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MONEY MARKETS DURING WEEK ENDED 8 JULY

General Features

The general tone of uncertainty which has been evident for some weeks was heightened by the Bank's action on Monday afternoon when two houses were forced to borrow (at 2.30 pm) for a week at a 'rate above MLR', subsequently announced as 12 1/4% (the publication of the precise rate followed rumours circulating in the market that the houses had to pay 2% above MLR). The Bank had offered assistance to the market by way of a three-day 'repo' but the rates bid by the houses were rejected as too low (11 1/2% or below) both before and after lunch.

The reaction of the money markets to the Bank's action was to mark up all rates - very sharply in some cases. Some houses withdrew the two-way prices on their tradeable assets while they tried to assess the implications for UK interest rates. The houses were certainly taken by surprise and there was considerable confusion and dismay, as they tried to fathom out the reasons for the move.

Monday's action did lead to a recovery in sterling on Tuesday, but the announcement of the June money supply figures perversely led to sterling easing again as any domestic need for higher interest rates was lessened. The reception given to the money figures has been strangely muted (more comment being passed on the fact that the Bank did not feel able to estimate the effect of the civil servants' dispute) and perhaps highlights the current nervousness over the future course of interest rates.

Yesterday markets were very quiet with little trading and much attention directed to possible interest rate policy objectives in the US. More prime rate increases to 20 1/2% by the large US banks yesterday afternoon had an effect on sterling.

ALC 9/7

Daily Money Conditions

Against expectations of some larger shortages than the market has experienced lately, the daily money positions have generally been fairly comfortable (Monday afternoon's events excepted). Some substantial shortfalls in Government revenue meant that the Bank's morning forecast proved on some days to be more unfavourable to the market than the eventual out-turn. However we were able to sell some Treasury Bills on Thursday and Friday last week (which were used to offset the expected shortage yesterday when up to £300 mn was expected by way of applications for the £1 bn index-linked stock).

Rates in the inter-bank market are now (compared with last Thursday) 3/4% higher for seven day and one month money, 5/8% up in the three-month period, and 3/8% up for the year. Bill rates have also jumped with the three-month eligible bank bill now being bid at 12 7/8% (a yield of over 13%), compared with 12 1/8% last Thursday.

up further this morning

Treasury Bill Tender

The pro rata price fell last Friday by 4p after the rises of the last few weeks, mainly as a result of increased nervousness about interest rates. The tender also attracted fewer outside bidders (although those who did obtained them in full), while the houses who obtained the bills (at a discount rate just over 12%) now find themselves unable to sell them - except at a loss. This Friday there is likely to be a sharp fall-back in the pro rata price - perhaps by 15p.

Other Points

The Sunday Times' article on sterling had quite an unsettling effect on the market, adding to the reactions by the market to Monday's events.

Mainly as a result of the rumours which spread through the market on Monday, we have now started publishing at around 12.20 and 2.30

information on the spread of rates at which we have dealt in our daily money market operations (and also saying when we have not dealt) - this has been generally welcomed by the market.

The discount houses have been seeing signs of a slight falling-off in the number of bank bills drawn in recent weeks - nevertheless many houses have very full books in bank bills and other 'undefined' assets. The cost of bill finance at current levels is likely to see further reductions in the numbers issued, with drawers in some cases turning to overdraft.

MRS

Money Markets Division
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(HO-G)