Mr Fforde Copy to DOPS

for 3.30 weekly 13/2

Money mkts file (photo)

CONFIDENTIAL

12. 2.81

MR COLEBY
MR FFORDE

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

ALC MTRS pl see the Governor's response. Best if in future the note is sent to the Gov direct & copied to myself & others

The Governors. DG has copy

This is one of a weekly series of intelligence reports prepared for ALC & others by M. Smith. They are interesting and useful; and we have been wondering how they could be used as briefing for yourselves. Would you like to have them by lunchtime on Thursday, to be read just before seeing the Market after lunch? We have thought of circulating them for Wednesday books but don't think they are suitable.

MONEY MARKETS DURING WEEK ENDED 11 FEBRUARY

General

The announcement of no change in MLR last Thursday led to a slight hardening of rates in the inter-bank market and there is a feeling that rates have gone down as far as the situation warrants, especially in the period rates, where the rise of 1/16-1/8 last Friday has been maintained through the week. The market is now resigned to no movement in MLR till the Budget and certainly in the three days this week activity has fallen off. Tuesday's announcement of the January money supply figures and bank lending was received in a mood of 'it could have been worse'.

Money market conditions have been a little tighter than expected and on Friday, Monday and Tuesday the Bank bought a total of £750 mn paper, of which £640 mn consisted of commercial bank bills (the small number of Treasury Bills involved reflects the low holdings by the discount houses - on 28 January amounting to about £150 mn, as compared to nearly £600 mn in mid-December). One reason for the tighter conditions was late Exchequer swings against the market on both Friday and Monday - examples of the difficulties which we still face in improving information flows for our open-market operations.

Bank Bills

An effect of our open-market operations on these three days has been a return of the competition between houses for eligible bank bills, which has helped to push rates down by 1/8 in the last day. The competition for those bills which are issued is keen as despite the rate attractions of drawing bills, there is a reluctance to do so with current expectations of a fall in MLR. For example, BP, which usually has over £100 mn of bills in circulation, has apparently not renewed some maturing bills in the last few days - a parcel of £15 mn or so was involved.

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Treasury Bills

The decision not to follow the tender rate down for the Bank's published one-month dealing rate provoked no reaction, so 'irrelevant' is the Treasury Bill now regarded by the market. One house, Gerrard & National, obtained £80 mn. out of the £100 mn. bills on offer last week. Nevertheless it will be interesting to see how the market reacts this week at the tender to the Bank's decision last Friday.

Union Discount

When ARL and I visited Union Discount yesterday, we found Richard Petherbridge in fairly sombre mood. He (and his fellow directors and managers) is uncertain as to what the future holds and is concerned at the lack of 'good news'. Their view is reflected in a total book currently some 40% below the maximum book allowed i.e. just below £1 bn. as compared to a 30x limit of £1.6 bn. They have kept their book at this level for nearly three weeks, during which time their cost of money has remained static at 13.75%. They are concerned at the lack of flexibility in their liquidity given that they have a sizeable gilt book and can use only £100 mn. of their gilts as collateral for 2.45 borrowing (i.e. 2x resources). With the 'negative running cost' of maintaining liquid assets at the moment (all eligible bills yield less than the cost of their money) they would be extremely concerned if no reduction in MLR had taken place by the Budget. Because of their smaller book, Union currently find themselves well positioned on days of shortages, but because by practice they cannot sell bills to the Bank in excess of their shortage, they have in the past few days been lending into the inter-bank market in order to create a bigger shortage and so to sell us bills. He therefore wonders whether this is what the Bank really intends by this practice.

Petroleum Revenue Tax - 2 March

The market is concerned at the prospective shortage on 2 March caused by the payment of PRT (partly because we have alerted them to it). One house (Smiths) mentioned that it was already positioning itself for that day, but there is also worry over whether the houses will collectively have sufficient liquidity. Moreover Union are studying the consequences of the Bank lending to the market on 2 March for a week, and the effect this would have on their book in the absence of a sizeable Treasury Bill offering.

Other Points

One house (Smith St Aubyn) applied for £14 mn. of the new Treasury Stock yesterday.

In the Euro-sterling market, there has apparently been quite a lot of two-way business in the three and six-month periods. Funds have been coming off the Far East and being taken up in Europe.

MRS

Money Markets Division (HO-M)
12 February 1981

M T R Smith (4710)