9B

CONFIDENTIAL

22. 1.81

MR COLEBY
MR FFORDE

This raises a number of interesting questions which we should pursue in context of discussions of the 'money market' paper being prepared for the Monck group. A.L.C.

23/1

Copies to Mr George
Mr Gill
Mr Byatt
Mr Latter
Mr Foot
Mrs Drummond

ALC

Thank you. I am conscious of these notes not getting the attention they deserve. Perhaps they sh'd be part of the agenda for the regular Friday p.m. meetings (or, if they are there already, taken more notice of).

MONEY MARKETS IN WEEK ENDED 21 JANUARY 1981

General

The last week (i.e. Thursday to Wednesday) has produced a fair test of the market's ability to respond to the Bank's open-market operations. In these five days we have bought a total of £680 mn. TBs (thus reducing the amount held by the market to well below £1 bn.) and £750 mn. Commercial Bills, as well as £200 mn. Local Authority Bills. Only yesterday did we have to lend (unpublicised) to the market; that was at 2.45 p.m. to two houses for small amounts.

The effect of these large-scale operations has been most marked in the commercial bill rates where the three-month rate has fallen by over 1/4% in the last week. This is to some extent a direct result of the houses' need to buy paper and with money market conditions being relatively comparable (i.e. the inter-bank market), there has not been great incentive for companies to draw bills in preference to ~~overdrafts~~ market-related facilities. There is thus keen competition among the houses for the paper that is offered and while there has been a slight reduction in the number of bills, particularly HP lines, some houses have also lost business through not bidding sufficiently attractive rates (Smith St Aubyn's contingent liability figure dropped by £50 mn. last week). There has also been some market buying of bills, reflecting a fairly bullish tone which appeared at the beginning of this week.

Of the commercial bills purchased, about £500 mn. was paper maturing within the next month, for which we set a rate of 13 15/16% and subsequently 13 7/8%.

Inter-bank market

There has been quite heavy trading in this market with demand for one-week money rather higher than usual. Rates were until yesterday fairly stable with the 1-week rate around 14 but a shortage of over 500 yesterday resulted in the first noticeable liquidity shortage

ALC 22/1 6 JSFf 23/1 4

since the RAR was reduced. Overnight money was bid up to 100% at one stage in the last hour of trading with quite a wide range of takers on the way up and this undoubtedly will have an effect on the clearing banks' figures for January. Most of the clearing banks were reporting considerable 'soft' arbitrage but it is unlikely that 'hard' arbitrage took place on any scale, given that the one-week rate did not go much above 15% during the day.

The return of these tight conditions in the inter-bank market appears to be due to a combination of factors - a swing of £125 mn. against the market during the day, the full extent of the shortage not being reflected in the discount market and perhaps an over-cautious approach to the first official make-up day since the announcement of the new RAR.

Treasury bills

The pro rata price was again higher last Friday with four houses obtaining the £100 mn. on offer and virtually no interest from outsiders. The fact that the Bank followed the rate down with its dealing rates came as a surprise to some houses who had expected as a result of what they had read into the Bank's action the previous week that the Bank would not follow the market rate. There is a feeling that the market will continue to push the rate down if only because of the small 'turn' they will make in buying them and then selling them back to the Bank the following week.

Other points

Union and Alexander both published their 1980 results this week and market reaction has been one of 'relief' at Alexander's recovery from their 1979 troubles and welcome for Union's strong performance.

MTRS

Money Markets Division (HO-M)
22 January 1981

M T R Smith (4710)