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MONEY MARKETS IN WEEK ENDED 22 DECEMBER

General Features

The markets have again given vent to renewed anxieties about the course of interest rates with period rates showing fairly considerable rises. The high bank lending figures revealed last Thursday for the November banking month, plus the continued uncertainties about the basis of the Government's monetary policy, have tended to increase the uneasiness of market participants. While some seasonal factors, notably heavy rollovers, may have had some influence in pushing up rates, the volatility of the last 2/3 weeks (indeed since base rates were cut to 14 1/2%) reflects partly the underlying doubts about the domestic economy and the Government's prospects of achieving its aims as well as the level of US interest rates.

Since last Thursday interbank rates have been creeping upwards and the three-month rate was yesterday morning 9/16% higher and the 12-month rate 7/16% higher. While a three-month rate of 16% is clearly uncomfortable for the banks in relation to a 14 1/2% base rate, there is little talk of base rates having to rise, especially so long as rates at the short end (the one week is just under 15%) are held at current levels by the Bank's money market operations.

The discount houses remain uneasy about current market conditions and in such circumstances are anxious to get bill rates up to a level commensurate with both the cost of their money and the general uncertainty.

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Daily money conditions

With the notable exception of last Friday when there was a shortage of over £400 mn, daily money positions have been much more comfortable than of late. This is very much a temporary respite during which there has been few sales of gilts and very little evidence of any payments of back tax. Thus we found ourselves in the position on Monday of not needing to operate (for the first time since 7 October) and yesterday selling Treasury Bills to the market for only the second time under the new arrangements. On both occasions money was slow to appear among the banks, with the result on Monday that six discount houses were forced to make use of the 2.45 mn unpublished facility to borrow a total of £140 mn (at a basic rate of 15 1/4% - which in itself caused a stir among the borrowers concerned).

In our operations last Friday we again dealt in Band 4, as well as Bands 1 and 2, but did not operate in Band 3 (mainly because there was very little offered). Our 'stop' rates continued at the levels set earlier in the week but as a result of the Bank not purchasing any bills so far this week - at a time when longer period rates have been rising - there is inevitably some speculation as to the Bank's likely dealing rates today when a shortage (of at least £400 mn) is expected.

Treasury Bill Tender

The houses tendered last Friday at a jointly-agreed price of £96.355 which gave them 80% of the bills on offer at an effective yield of 15 3/16%. This produced an average rate of allotment close to the previous week's, but the subsequent upward movement in rates has left the purchase price looking out of line. With houses generally running full books and not very keen to take on fresh three-month paper, the price at tomorrow's tender is likely to be markedly lower - probably not less than 10 p lower and giving a yield of at least 15 5/8%.

The tender takes place at 11 am with the published results available at 1 pm.

Other points

Houses have, as a result of renewals of bill lines in the last two days of at least £400 mn, found themselves up against their 30x trading limits - which also has created upward pressure on the level of bill rates.

A meeting was held on Monday with a CLCB Working Party to discuss some of the operational arrangements of the new system.

MRS

Money Market Division HO-G
23 December 1981

M T R Smith (4710)