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MR COLEBY
THE DEPUTY GOVERNOR'S
PRIVATE SECRETARY

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GPS

MONEY MARKETS DURING WEEK ENDED 30 SEPTEMBER

General Features

The markets generally are at sea without a paddle or even an oar to cope with the increasingly turbulent waters. No one knows what the level of short-term rates should be and the general disarray in world markets only serves to increase the uncertainties. The discount houses are entrenched in defensive tactics which involve keeping the length of their assets as short as possible and refusing to take on paper of much longer than one month, except at higher yields each time.

Inter-bank rates over the week have edged fairly consistently upwards with the 3-month rate closing last night at 16 3/4%, up 1 1/8% on the week - after touching 17% earlier yesterday. As a result of our operations, the overnight and week rates have, until yesterday, remained reasonably steady, but a combination of factors led to these periods trading yesterday morning between 15 and 16%. Such levels have undoubtedly increased pressures on the clearing banks to raise their base rates since funding of their book at any rate will be expensive in contrast to overdraft borrowing by their 'blue chip' customers at rates of as low as 14 5/8%. The market seems to be looking for a rise of 2% in base rates.

Daily Conditions

With daily money conditions proving particularly volatile this week, mainly due to higher levels of tax revenue, we found ourselves having to relieve a much larger-than-expected shortage yesterday (when as a result of earlier forecasts of a surplus, a special issue of £300 mn 3-week Treasury bills was taken up). With market rates noticeably higher at the short end, our purchases were undertaken at rates higher

than when last we dealt, but it appeared that our operations had little effect on the structure of interest rates, although foreign exchange markets reacted favourably.

Yesterday's events apart, the interesting feature of the week was our success in mopping-up a surplus on Monday by selling a few (£5 mn) Treasury bills to a discount house, the first time this has been achieved since the new monetary system came into operation.

Treasury Bill Tenders

The results of the two tenders in the last week. - £100 mn 91-day bills on offer last Friday and £300 mn 3-week bills on offer on Tuesday - had an unsettling effect on the markets as a result of the rates accepted. The lack of appetite for 3-month paper last Friday led to a sharp fall in the pro rata price and an effective yield of 16% on such paper. On Tuesday the tender for the special bills (to counteract the likely surplus conditions created by VAT rebates) again attracted bearish bids, mainly because the bills were regarded as a lock-up till 21 October.

The appetite for this week's 91-day bills and the further tranche of special short-term bills next week is likely to be very slight with a prospective further fall in the pro rata price to around 96.0 (from 96.165).

Other Points

I have had 2 banks (Barclays and Citibank) commenting to me at the wide margin currently available to discount houses between the cost of their money and the yield on eligible bills. Most call money is currently 14% (with some up to 14 1/2%), while the yield on eligible bills is nearly 16% and the overnight inter-bank rate is well over 15%. This is undoubtedly a reflection of the volatile conditions but we are monitoring the relationship of the various rates to ensure that the discount houses are not abusing their position.

The current market rates are inevitably having an effect on the issue of bills with many borrowers resorting to overdraft as their lines run off. I understand that the first issue of bills by Pemex (who recently signed a £365 mn acceptance credit facility) was to have taken

place this week, but has been delayed by procedure problems. The first amount is likely to be about £30 mn but in current market conditions the houses are not rushing to buy bills.

The Clearing Banks are due to pay over today to HMG 50% of the special tax levied on them in the Budget. The remaining amount is to be paid in 2 equal instalments on 1 Decemebr and 1 February 1982.

The proposed merger between Cater Ryder and Allen Harvey & Ross, the terms of which were announced yesterday, appears to be receiving favourable comment - the actual merger is not likely to be effective till around the end of the year.

MTR

1 October 1981

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