

MR COLLEBY
MR FFORME

Handwritten initials and date: "A.C." and "27/11"

Copies to Mr George
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MONEY MARKETS DURING THE WEEK ENDED 26 NOVEMBER

Market Conditions

The week has of course been dominated by Monday's statement by the Chancellor and in particular by the cut in MLR to 14%. General reaction has been one of surprise that the cut was more than 1% and this in turn has led to the feeling that the November money supply figures must be very good indeed (I sense that any other outcome would lead to considerable disillusionment, much on the lines of the reaction after the 1% cut in MLR in July and the subsequent poor M3 figures). Nevertheless, the discount market welcomed the drop and for the moment is optimistic about the course of events.

Reverting to the end of last week, it would seem certain that the Clearing Banks ended up last Wednesday with RAR of well over 13%. Gerrard and National reported to GMG that three Clearing Banks had asked them to change call money to non-callable money because they wished to reduce the size of their RAR over make-up day. This accounts for the very substantial increase from mid-October 1980 in the amount of 'other funds' discount houses have taken from listed banks - from £45 mn. to £285 mn. (of which Gerrard and National £160 mn.).

Money conditions on Thursday and Friday were very tight and on both days the Bank purchased a considerable amount of bank bills outright - £300 mn. all maturing within the next month. Another £250 mn. have been purchased so far this week.

The Treasury Bill tender last Friday saw the rate pushed markedly down - from 14.37 to £14.0877 - mainly as a result of one particular house (Union) taking a view on rates (derived in part from a rumour along the lines of the week-end press reports).

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Yesterday's conditions of a higher-than-large surplus in the market should have led to mopping-up on a considerable scale, but all the banks were seeing money going out during the morning and even at 4 p.m. when I spoke to National Westminster they expected to be on target. Most of them are however very comfortable on their RAR and with call money now at 13 1/2 - 13 1/4 will be finding the inter-bank market more attractive.

Talking Points

Last Thursday's meeting with the Chairmen of the 13 Discount Houses provided a useful discussion on the Bank's actions in the markets over the last year. For the most part the explanations were much appreciated, and coupled with reassurances on a continuing role for the market in any new monetary system, led to renewed confidence about their future.

Monday's notice on the future of the monetary system* has led to speculation among the houses on the effects of greater reliance by the Bank on open market operations and less on discount window lending. Tuesday's operations in which the Bank bought out a large shortage by purchasing eligible bills, including the technique of responding to rate offers on 2 - 3-month bank bills, and by refusing to lend at 2.30 p.m. has already raised speculation on the relative worth of the various assets held by the houses. The prime role given to eligible bank bills has already led to wider margins between eligibles and ineligibles (3/8 as compared to 1/8) while the possibility of less overnight lending has raised doubts about the value of holding gilts (currently used as security for their borrowings from the Bank). Some are wondering whether the Bank is likely to buy out shortages in future only by purchases of eligible bills and considering the effect this would have on their books.

Another consequence of Tuesday's open-market operations was that at least two houses were prepared to bid rates slightly higher than MLR at the end of the day (in one case raising the necessary balance from a non-bank source) in order to avoid coming to the Bank at 2.45 p.m. and having to borrow for one week.

*There was surprisingly little reaction from the Clearing Bank money contacts whom I saw (one of them had not even seen the notice by yesterday).

There has been little talk about Friday's Treasury Bill tender, with rates (as generally speaking) likely to take some time to settle down after Monday's drop in MLR. On current indications bids are likely to be somewhere in the region of £96.70 (13 1/4%) to £96.725 (13 1/8%), but may possibly be as low as £96.76 (13%).

Euro-Sterling Market

There is still talk of increasing business in the market, with a steady flow of new names (European and North American banks) appearing and Nassau becoming quite an important centre (as for Euro-^{sterling}sterling). I heard of a Japanese bank putting £35 mn. (£50 mn. according to one source) into three-month Euro-sterling but activity was apparent in all the period rates from one month to one year.

mms
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