CONFIDENTIAL 12. 3.81

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MONEY MARKETS DURING THE WEEK ENDED 11 MARCH

General

After the relative success of smoothing the huge shortage caused by the payment of PRT on 2 March, the need to restore reserve assets to 10% by the night of 10 March, coupled with signs of reactions to the prospects of a big cut in MLR in the Budget, led to difficult conditions this week. Overnight inter-bank rates between Friday and Tuesday (both inclusive) have touched 50% each day but the bulk of the business has taken place in the low 20s. The first signs of reaction to the level which market rates had reached appeared last Friday as market operators tried to cover themselves, and with round-tripping ('soft arbitrage') occurring on a large scale as a result of the high short-term rates, we have seen repeat performances of the very difficult conditions which were experienced last autumn on make-up days.

The apparent lack of positioning of the banking system to the shortages of the last 10 days has certainly not helped the situation and this applies to the restoration of the 10% RAR, as much as to anything. According to my contacts in the main Clearing Banks, 3 out of the 5 did not manage to reach the 10% RAR on Tuesday night and one of the two which did, achieved this only by pretty aggressive activity in the inter-bank market. One of the consequences of this situation was that yesterday Barclays 'broke' some £100 mn. fixtures which they had placed in the market.

Daily money positions

During this period there have been shortages each day in the market, mostly of a moderate size. On two occasions (Friday and Wednesday), use was made of the new 'repo' technique which provided two-week and four-week money respectively at rates bid by the houses, against the collateral of longer bills. At a time when discount houses' liquidity has come under strain, this has proved a useful technique. On Monday two houses made use of the 2.45 lending facility (for a week) while on Tuesday a small amount was lent to one house on conventional 2.30 terms.

Budget

Although general reaction to the Budget has not been good, there has been some relief in the discount market that the Government has stuck to its strategy and not changed course. The cut of 2% in MLR had already been virtually wholly discounted by the market and indeed period rates showed rises of 3/4% in the one-month rate and 3/8% in the three-month rate in the Budget's aftermath. Longer bill rates also showed an upward trend, as paper which had been held back prior to the Budget, was put into the market - but found few willing takers in view of the houses' desire to keep their books as short as possible. Generally speaking, until rates settle down to the new MLR of 12%, the houses are unlikely to consider changing their cautious approach and will be concentrating on rebuilding (in most cases) their liquidity which has been eroded by recent market shortages.

The outlook

The announcement last night of a reduction in the RAR to 8% for the period 12 March to 30 April is likely to be greeted with some dismay by the discount houses. With a shortage of £550 mn. today and another £400 mn. tomorrow, the houses will again see the loss of call money which they were beginning to take back earlier this week as the banks moved back to 10%. Having positioned themselves for what was already likely to be two short days today and tomorrow, they will need some reassurance that help will be available to them. There is little doubt that there is insufficient liquidity in the discount market to cope with such shortages over the next two days. In giving the banks greater room for manoeuvre to cope with the unexpected shortages caused by very heavy gilt sales and higher-than-expected Government revenue in the next few weeks, we shall be stressing the importance and need for the banks to create more reserve assets.

Treasury Bills

A further rise of 5p in the pro rata price at last Friday's tender was again a reflection of a small number of bulls, the majority of the bills going to outsiders. With market rates still to find their new levels, it is difficult to predict the outcome of this week's tender. Logic would point to a possible retreat from last week's level, but...!

Other points

At last Thursday's meeting with the discount houses chairmen, the latter gave a generally favourable reception to the Bank's proposals on eligibility and call money banks - which are to be published in a consultative form later today.

The four main Clearers have all reduced their Base Rates to 12% and their deposit rates from 11 1/2% to 9%, thus widening the margin.

MTRS

Money Markets Division
12 March 1981

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HO-G