GE1/16A

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MONEY MARKETS DURING THE WEEK ENDED 21 OCTOBER

General Features

The market remains unsettled and nervous about the outlook for interest rates with the trend in the last week towards higher period rates. The one-month inter-bank rate has edged up by 1/4% and the three and six-month rate by nearly 1/2%. There are the many underlying doubts and concerns about the effectiveness of the Government's policies and rates ~~thus~~ remain highly vulnerable to the performance of sterling in the foreign exchange market. Trading activity in, for instance, the inter-bank market has dropped off considerably from the turnover experienced earlier in the month, while discount houses, after a slight rush of blood to the head two weeks ago, have again gone on the defensive, shortening their books and clearing out (usually at a loss) longer paper.

There is some talk in the market that with the present rate structure, clearing banks may find it hard to maintain base rates at 15 1/2% for very long. This week's announcements i.e. unemployment figures and the September trade outcome, have had little material effect on markets, but at least in the last two days rates have remained relatively steady. Expectations among the discount houses are that rates are unlikely to come down very much from their current levels and that there is a greater likelihood of them going higher.

Daily Money Conditions

Shortages have occurred every day in the last week and until yesterday these have been dealt with by the repo technique, primarily to smooth out money market flows over the next 10 days or so. This followed a period of very heavy purchases of bills which had reduced the available stock of very short (under one month) maturities in the market's hands. The change to 'repos' also assisted us in unhooking ourselves from the 'stop' rate in our purchases of Band 1 and 2 paper.

Yesterday (the October make-up day) a return to outright purchases was made to deal with a shortage which at the start of the day was forecast at £500 mn. Unlike make-up days under the reserve asset system (when such a shortage would have led to high overnight and very short period rates), there was no noticeable effect on these rates and the Bank's assistance (just under £400 mn to meet a revised forecast of £400 mn) meant that there was no pressure on the inter-bank market. Our dealing rates in the paper purchased - all in Bands 1 and 2 - involved a 'stop' rate of 15% and 15 1/4% respectively.

The two main factors contributing to the shortages in the last week have been the number of bank bills maturing in the Bank's hands (as a result of previous operations) and tax revenues (which have been higher than expected despite some more VAT rebates).

Treasury Bill Tender

The outcome of the tender last Friday - an increase in the pro rata discount rate from 14 13/16% to 15 3/8% (giving a yield of nearly 16%) - was a reflection of the renewed nervousness among the houses. There was little outside interest in the bills and, as a result, the houses obtained 67% of the £100 mn on offer.

On the present rate structure, bids this Friday are likely to be at a slightly higher rate - at least 15 1/2% - although in their present defensive mood there may be a inclination to push the rate even higher.

Other Points

Three houses have made half-yearly statements this week with a fourth (Clive) to follow tomorrow. Gerrard and National reported a small profit but both Smith and Jessels have referred to losses in their six months to end-September.

An interesting feature yesterday was that some houses reported quite a lot of money on offer from banks (against a £500 mn shortage), giving rise to a feeling that some banks were boosting their liquid assets for reporting day.

MTRS

22 October 1981

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