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MONEY MARKETS DURING WEEK ENDED 14 OCTOBER

General Features

The week has certainly proved interesting as an example of the workings of the new monetary control system, with the first downward adjustment in banks' base rates - by ½% to 15½% effective yesterday. The market generated a considerable head of steam last week in pushing down rates and it was mainly as a result of the fall in sterling on Monday that this downward pressure eased. Since then the rate structure has steadied somewhat, developing a very flat profile with longer-period rates (6 and 12 months) creeping up by 1/8 and thus arresting the trend towards a reverse yield curve. The base rate move had been already discounted and so had little or no effect on rates yesterday.

While the heady levels of trading experienced last week have not been maintained since the week-end, nevertheless there is still some interest in the longer periods. Market expectations are somewhat mixed with some still looking for further downward moves, while others feel uneasy and nervous, citing the very clouded outlook for US interest rates as having particular relevance for the course of UK rates. Moreover, following the unexpected (to the market) base rate move, many forecast greater volatility in UK rates as a result of the new system.

The discount houses in particular, while welcoming the better sentiment last week, were a little apprehensive that rates were coming off too fast and the steadier features in the last 3 days have thus been welcomed. Most have taken the opportunity to lengthen their books.

Daily Conditions

With varying shortages throughout the last week, we have been required to provide assistance every day, on each occasion by outright purchases of bills. Most of these have been in Bands 1 and 2 (up to 33 days) but with signs of shortages of such bills in some houses, we have operated in Band 3 (34-63 days) on each of the last 2 days - the first time we have done so since 25 August. Our dealing rates have reflected the downward pressure on rates last week with the lowest rates in Band 1 being 15 1/8% last Thursday and 15% on Friday. This rate has continued to be the 'stop' rate in our dealings in Band 1 this week, with 15 1/4% being the lowest rate in Band 2 and Band 3. The most significant influences on the market over the week have been the sales of gilts and, to a lesser extent, higher-than-expected Government revenue. One interesting feature in this period was that on Tuesday as a result of a particularly sharp swing against the market between 12 noon and 2.00 p.m., our assistance included the purchase of Treasury and Local Authority Bills direct from the banks (the discount houses having offered insufficient paper at acceptable rates to relieve the shortage). - reflecting the fact that the banks had not called sufficiently heavily from them.

Treasury Bill Tender

The bids for Treasury Bills last Friday reflected the increasing demand for 3-month paper in the market and the average rate of discount fell by just over 1% to 14.80% (yield 15.35%). Three houses obtained all but £2 mn of the £100 mn bills on offer but have subsequently found less market appetite for 3-month paper. On present indications I would not expect to see much change in the pro rata price (96.305) this week - but 24 hours can be a long time in current market conditions.

Other Points

The discount houses' resources fell by 7.6% between end-June and end-September and this will mean a reduction in their maximum book (collectively) of £450 mn during the current quarter.

MMD

Money Markets Division
15 October 1981

M T R Smith (4710)
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