

Market Boss
Sent by surface to HMT - Divisions 16. 1.81

FINANCIAL MARKETS (20 NOVEMBER 1980-10 DECEMBER 1980)

(i) Gilts

After a firm start to the banking month conditions became unsettled as the market readjusted its expectations after the Chancellor's statement on 24 November and the long-awaited cut in MLR. Prices fell sharply at the end of the period following the announcement of the November banking figures.

The market remained firm at the beginning of the period and the issue of £1 bn of 11½% Treasury 2003/07 "A" on 20 November was almost fully subscribed: the Bank announced that it would not be operated as a tap stock. The market recovered quickly from disappointment that the stock was not heavily oversubscribed and was steady enough the following day for another new issue to be announced: a further tranche of £1 bn of 11½% Treasury 1989 (11½% Exchequer 1986 having been withdrawn as a tap after heavy sales earlier in the week).

Events the following week were dominated by the Chancellor's economic package announced on 24 November and the cut in MLR from 16% to 14%. Prices of longs fell back after the announcement although shorts, which benefited more directly from the cut in MLR, remained basically firm. Tenders for the new issue of 11½% Treasury 1989 "A" on 26 November were small.

Prices at the medium and long end moved erratically over the next week as the market readjusted its expectations after the Chancellor's measures and reacted to the continuing rise in US prime rates. Thereafter the market settled into a gradual decline in quiet trading in advance of the publication of the November banking figures.

The higher than expected estimate of EM3 growth (2%) which accompanied the figures on 9 December caused some quite substantial sellers to appear and prices were marked sharply lower. Sentiment

was also affected by a further rise in US prime rates. Further consideration of the banking figures, together with another rise in US prime rates (to 20%), led to continuing weakness on the last day of the banking month.

Over the banking month as a whole yields on shorts rose by about 1/2-1/3% and those on longs by 1/4% or more.

(ii) Money

The money market tended to be short of funds almost throughout the period, partly as a result of the Bank's decision not to extend again the gilt purchase and resale agreements which matured on 24 November and 3 December. Conditions were also adversely affected at the beginning of the month by applications (on 20 November) for 11 1/4% Treasury 2003/07 "A", and in the second week by further gilt sales; in addition, the note circulation underwent a substantial seasonal increase.

The main factor in the market's favour was the position of the Exchequer which was generally and often very substantially in deficit throughout the period. The market was also helped by certain specific factors, notably the redemption of 13% Exchequer 1980 on 25 November and sizeable purchases of near maturities towards the very end of the month.

Market assistance by the Bank, consisting largely of outright purchases of commercial bills, was necessary on most days during the month. Treasury Bills were sold to absorb surplus funds on 27 November and on the last three days of the month.

Short interbank rates fell, reflecting the 2% cut in MLR on 24 November, with seven day and one month rates declining initially by about 1 1/4%. In the second week of the month, with stringent conditions prevailing, rates up to one month were generally firm, but there was a further decline as pressure on funds eased in the week of makeup day. The seven day rate, which stood at 16 7/16% on 20 November, had fallen by 10 December to 13 1/4%.

Longer rates to some extent discounted the MLR cut in advance, and six and twelve month rates remained generally firm after the announcement. This firmness was still evident in the following week but gave way to some fluctuation in rates in the last few days of the month. The three month rate opened the month at 15 9/16% and finished at 14 5/8%.

The average rate of discount at the Treasury Bill tender fell by 1.1375 to 12.9502 on 28 November following the MLR cut, but rose again to 12.9977 on 5 December.

16 January 1981