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MR COLLEBY  
THE DEPUTY GOVERNOR'S  
PRIVATE SECRETARY

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GPS

MONEY MARKETS DURING WEEK ENDED 18 NOVEMBER

General Features

The market's downward plunge came to a relatively abrupt stop on Monday as a result of the Bank lending to the discount houses at a penal rate (15 1/8%). The very bullish tone, which had been gathering pace, emanated very heavily from developments in the US, and while the touch on the tiller has certainly had the desired effect, market sentiment remains quite bullish, with talk of a further cut in base rates far from being dismissed. The question is more one of timing and the market has, I think, taken to heart the implicit message contained in the Bank's action on Monday.

The other notable factor of the last week has been the squeeze on the clearing banks' liquidity, caused by fairly massive flows of money to the Exchequer. A combination of gilt sales, normal tax payments, payment of taxes held up by the strike, attractive CTD rates and the Exco applications have caused some confusion among the banks' treasurers. One of the results has been that very short inter-bank rates have become quite firm - and in trading after our 2.15 operations, have reached as high as 100% (on Monday). Moreover, there are signs that difficulties among the banks in the flow of information through to their treasurers' offices have given rise to wrong positioning on the day - on Monday the forecast shortage was certainly not manifest in the discount market.

The pattern of rates in the last week has inevitably been a little volatile with falls of up to 7/8% occurring between last Thursday morning and Monday morning. The falls were spread throughout the period rates and, equally, the reaction to the Bank's move on Monday has been similarly spread with rises of up to 7/16%. Over the week, as a whole, the net fall has been about 1/4% in the period rates.

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With the tightening of the very short end, we now have quite a pronounced reverse yield curve.

The discount houses remain optimistic about the immediate prospect for interest rates and have been lengthening and enlarging their books, without taking too many risks.

#### Daily Money Conditions

As will have been apparent, these have been very tight, with a very considerable quantity of assistance necessary. Over the week, the cumulative shortage has been £2.5 bn and we have purchased £1.5 bn bills and another £0.6 bn on a 'repo' basis. In addition, we have been obliged to provide unofficial assistance to the gilt-edged jobbers (in some quantity), the discount houses (apart from Monday's published lending) and even a couple of banks (by discounting bills). The discount houses have performed their required role very capably and responsibly.

With such large shortages, we have been buying bills in Bands 1, 2 and 3 although the great majority have been in Bands 1 and 2. We were, in fact, able to reduce our 'stop' rates in Bands 2 and 3 yesterday - to avoid the impression that we had done more than touch the tiller on Monday - so that our stop rates are now 14 5/8% in Band 1, 14 9/16% in Band 2 and 14 7/16% in Band 3.

#### Treasury Bill Tender

The average rate of discount fell last Friday by over 1% to 13.84% with outsiders (notably the CTSB) obtaining 67% of the bills allotted (£100 mn). Inevitably the three-month rate for Treasury Bills has been affected by the slight upturn in rates since last Friday, but I still expect the pro rata price on Friday (96.54%) to be near last week's level. But much may depend on the outcome of tenders for today's tap stock issue (14% Exchequer 1986), and the mood of the markets. Moreover, money is likely to be quite short both today and tomorrow, even without the gilt issue.

#### Other Points

The operational date for the merger of Cater Ryder and Allen Harvey & Ross is Monday, 7 December.

*MMS*

19 November 1981

M T R Smith (4710)