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Mr. Lytton 17/9

I was especially interested in what you had
 to say about Eligible Bills (clausing etc) and

MR COLEBY

THE GOVERNOR'S PRIVATE SECRETARY

Copies to Mr Ffogg o/r

Mr George
 Mr Gill
 Mr Byatt
 Mr Latter
 Mr Foot o/r
 Mr W A Allen/Mr Iles
 Mrs Drummond
 Mr Erskine
 DGPS

17/9

Very glad to know that we are keeping
 up the Campaign on clausing & quality.

MONEY MARKETS DURING THE WEEK ENDED 10 SEPTEMBER

General Features

Despite the depressing tone of recent economic news and the increasing mood of uncertainty and caution evident in the markets last week, the Bank's interest rate move on Monday took the market by surprise. There were inevitably some cynics who lamented the Bank's move so soon after the new monetary arrangements had come into being, but on the whole the Bank's action (and the explicit reasons for it) has been recognised as necessary in view of developments in recent weeks.

The markets took some time to adjust to new levels of rates, a factor which probably explained the Clearing Bank's hesitancy in adjusting their base rates, and with worries about money supply and levels of bank lending still very evident, it may be some time before the rate structure settles down at these higher levels.

Daily Operations

Over the last week we have brought just over £200 mn of bills outright on 2 days, on one of which we also brought £250 mn of bills on a repurchase basis. Monday's business consisted solely of lending (to push rates up) and on the last 2 days we have lent money using the private 2.45 facility to one house on each occasion. In the case of Tuesday's lending, the house in question had offered bills to us, but as their rate was unacceptable, they were left with a fairly substantial shortage. In yesterday's case, our reading

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of a market surplus of about £100 mn was never really reflected in market conditions, thus prompting one house to seek assistance and we were unable to proceed with offering Treasury Bills for sale (which so far has not proved possible under our new system). As well as being the first make-up day since 20 August (without however the same likely market impact as make-up days before), the clearers may well have found it difficult to gauge their position as a result of all the switching between market lines and overdraft and vice versa by their big corporate customers over the last two days.

Interest Rates

The spread of rates in the inter-bank market between the overnight and 1 year rates is very narrow (14 - 14½) with discount houses obtaining call money at around 13½%. Bill rates are still tentative but now that base rates have moved into line with market rates it is possible that a somewhat larger supply of bank bills will become available to houses and thus influence the structure of these rates. It looks at present as if the Treasury Bill tender on Friday will result in a rate of at least 14% discount (yield 14½%) - some 18½p down on last week's pro rata price of £96.695.

Bills

We continue to receive a considerable number of enquiries about the clausung and quality of eligible bank bills, and are carefully checking bills which we buy in our operations (which has resulted in some bills being retired on these grounds). Foreign interest in the use of bills is particularly strong, partly as a result of the £100 mn acceptance credit facility announced early this week for New Zealand (which we are prepared to allow on a short-term basis - 6-9 months - prior to a longer term issue).

I understand that 3 firms of sterling money brokers are now quoting prices for bank bills (hitherto only quoted by discount houses) and discount houses are thus likely to be kept on their mettle if this development becomes more widespread.

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Money Markets Division HO-G
17 September 1981

M T R Smith (4710)