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3.12.81

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THE GOVERNOR'S PRIVATE SECRETARY

Copies to Mr Ffordge
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Mr Foot
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DGPS

M. Fuld 3/12
It will be interesting to see the outcome of today's meeting with the Market.

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MONEY MARKETS DURING WEEK ENDED 2 DECEMBER

General Features

The main development in the money markets over the last week has been the gradual firming of period rates and, accordingly, a reduction in the press-inspired talk of base rate cuts. The short end of the market has remained firm, with an easing only becoming apparent yesterday after two comfortable money positions this week and the deliberate provision of surplus assistance to the market by the Bank. Generally speaking, the firm overnight and week rates have continued to reflect a tight liquidity position in the banking system - with an outlook of little relief over the next three months.

The firming of period rates reflects the funding difficulties which traders had begun to have in holding longer assets which had been purchased on the bullish market of the last few weeks. This includes the discount houses which have been finding it increasingly difficult to hold longer bills yielding 14 1/2% or less against a continuing average money cost of around 14 7/8-15%.

With this stalemate situation market activity has been fairly subdued and the prospect of the Chancellor's statement yesterday undoubtedly contributed. The initial effects, however, of the latter have been neutral and it remains to be seen how rates will react. With prospective sizeable shortages for the next two weeks, much will depend on the banking system's liquidity.

Over the week, the one-week rate has shown very little change, down 1/8% as a result of yesterday's easing, while the three-month rate has risen by 1/4%, and the one-year by 3/8%.

Daily Money Conditions

While the aggregate of shortages over the last week has been considerably lower than in the previous two weeks, we have provided assistance to the market each day, on all but one day by outright purchases. These operations have totalled £1.25 bn with £400 mn by way of a repo (till 14 December), and in that time our dealing rates have remained unchanged (having moved down on Wednesday last week).

The supply of bank bills appears to be very satisfactory with a lot of renewals having taken place in the last few days. The bill rates have undoubtedly been conducive to companies drawing bills rather than resorting to overdrafts, although there was some evidence last week that companies were prepared to hold off drawing bills in expectation of a cut in base rate (however, the bill rates had already discounted a fall in base rates).

Treasury Bill Tender

There was little change in last Friday's tender with the pro rata price moving up by 1p to £96.56. Discount houses obtained some 74 mn of the 100 mn bills on offer (of which Gerrard & National took 70 mn), but with longer bill rates creeping higher over the last week, the outcome on Friday is likely to be a lower pro rata price - say, £96.51 which would be equivalent to a discount rate of 14% (yield 14 1/2%).

Other Points

A meeting is being held this afternoon with the Chairmen of the 13 Discount Houses primarily to review the experience - after 3 1/2 months - of the new monetary control system, but also to discuss specific issues such as a risk assets ratio to replace the current multiplier (30 times) restriction on the size of houses' books.

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Money Markets Division
3 December 1981

M T R Smith (4710)