MTRS Pl. recall. A.C. CONFIDENTIAL MTRS 15/12 11.12.80

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JSF. 15/12 interesting.

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MONEY MARKETS DURING THE WEEK ENDED 10 DECEMBER

Market Conditions

Conditions have been very comfortable in the last week. Shortages on Thursday and Friday last week were relieved in part by the purchase of a moderate level of Treasury Bills, some which were 'hots' (reflecting a feeling that the tender outcome the previous week was on the low side). Surpluses this week have led to moderate 'mopping-up' on each day (by the issue of one-day Treasury Bills) and with December make-up day falling yesterday, it is most unlikely that distortions will have taken place. Overnight rates yesterday in fact were soft from the outset and the liquidity of the market is likely to be reflected in high Reserve Asset ratios again! The Discount Houses had considerable offers of money yesterday morning, including some from 'irregular' customers, so that rates for call money were in the region of 11-12%.

The publication of the £M3 estimate for November and the CGBR figure was hardly the best tonic for the market. I found the Chairman of the Market in a particularly gloomy mood yesterday when I called, his worry being centred on the uncertainty of the present situation. He and his fellow directors at Union question whether the 'other end of town' really know what the figures are likely to be for the rest of the fiscal year. They are also concerned at the possible impact on market liquidity of the forecast of high government revenue in the Jan-March quarter - Union currently have a higher level of fixtures than usual, with most of them maturing in January and February, and this leads them to believe that the banks are preparing for a drain on their liquidity at that time. But what, they question, will happen if this liquidity shortage cannot be met by sales of eligible bills to the Bank?

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Gilt market apart, the £M3 increase did not have too marked an effect on market rates. Inter-bank rates have been very steady over the period, the only change being in the 12-month period where the rate rose by 1/4%. Bill rates have been relatively stable with, however, a reverse yield curve opening up gradually. Demand for 'hot' Treasury Bills has not been significant, which may indicate a further backward move this Friday from last week's pro rata price of £96.75 (and an average rate of just under 13%) - perhaps by anything up to 5p.

<u>Talking Points</u>

The Chairman of the Market is concerned about the Bank's quality requirements for eligible bank bills, particularly as no definitive statement has been made. Because the Bank's broker has been telling the market that our formal requirements are a maximum of 25% Inland Finance of which no more than 10% should be HP, but adding the phrase 'try it and see', i.e. see what the Bank will accept, there is a certain amount of confusion.. I have told RJP that we have been trying to be as flexible as possible in applying quality controls to our fairly large purchases of eligible bank bills and that we have generally been looking for a maximum of 20% HP (incl. leasing) in any parcel without drawing a line on inland finance paper. His reaction was that they have been selling the Bank paper of too high a quality in recent weeks and that we can in future expect to see a lower quality from Union.

I have spoken to RJP about this; we are not in any position to be entirely definitive

Hambros have recently placed in the market a £75 mn. issue of bills drawn by Credit National. I understand that their customer is planning a long-term issue in the domestic sterling market (IP is aware) but is waiting for more favourable conditions. The issue of short-term bank bills therefore represents a holding operation, the implication being that Credit National have already converted the sterling proceeds of the bill issue into French francs. The line of credit given by Hambros is, I believe, initially for one year.

There is some talk in the market about the issue in London of bank bills covering the financing of trade between two foreign countries.

The financing of trade between non-scheduled Territories by the use of official foreign exchange was explicitly prohibited under exchange control rules (introduced in November 1976), but with the removal of controls last year, we may well be seeing the re-emergence of the international use of 'the bill on London'.

Union mentioned that last week they had bought £50 mn. nationalised industry bills (of two month tenor ) drawn by the Coal Board on the CEGB.

I understand that the CLCB working party which recently met with ALC on the future of the monetary system is now in the wake of the Bank's paper looking at the question of their rôle as 'lender of last resort' to the rest of the banking sector - there is a strong feeling that they must attempt to cost this service and charge accordingly.

Money Markets Division (HO-M)
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