GE 1/16A DUP SPARED Money Markets Division 26.11.81

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MONEY MARKETS DURING WEEK ENDED 18 NOVEMBER

General Features

The continuing daily shortages in the money markets have tended to dominate the trend in interest rates in the last week. The shortages in the period Monday-Friday last week totalled near £2.5 bn and by the end of that period the pressure on banks' liquidity had resulted in overnight rates of 17%+ and week rates of 16 1/2%. While there has been some relaxation in both the size of the shortages this week (in the three days £0.8 bn) and in the short period rates, the fact that the shortages are continuing appears to be holding up the short end (while the shortage this week has been mainly in the discount market because of bills maturing in our hands and 'repos' unwinding, the banks are trying to replenish their liquidity). Partly as a result of these pressures on the short end, longer period rates have tended to firm slightly over the week.

With the market expecting further large shortages today and tomorrow, there may be little movement in rates, despite the Bank lowering its dealing rates by 1/16 in all three bands yesterday. The cuts in US banks' prime rates have had little effect on the structure of rates, the main follow-through occurring in the gilt market. All in all, it probably needs a couple of days of easier market conditions for rates to show any change.

General expectations are still for a cut in base rates in the near future. Over the week, however, the one-week rate has come down 5/8 while the three-month rate has shown no change.

Daily Money Conditions

As mentioned above, shortages have continued, with a total of just over £2 bn since last Thursday. The main factors have been a very large

ALC 26/11

quantity of maturing commercial bills (£0.8 bn) in our bands, some gilt sales (mainly the tenders last Thursday for 14% Exchequer 1986), a large number of 'repos' unwinding and payments of back tax. Our assistance has been mainly by outright purchases of bills with the use of 'repos' as an additional means of unlocking longer bills. Certainly the current supply of Band 1 and 2 bills has been reduced to very small quantities by our operations, and because of the 7-day rule (the Bank does not buy new bills until they have been in the market for 7 days) it will take a few days for the market to replenish their supply of saleable bills.

In the last week our dealing rates in Bands 1, 2 and 3 have all come down, 1/16 in the case of Band 1, 1/8 in Band 2 and 1/4 in Band 3. Last Thursday's move down was a sign that the previous Monday's action in forcing the houses to borrow at 2.30, was no more than a touch on the brake.

Treasury Bill Tender

There was very little change in the pro rata price last Friday with only a 1p rise to £96.55. Again, the majority of bills (64%) went to 'outsiders' and since then the rates for three-month paper have, if anything, firmed slightly. It is unlikely that there will be much change again this week.

Other Points

The local authority market, which has not been very active in the last week, does not appear to have been affected by the publicity given to Government proposals on local government.

Discount houses are finding their trading margins not very profitable as a result of the reverse yield curve and while the average cost of money is around 14.85/14.90, the yield on three-month bills is currently only 14.44%. Unless there is some decline in short-term rates, we could see bill rates edging upwards again fairly soon.

There is to be a meeting with the Chairmen of the discount houses next Thursday to review the operation of the new system.

MTRS

Money Markets Division
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M T R Smith (4710)
HO-G