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THE GOVERNOR'S PRIVATE SECRETARY

GR 18/6.

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MONEY MARKETS IN WEEK ENDED 17 JUNE

General Features

After the very nervous conditions last week, the past week has been notable for the steadiness of rates in the domestic markets. However, the mood in the discount houses is still one of uncertainty as to the future course of interest rates - and the economy - and it is worth recording that rates have not recovered to their levels prior to the sharp fall of sterling 2 weeks ago e.g. the 3-month inter-bank rate is 1/4% higher, the 1-year rate 1/2% higher and 3-month bill rates nearly a 1/2% higher.

Many eyes will be watching current developments in Whitehall and while Mrs Thatcher's speech to the CBI dinner on Tuesday evening spelt out laudable aims, the market is sceptical on her chances of achieving them. The recovery in sterling, helped by expectations of lower rates in the US, has contributed to offsetting their fears a little, but any unfavourable developments could spark off another bout of nerves.

Daily Money Conditions

These continue to be relatively comfortable and the June make-up yesterday passed off quietly with the Bank only having to provide a very small amount of assistance. As a result, the very short-term inter-bank rates remained below 12%, giving no cause for concern about arbitrage opportunities.

Apart from yesterday, we have used a varying set of techniques to relieve shortages last Thursday, Friday and Tuesday this week, these being designed mainly to smooth out surpluses in the weeks ahead.

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Most of the rates we have dealt in have been in the 1-14 days range, except for Tuesday when we bought outright bank bills maturing in the period 24 July/23 August.

Our operations apart, the markets have, on the whole, been very quiet with the positive yield curve maintaining a flatter profile following the effects of our operations last week on the short-end of the market.

Treasury Bill Tender

Somewhat surprisingly, there was a high level of applications at last Friday's tender with the outsiders appearing again and helping to push the pro rata price up 8p to £96.975 after the previous week's fall of 24 1/2p. The discount houses departed from their recent practice of a jointly-agreed bid price and, with views differing, obtained only 37% of the bills on offer. The houses were somewhat concerned at the volume of bills on offer last Friday which, apart from £100 mn. Treasury Bills, included nearly £200 mn. Local Authority bills. In the event, the latter went at about 1/16% higher than the Treasury Bill tender, and I understand that there has been good demand for both types of bills this week. It is therefore possible that this Friday's bids will push the pro rata price up by 3-4p.

Other Points

Discount Houses have been keeping a low profile in the gilt market with one of the 2 big houses selling off part of its fixed-rate gilts holding at the beginning of last week and the other big house (which had reduced its fixed-rate holdings a few weeks ago) apparently being a small net buyer on Monday this week.

Market reaction to the Bank's notice last Thursday reducing the minimum maturity of a sterling CD from 3 months to 28 days has been muted after a brief flurry of new 1 and 2-month paper (by lesser names in the market) at the end of last week. The market, however, generally welcomes the greater flexibility provided by this move.

After a quiet period, local authorities' demand for funds at the longer end (up to 10 years) has apparently been picking up. Names, such as certain London boroughs and Scottish districts, have been meeting resistance from some traditional lenders and premiums of 1/16/1/8 are being conceded.

Two Treasury people (Andrew Turnbull and Howard Davies) are each visiting Union Discount for a couple of days in the near future.

MTRS

Money Markets Division (HO-G)
18 June 1981

M T R Smith (4710)