a large surplus on the day, we were able to mop up with the sale of £60 mn. 1-day Treasury Bills. Because of the sizeable Exchequer swing in favour of the market on the first three days of this week (nearly £400 mn.) and the lack of activity in the gilt market (until yesterday), there was probably a surplus of reserve assets in the system.

As regards make-up day, there is little doubt that the Bank's letter to banks on the maintenance of the RAR at least created a psychologically favourable climate, and the fact that spot checks have actually taken place has further boosted the notion that every day is potentially a make-up day!

Following our intimation to the Clearers about new 'mopping up' procedures, conditions provided opportunities to test reactions on Tuesday and Wednesday. In the event little response was made by the banks - buying only £18 mn. out of £78 mn. sold to the market on these two days - and some of the banks thus carried over surplus balances. As a result aggregate balances are nearly on average £40 mn. above target for the five-week period ending on 28/11. This is likely to result in lower targeting for the next week (the Nat. West. have already intimated that they will be aiming for £105 mn. rather than £130 mn.).

Talking Points

After the reaction to the Bank's failure to offer to buy TBs outright earlier last week, the return to this traditional way of providing assistance on Thursday brought an instant relaxation in the market and far from pushing the pro rata price down at the TB tender, the pro rata price actually rose by $\frac{1}{2}$ p.

With the bullish tone which developed on Tuesday and Wednesday, it seems likely that this week's tender will show another rise in the pro rata price - probably to at least £96.44 (after £96.41 $\frac{1}{2}$). This week the Bank's dealing rates for TBs have been further flattened out after last week's tender, with only two separate rates - one for all maturities except 'hots' and the other for 'hots', producing a virtually flat yield curve. My contacts at the Clearing Banks feel that over the last banking month the size of their ELs has come down in one or two cases quite markedly. Barclays told ARL and myself last Friday that they had seen a sharp drop of £500 mn. in their lending in the two weeks since 24 October. Lloyds felt that the level of lending had in their case flattened out.

There is a lot of keen anticipation in the market for today's meeting at the Bank when it is expected that at least some of the discussion will centre on the Bank's tactics in recent weeks which have in some instances left the market a little bemused.

Money Markets Division HO-M
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MTR