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MONEY MARKETS IN WEEK ENDED 16 DECEMBER

General Features

The last week has been another example of the increasing volatility of the markets in response both to interest rate developments elsewhere and to the economic outlook in the UK (the high clearing bank lending figure for November being a particular factor). Market awareness of the relevance of sterling's performance to UK monetary policy contributed to the fluctuations over the last few days when the 1-year rate rose by 3/4 between Thursday last week and Monday morning but then subsequently fell by 5/8 by last night. The 3-month rate in the meantime reached a peak of 15 3/4% on Monday morning (1/2 up on Thursday morning) but has subsequently fallen back to just below 15 1/2%. Monday morning was undoubtedly the most nervous time for the market but since then the Bank's actions in its open-market operations and a slight easing of US rates have helped to calm sentiment. While the rate structure has generally been flat over the period, the latest easing of rates at the longer end do point to market expectations that rates will ultimately go down rather than up. But overall the mood of the markets is brittle.

The discount houses, while maintaining a generally defensive approach, were finding the reverse yield curve on bills last week more uncomfortable in the face of higher money rates and although in many cases books have been lengthened in expectation of lower rates, their bids at last Friday's Treasury Bill Tender reflected their uneasiness at the prospect of taking on further 3-month paper (they were also tendering for over £200 mn Local Authority bills later that afternoon).

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Daily Money Conditions

Needless to say, we have had again to give assistance to the market each day, with shortages over the week totalling £1.75 bn. While much of that figure has been concentrated in the discount market as a result of maturing bills and a large (£400 mn) 'repo' transaction unwinding (on Monday), the banks have also found their liquidity under pressure again, due partly to the seasonal notes requirement and partly to payments of outstanding strike-delayed tax.

All our operations have been by means of outright purchases of bills with 2 significant features - (a) we operated for the first time under the new post-August 20 system in Band 4 (64-91 days) on Tuesday when faced with a £700 mn shortage; and (b) while maintaining a 'stop'rate of 14 3/8% in Band 1, we allowed the stop rates in Bands 2 and 3 to rise to 14 3/8% from 14 1/4% and 14 1/8% respectively in view of the rise in market rates. Operations in Band 4 were not only helpful in mobilising additional paper, but will also roll forward the maturities to the post-tax season period. The Bank's operations this week appear to have been regarded in a favourable light by the market.

Treasury Bill Tender

As mentioned earlier, the houses put in defensive tenders last Friday, having agreed jointly on a price just below 15%. The outcome of the tender was an average rate of just over 14 9/16% which reflected the wide spread of bids from outsiders, as the houses obtained 32% of the bills at their rate of 14 15/16%. The subsequent large local authority tenders produced rates of around 15%.

This week, the small recovery since Monday and the market's capacity to take on new paper after the heavy bill purchases earlier this week, will probably involve a higher pro rata price than last week (96.265) - possibly around 10p higher, but perhaps not producing much change in the average rate of discount.

Local Authority Market

My money broker contact tells me that the local authority money market is fairly depressed with authorities appearing to be in no need of funds and in fact having surplus funds which are being used to repay loans (especially floating rate loans). This appears to be partly due to the supplementary rate income of the last 2 months.

MTS

Money Market Division HO-G
17 December 1981

M T R Smith (4710)