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MONEY MARKETS IN WEEK ENDED 15 JULY

General Features

The markets continue to stutter along from day to day looking for indications relevant to the future course of interest rates. The mood is generally one of bemusement, nervousness and uncertainty, as much caused by the movements of sterling in the foreign exchange markets as by the difficult domestic, political and financial situation. Some are more optimistic about US interest rates than others; most agree that developments there hold the key to the course of sterling interest rates. Many however expect to see sterling interest rates move up in the short-term. Our objective in keeping a tight rein on short-term interest rates has been maintained, through the week, helped by short money conditions most days. One effect of the higher overnight and week rates has been the re-emergence of soft arbitrage by bank customers, who have been falling back on their overdrafts with the clearers as market lines have become more expensive. Rates longer than 1 week in the inter bank market have moved only slightly, the 1 year rate being virtually unchanged over the week at 13⅞%, with a slight easing on Monday morning being fairly quickly reversed.

Daily Money Conditions

The past week has seen considerable variations in day-to-day conditions. Gilt sales totalling £350 mn (including part of the index-linked stock) at the end of last week were offset by Exchequer swings in the market's favour of £250 mn over the last week and by purchases of the next-but-one maturity this week.

After successfully selling £200 mn Treasury Bills last Thursday (thereby adding to the shortage in the market the next day), we have been relieving the day-to-day shortages mainly by use of the 'repo' technique which has been effectively providing money to the market on a short-term basis (up to 10 days) at between 12 and 12¼%. With last Friday's 'higher-than-large' shortage we also bought very short bank bills outright, while on Monday and yesterday we provided a small amount of 2.45 (unpublished) lending to one house on each occasion.

Make-up day yesterday passed off fairly smoothly with short-term rates staying firm till very late in the day, despite a flat money position and a very tight opening when overnight money was trading at 12½-12¾%.

Treasury Bill Tender

The pro rata price fell quite sharply - as expected in view of developments earlier in the week - with the discount houses going in at a jointly agreed price of £96.76, some 3p below the pro rata price which represents a discount rate of just under 12⅞%. Virtually all the bills went to US banks (Bank of America, Citibank and Morgan Guaranty) who may have been taking a view that US rates were coming down very soon and that this would feed quickly through to the sterling market (this view is further substantiated by a report of a US bank buying one-year £CDs on Friday - only to off-load them on Monday at a loss).

This week there are £200 mn Treasury Bills on offer, which in the current climate is likely to result in the pro rata price falling by perhaps 3p ie in line with the discount houses' bid last Friday. We have received agreement from the Treasury to an offer, initially on 24 July, of Treasury Bills (to be taken up in the following week) which will mature on 1 September, ie the day on which the half-yearly payment of Petroleum Revenue Tax (assessed at around £1.3 bn) is due. The amount on offer (which will be in addition to the normal 91-day offering) will be decided nearer the day, but is likely to be at least £500 mn.

Other Points

Discount houses' resources at the end of June (calculated from the quarterly returns) reveal a decline of 1½% over the quarter - the biggest drops being in houses with sizeable holdings of fixed-rate gilts. Houses are continuing to reduce their gilt-holdings and most are keeping a short book (the average life of their paper assets seems to be in the region of 40-45 days).

Union Discount reported yesterday that their half-year figures (to end-June) were down on the same period last year, but up on the second half of last year. Their interim dividend is unchanged. The five houses who applied for seats on LIFFE have been accepted, with Gerrard & National obtaining 2 seats.

MTRS

Money Markets Division HO-G
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M T R Smith (4710)