

BB

Sub for copy
filed

CONFIDENTIAL

23. 7.81

MR COLBY
THE GOVERNOR'S PRIVATE SECRETARY

- Copies to
- Mr Fforde
- Mr Georgeo/r
- Mr Gill
- Mr Byatt
- Mr Latter
- Mr Foot
- Mr W A Allen/
- Mr Iles
- Mrs Drummond
- DGPS

MONEY MARKETS IN WEEK ENDED 22 JULY

General Features

The events of the last week are probably well enough known not to require too much elaboration. Factors which contributed to rises of 1 1/2 points in the 1-month inter-bank rate and 3/4 of a point for 12-month money over the period could be summarised as follows:

Thursday 16th - some market concern at the Bank's dealing rates for mopping-up bills (12 5/8-12 3/8) i.e. that they pointed to higher short-term rates (which they were not designed to do);

Friday 17th - apart from the by-election result at Warrington, the larger number of Treasury Bills on offer at the weekly tender, plus, subsequently, alarm at the announcement of the £800 mn. special Treasury Bills on offer this coming Friday;

Monday 20th - the higher-than-expected US money-supply figures announced on Friday evening and the implications for sterling of continuing high US interest rates;

Tuesday 21st - continued concern at US interest rates.

Despite bill rates which now show yields of 14 1/2% and upwards for 3-month paper, discount houses are finding it almost impossible to sell any paper except for very short-term bank bills and are quick to

ALC23/74

point to the lack of a 'marker rate' as the main contributor to the extreme unease and uncertainty in the present situation. Inevitably much attention is directed to the pressures which the present interest-rate structure is putting on the banks' base rates. Above all, the market is looking to the Bank for some indication of where interest rates should be and, as an example of the new policy of allowing market forces to determine levels, the experience of the last week has not exactly been encouraging.

Daily Money Conditions

These have again been made variable by shortfalls in expected Government revenue, which have proved to be even larger than expected, totalling some £550 mn. over the last five days. This has made control over the very short-term rates more difficult and market assistance has therefore consisted of very short-date (up to 7 days) 'repos'. In this way we have been able to provide money to the houses at rates between 12 and 12 1/4% which has helped to steady the overnight inter-bank rate at about these levels and thus avoid too much pressure on banks' base rates.

The discount houses, unable to sell paper direct to the Bank, are, in many cases, having to turn away bills offered to them as they find themselves up against their trading limits, and the expectation of tendering for £1,000 mn. Treasury Bills on Friday is, if anything, causing further upward pressure on their rates.

Treasury Bill Tender


Last week's pro rata price fell by 15p (to a discount rate of 13 1/2%) with very few outsiders submitting tenders (mainly because they had obtained all the bills the previous week) and the discount houses again tendering at a jointly-agreed price.

With little demand for these bills and having already suffered losses on last week's bills, the houses' appetite for this week's tender, which is made up of £200 mn. 91-day bills and £800 mn. 5-week bills, is very lukewarm. Talk in the market is of bids from the houses for the short bills somewhere between 14 and 15%.

Other Points

The supply of bank bills is undoubtedly falling-off as a result of the high market rates, with the cost of a 3-month bank bill (to the drawer) now between 15 1/4-15 1/2% (including acceptance commission). Most bills are being drawn for periods of 1 month or less.

One discount house has started buying small amounts of gilts (1990 stock), attracted by the high yields, relative to the cost of their money (about 12%).

 The new monetary control system, earmarked for 20 August, continues to be a further unsettling factor, with rather a lot of wild talk about banks' liquidity after that date.

hcs

Money Markets Division
23 July 1981

M T R Smith (4710)
HO-G