

MMO via ee 81
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GR 26/3

MONEY MARKETS DURING WEEK ENDED 25 MARCH

General Conditions

Although the markets have been quite active in the last week, no discernible trend has emerged. There was a brief flurry of speculative activity last Friday involving buying of CDs, but it soon fizzled out. Over the week, in fact, inter-bank rates have shown a firmer tendency, partly due to the uncertainties caused by strikes in the Civil Service and banks, and partly due to expectations of difficult market conditions on Friday (arising from tenders for the index-linked gilt).

On a daily basis, we are now seeing significant shortfalls in expected revenue - which has helped to ease the shortages! Thus on Monday and Tuesday there were swings totalling £600 mn. in the market's favour, but the favourable effect of this has been offset to some extent by the banks taking greater precautions against all possible eventualities. Thus houses have not found it easy to attract funds and, indeed, partly as a result of the lower RAR and partly because five houses have their end-year in the next two weeks, they are seen as aggressive bidders for money.

Daily Money Positions

Despite the shortfall in revenue in the early part of this week, total assistance to the discount houses in the past week has totalled £1.3 bn. Most of this took place last Thursday, Friday and Monday and included £450 mn. by way of lending for periods of between five days and 1 week (partly to smooth out day-to-day conditions this week) at a rate 'above MLR' (i.e. 12 1/4%). So again a considerable volume of paper has been mobilised, some of it by means of the 'repo' technique.

Supply of Bills

Liquidity is still a matter of concern to some houses, after the heavy purchases of bills in recent weeks. There are signs not only that bills are being drawn for longer periods but also that the volume of bills is declining somewhat. This latter development may be a sign that some bills during the last month/six weeks have been drawn for arbitrage reasons (with high inter-bank rates in the one-week and one-month periods) - there was certainly a very large run-off of bills last week in the Bank's hands, not all of which have been renewed.

Treasury Bill Tender

The houses obtained all the bills on offer last Friday, paying on average 2 1/2p more than the previous week and bringing the yield down to 11.90 (as against an average cost of money which, for all houses, still exceeds 12%). There was some surprise in the market that the Bank lowered its one-month posted dealing rate for TBs (and L/A Bills), and so long as we continue to post a dealing rate for one-month paper, the houses may well pay more at the tender.

Other Markets

The inter-bank market has apparently been quite active all week with, I gather, some of the Clearers taking longer-period money in the 3-12 month range.

Reaction to the announcement of the Leeds stock issue is that the terms are very generous and that it is likely to be heavily oversubscribed (by as much as 15 times). There is genuine surprise that Leeds have gone for such a large and long-dated issue.

Local authorities are also still actively looking for funds - in periods from 1-20 years with sufficient of a spread to enable them to conform to the 7-year minimum life of their debt.

Other Points

In some areas of the discount market there is considerable gloom over the likely effects of 'Monetary Control: Next Steps'. While there are some who look forward enthusiastically to the challenge of the new system (generally younger directors), others see considerable threats to their operations, caused by:

- (a) possible by-passing of the discount market by banks seeking bills for liquidity purposes;
- (b) the Bank's reliance on purchases of bills rather than discount-window lending - which will, in their view, involve holding bills as loss-leaders with few alternative assets on which profits can be made;
- (c) as an extension of (b), the threat of a greater exposure to gilt losses and memories of the problems caused in 1973.

MTR

Money Markets Division
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