CONFIDENTIAL

28.8.80

Mr. Flemming 29/8

Mr. George

Mr. Gill

Please see comment at end. ALC

Let us discuss this with A.L.C next week, please BAMMS

NOTE FOR RECORD

Copies to Mr Coleby
Mr Gill

MONEY MARKETS: 20 AUGUST (MAKE-UP DAY)

There was considerable publicity given to the difficulties experienced in the markets on make-up day - difficulties which became apparent on Tuesday afternoon when the T/N inter-bank rate was bid up to 18/19%. I understand that LABCO was active at that time, but in general it is likely that the non-clearing banks were bidding for reserve assets.

On Wednesday morning all four big clearers were under pressure from a combination of normal liquidity problems and reserve asset shortage. In all they called some £280 mn from the discount market but this in itself was not going to help their RARs. Three of them were in difficulties with their 12½% and Lloyds were reported to have no chance of achieving 12½%.

The ending of the corset has apparently done little to relieve the problems of make-up day. The inter-bank rates pertaining * in the week leading up to make-up day contributed to the problems by encouraging round-tripping by customers and Barclays were well aware of this (but at the regional and local levels there is great reluctance to stamp it out). Indeed both Barclays and National Westminster have told me this week that their "marginal" borrowings now seem to total up to £400 mn ie this is the variation which they tend to see when rates are high.

An allowance for this marginal borrowing and a desire not to be caught below 12½% mean that the banks pitch their target at a higher level and thus push up their need for reserve assets. Barclays for instance usually operate on a daily figure of 12.7 or 12.8% but target for 13% on make-up day.

As it turned out, the banks all achieved their targets although Barclays were just over 12½%. Lloyds on the other hand went to

* that is not really true; at no time up to + including the morning of Tuesday 19 August did we see an interbank rate higher than 16 11/16 (that for one-month money). The pressure was all concentrated in the final 24+ hours. JSF 29/8

ALC 29/8

bed with a bank balance of £220 mn, some £150 mn above their target, and a reserve asset ratio of 13.7%. Money certainly came out in the afternoon and that without too much aggressive bidding by the big banks in the inter-bank market. But there is genuine concern about the likelihood of a false picture being presented by their figures on make-up day with lending at a higher level - because of round tripping - than is warranted by the underlying position.

(i) I think there are two points to consider. One is that the performance of the individual clearers in managing their ratio & their money target varies widely, & reflects the care & intensity of effort devoted to it. Lloyds is egregious, but I am having some work done on a comparative study of the big four. This will be useful when we receive & begin to discuss their more detailed comments on this aspect of the Monetary Control paper; but more particularly will enable us to put pressure on the laggards to do better, perhaps starting with the CEO.

(ii) The second is that the system remains evidently subject to vast flows which, post-corset, are explicable only on the basis that some practitioners do not observe the r.a.r. between make-up days. We shall have to consider whether we should take steps to monitor observance, whether of the rar or its successor liquidity formula, either a good deal more frequently, or by occasional special check, in order to eradicate these disturbances to the system.

A.

Money Markets Division HO-M
27 August 1980

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pp M T R Smith (4710)