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THE GOVERNOR'S PRIVATE SECRETARY

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29/10

MONEY MARKETS DURING WEEK ENDED 28 OCTOBER

General Features

The general market nervousness which was initially reflected in higher period rates last Wednesday (and appeared to be attributable to expectations of higher dollar rates) persisted through much of the last week. However, after the 3-month rate briefly touched 17% on Monday, rates have generally eased in the last two days and a very small degree of confidence has returned as sterling remains steady and apparently unaffected by the outlook for the dollar. There is probably little depth to this confidence and indeed little has happened in the last week to change the market's outlook on interest rates. In our daily money market operations we have tried not to rock the boat and this appears to have helped the steadying and easing of rates. Over the week one, three and six-month inter-bank rates are 1/16/1/8% higher, having been 3/8% up on Monday, while the one-year rate has actually eased by 1/8%. On the whole, the current rate structure looks rather more natural than it did at various times in the last week.

Talk of higher base rates has been fairly widespread, much of it fuelled by the press. The reaction of the banks, to whom I have spoken, has depended on how it funds its lending, eg one clearing bank confessed to finding it unprofitable to borrow three-month money at around 16 1/2% to on-lend to prime borrowers at the same rate! However, the lack of arbitrage opportunities for commercial customers has helped to restrict the pressure on the clearing banks.

Daily Money Conditions

Assistance has been necessary each day with one contributing factor being the payment of backlog tax, particularly yesterday. Last

Thursday there was a continuation of outright purchases which embraced Band 3 paper (up to two months). With the upward pressure on rates gaining momentum at the end of last week, we resorted to the 'repo' technique on Friday (mainly to smooth out money market flows) with funds being made available to the houses for up to six days at rates of interest of 15-15 1/8%. This policy was continued on Monday and Tuesday/ with the rates slightly up at 15 1/8-1/4%, but on Wednesday outright purchases were made in Bands 1 and 2. While the 'stop' rate for Band 2 paper continued to be 15 1/4%, the published lowest rate for Band 1 yesterday was 15 1/8%, as opposed to 15% last Thursday.

On two days in the last week, the overnight inter-bank rate has come under considerable pressure after we have finished our assistance. Last Friday deals were done up to 85% with one discount house having to pay 80% for £2 mn from a clearing bank. High closing rates were also reported on Monday. While it turned out that we had left the system short by £70 mn on Friday (mainly due to a late swing against the market), no such reason was evident on Monday.

Treasury Bill Tender

There was considerable doubt about where the houses would pitch their tenders last Friday, since the general nervousness had become particularly acute by Friday. In the event, their bids (at an agreed price) were at a rate just below 16%, which, while up by over 1/2% on the previous week, was roughly in line with the market on Friday morning. The houses in fact obtained roughly half of the bills on offer.

Tenders this week will again be subject to the views on the day - at this distance and at current market rates, there is unlikely to be much change.

Other Points

The discount houses are studying the question of disclosure of reserves in the light of the draft EEC proposals.

MTRS

Money Markets Division
29 October 1981

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(HO-G)