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MONEY MARKETS IN WEEK ENDED 5 AUGUST

General Features

The product of many months' debate, discussion and detailed work was duly launched yesterday with a 2 weeks' countdown to full implementation. Much of the substance of the provisions for monetary control is already known to the market, with the real interest in yesterday's announcement being centred on the new list of eligible names (just under 100, as compared with around 50 hitherto), and the aide-memoire giving the Bank's guidance on its practices when purchasing eligible bank bills from the market (preliminary indications are that this latter item has been particularly welcomed, at least by the discount houses).

As regards the general tone of the markets over the last week, it is fair to say that little has changed, with uncertainties and nervousness over the future outlook for interest rates dominating sentiment. After the unexpectedly difficult money conditions last week, the pattern has changed to surplus conditions in the last 2 days. As a result, rates up to and including 1 month have shown marked falls since this time last week - the week down by 1% and the 1 month by 1/2% - with smaller falls at the longer end.

The settling of the civil servants' dispute last Thursday led to immediate fears about the effects on short-term interest rates of the unwinding of the £6-6 1/2 bn backlog of tax. As Treasury estimates are for a gradual and fairly prolonged unwinding with only about £500 mn expected to come through this month, we have been passing this message to the clearing banks and discount houses, while the Treasury released a statement on Tuesday which, according to a broker contact, has had a considerable soothing effect (in that it gave rise to much more two-way trading in periods up to 3 months).

The sterling M3 and clearing bank lending figures released on Tuesday were not expected to be well received by the markets (market estimates had put the M3 increase in the range of 1 - 1 1/2%), and while they had an immediate impact in the gilt market, the markets generally have shrugged them off fairly quickly. Nevertheless, there is concern at the level of clearing bank lending, which however reflected the pattern of short-term rates in the latter part of July when resort to bank overdraft was cheaper for customers than market-related lines.

Daily Money Conditions

From shortages last Thursday and Friday, which resulted in assistance to the market of £800 mn (£200 mn by outright purchases and £600 mn by 'repos'), this week has seen a return to surpluses, mainly as a result of an unexpected payment into the market of £300 mn by the Paymaster-General on behalf of the EEC on Tuesday. This has led to the Bank being able to sell Treasury Bills (to smooth out future shortages in the next 2-3 weeks) totalling £350 mn. An interesting feature of yesterday's sales was that they were all to banks with the bids from the discount houses being at rates which were considered too high.

We have again seen marked discrepancies on a day-to-day basis between banks' positioning during the day regarding their balances and the Bank's information on the expected out-turn for the day. As a result, assistance to the houses has had to be overdone on one or two days resulting in the carry-forward of large surpluses on banks' balances. Much of this is due to the continual (in current market conditions) switching with overdraft by large companies and the resultant uncertainty as to the effect on banks' balances.

Treasury Bill Tender

With the ending of the civil service dispute, it was decided to cut back the number of Treasury Bills on offer last Friday - from £450 mn (£200 mn 91-day bills and £250 mn 1 September bills) to £200 mn (£100 mn of each). The outcome of the 91-day tender was another fall in the pro rata price - by 3p to £96.54 (a discount rate of 13 7/8%) with houses obtaining most of the bills at varying prices. One house, Union, obtained all the 1 September bills at 13 15/32% discount.

With muted demand in the market for the normal 3-month bills and a reluctance by some houses to hold such long paper at the moment, it is difficult to say what the outcome will be this Friday. With only £100 mn on offer (and no shorter bills), it is possible that the pro rata price may be unchanged (or even rise a little?).

Other Points

With the present rate structure, the discount houses are seeing a decline in the number of bank bills being drawn - and those that are, are usually for only 1 month. Nevertheless, the potential stock of eligible bank bills will be considerably increased after 20 August.

There still seems to be differing views among the houses about the immediate future - some being extremely cautious about the size and length of their books.

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