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13. 8.81

MR COLEBY
THE DEPUTY GOVERNOR'S
PRIVATE SECRETARY

Cum

Copies to Mr Fforde o/r
Mr George
Mr Gill o/r
Mr Byatt
Mr Latter o/r
Mr Foot
Mr W A Allen/Mr Iles
Mrs Drummond
Mr Erskine
GPS

MONEY MARKETS DURING WEEK ENDED 12 AUGUST

General Features

The market's mood is showing gradual signs of improving, although there are still many who are very cautious and wary with regard to the future course of interest rates. The stability evident in the very short-term rates (mainly as a result of the Bank's operations) has fed through to the longer rates which have continued the downward trend first evident 10 days ago. Whether this improvement which has led to renewed interest in longer money and assets can continue depends substantially on the level of interest rates in the US which many still feel will remain high for some months yet, (prior to yesterday afternoon's dramatic fall by the dollar).

Daily money conditions

The main feature of the last week has been the steady flow of backlog tax which has come through, amounting to £750 mn (approx). This is in fact larger than Treasury expectations and, while the effect has been to create greater shortages than anticipated, we have been able to roll these forward by means of repos to the next 2 weeks when conditions are expected to be more comfortable (due to the proposed release of overdue VAT repayments). In this way we avoid reducing the market's holdings of eligible bills prior

to 1 September when a huge amount of petroleum tax is due. Since last Thursday we have provided nearly £1 bn to the market by the repo technique and with expected shortages totalling £500 mn today and tomorrow, the market's liquidity which has so far remained comfortable may come under pressure.

Over the week, the three and six month inter-bank rates have eased back by about $\frac{3}{8}\%$ and the 1 year nearly $\frac{1}{2}\%$. Bill rates have also shown significant movements with the one-month eligible bank bill rate down by $\frac{1}{4}\%$ and the 3-month rate down by $\frac{1}{4}\%$.

Treasury Bill Tender

For the first time for some weeks, the pro rata price rose by 3p to £96.57 (discount rate $13\frac{3}{4}\%$) with discount houses tendering at a wide range of prices (depending on their view of rates). Outsiders captured nearly 50% of the £100 mn bills on offer.

With these bills trading now at lower levels, it could be expected that this week's tender will see a further rise in the pro rata price but with £200 mn 91-day bills on offer this Friday (increased because of the surplus originally forecast for next week) and another £200 mn 1 September bills on offer next Tuesday (to be taken up on Friday next week), it is a little more difficult to forecast the outcome. A rise of no more than 3p could be the outcome.

Other points

There has inevitably been a large number of enquiries following the despatch of letters last week to banks regarding monetary control, eligibility, cash ratio, etc. Many of these enquiries concern eligibility and our stated requirements on the clausing and quality of bank bills. ALC has been seeing some of the banks who just missed becoming eligible to explain the Bank's reasons for turning down the applications.

A meeting was held yesterday with representatives of the Clearing Banks to discuss the implementation of the the new system on 20 August, including their operational balances and our proposed new methods of transmitting the day's forecast and official money market operations to the markets. An aide-memoire explaining the latter change will be made available in the next couple of days.

So far there has been little reaction in the markets to the Lothian Local authority decision not to cut back their spending. But lenders are watching the amounts they have committed to certain authorities and in the last couple of months a small number of traditional lenders have dropped out of the local authority market.

A curtain will officially be drawn over the Minimum Lending Rate notice outside ALC's room next Wednesday at 3 pm - a press photographer will be there to record the event.

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Money Markets Division HO-G
13 August 1981

M T R Smith (4710)