CONFIDENTIAL 19. 2.81

Re Governor — for yr. 2.30 mtg with the Market

MR COLEBY
THE GOVERNOR'S
PRIVATE SECRETARY

Copies to
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Mr George
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MONEY MARKETS DURING WEEK ENDED 18 FEBRUARY

General

There has been little of note in the last week, with most market participants marking time till the Budget. 10 March is still regarded by most as the likely date for any cut in MLR, with 2% the slightly more 'popular' choice. It is pointed out that the market have already anticipated a cut of at least 1%.

Day-to-day money conditions have been relatively comfortable with only Monday producing a sizeable shortage (which the Bank bought out by the purchase of nearly £300 mn. bills). There are signs that some houses have used the opportunity to build up their books, despite the negative returns which this involves in some assets. They are also conscious of the need to build up liquidity in advance of the heavy market shortage expected on 2 March when the half-yearly payment of PRT is due.

February make-up day yesterday passed without incident, money being in surplus on the day. Indeed the day was described by a broker contact as featureless, although two discount houses reported offers of reserve asset money from banks with whom contact is infrequent. One consequence of the easy conditions is likely to be a lower level of lending among the clearing banks compared to January make-up day when they reported a large increase in their lending figures as a result of customers finding market-related lines too expensive and resorting to overdrafts. This will perhaps have put greater pressure on the non-clearing banks yesterday.

Bank Bills

There has been a further decline of nearly 1/4% in the three-month eligible bill rate over the last week and with the one-month rate

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to some extent anchored by the Bank's dealing rate, the yield curve has steepened further. Apart from lower rate expectations, this trend can also be attributed to competition among the houses for bills. From my contacts this week, I sense that there have been more bills issued, but the majority of them are for only one month. Three-month paper is much more difficult to obtain.

Treasury Bills

The tender last Friday resulted in yet another increase in the pro rata price - by 3 1/2p to £96.92 1/2. Significantly, however, the discount houses obtained only 27% of the £100 mn. bills with outsiders (CTSB, Citibank and Warburgs) obtaining a much larger share of the tender than for many weeks. The Bank, however, held its one-month dealing rate at 12 3/4%, but this again caused little comment in the market. With the high negative cost of running an asset such as Treasury Bills - and the relative unimportance of that particular bill - any aggressive bidding at the tender this week by the houses would seem to be unlikely.

Other Points

The discount houses have been taking stock of the recent trends in interest rates and the effect of the Bank's open-market operations on these. They have been reminded of the Bank's new aim of allowing the longer rates to find their own level as set out in the notice dated 24 November 1980 but inevitably they see the Bank's acceptance of lower and lower rates on two and three-month bills as 'passive but encouraging' acquiescence in the downward trend.

I have started my prudential interviews with the houses on their foreign currency business (as the start of a regular series of discussions with them on that aspect of their business).
Allen, Harvey & Ross's results for this year ended 5 February will be announced at the end of next week (27 February), and are likely to show much the same picture as last year. Professor Alan Walters is spending a day at Union Discount next week.

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Money Markets Division (HO-G)
19 February 1981

M T R Smith (4710)