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CONFIDENTIAL

10.12.81

MR COLEBY
THE GOVERNOR'S PRIVATE SECRETARY

Copies to Mr Fforde
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Mr Byatt
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DGPS

MONEY MARKETS IN WEEK ENDED 9 DECEMBER

General Features

After the cut of 1/2% in base rates announced last Thursday (effective on Friday), there have been few signs of any market expectation of further cuts in the short-term future. Markets remain dominated by events in the US and thus the latest fears of very large US budget deficits in the next three years have done little to settle sentiment. Moreover, the disappointing £M3 figure for banking November, in particular the high level of clearing bank lending, has dampened any prospective hopes for further cuts in base rates before Christmas. The overall effect has been that after the fairly sharp fall in rates prior to Nat West's announcement last Thursday morning, the market has tended to drift with rates beginning to edge up, especially at the longer end, in the last two days. As at last night the structure of rates was virtually flat with the one-week standing at 14 7/8, the three-month at 15 1/16 and the one-year at 14 7/8 - ie a level of rates uncomfortably on the high side for base rates of 14 1/2%. Over the week (since the close on Wednesday last week), the six-month and one-year rate are both 1/8 up, with the three-month and one-month down by 1/16 and 3/16 respectively.

Sentiment among the discount houses is for the prospect of a further cut in base rates at some stage, but most likely in the New Year. Bill rates still reflect this, although yields on three-month paper have been creeping up since last Friday, currently standing at 14.7%.

Daily Money Conditions

We have again had to purchase bills from the market each day, the forecast of a surplus yesterday morning being quickly overtaken by a

ALC 10/12

swing of £200 mn against the market during the day. While we were able to take out most of the revised shortage by bill purchases, the inter-bank market tightened up considerably near the close to finish at 30% - which may well have an impact on the clearing bank lending figures for the December make-up day.

In all, we have bought a total of nearly £1.1 bn bills in the last week, with nearly £600 mn of this being done on one day (last Friday). The shortages have been mainly due to the number of maturing bills in the Bank's hands (about £850 mn), as well as to the seasonal increase in the note circulation and continuing payments of back tax. The supply of bills remains adequate, but next week's prospective shortage of £1.5 bn (at least) is likely to provide a test of the system.

Our 'stop' rates in our Band dealings have come down a little in the wake of base rate cuts and currently stand at 14 3/8 (Band 1), 14 1/4 (Band 2) and 14 1/8 (Band 3).

Treasury Bill Tender

There was very little change in last Friday's tender when the pro rata price showed a rise of 1/2p on the previous week, giving an average rate of discount of 13 3/4% (yield 14 1/4%). Discount houses only obtained 38% of the £100 mn bills on offer and subsequent rate movements will have made profitable trading of these bills a little difficult.

This Friday there are over £200 mn Local Authority bills, as well as the normaly £100 mn Treasury Bills, on offer and with three-month rates at current levels, the outcome is likely to be a drop of around 10p in the pro rata price, giving a discount rate of 14 1/8-1/4.

Other Points

Cater Ryder and Allen Harvey & Ross formally merged their operations as Cater Allen on Monday 7 December, thus reducing the size of the Discount Market to 12.

Following the meeting last Thursday with the chairmen of the Discount Houses, the latter are considering a response to the Bank's paper on the measurement of capital for houses.

The Electricity Council are reported to be prepared to pay only 1/8% acceptance commission on a facility under which they would draw bills.

MiDS

10 December 1981
M T R Smith (4710)