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Disc Mkt

CONFIDENTIAL

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END-QUARTER MAKE-UP DAY - 30 SEPTEMBER

It would be fair to say that against general expectations the September make-up day produced a now not uncommon flurry of activity. With market conditions having been generally comfortable for the last week, there were signs that there was, if anything, too much money floating around. Certainly Lloyds Bank were placing surplus funds in the inter-bank market at the end of last week rather than placing it with the discount market (some houses were not prepared to pay the rate Lloyds were seeking), and some discount houses were finding themselves constrained by multiplier problems from taking all that was being offered.

As far as I could establish, the clearing banks did not foresee any reserve asset shortage and given the market forecast for Monday and Tuesday, the stage seemed set for a fairly smooth make-up day. The main talking point in the morning was the number of 'outsiders' placing money with discount houses for the purpose of creating reserve assets. The clearing banks in particular increasingly feel this is not playing the game, as in this situation they find it more difficult to place their own funds with the market (and also suspect that the outsiders are not maintaining their RAR throughout the month).

The inter-bank rate will usually reflect, of course, any undue demand for money, and certainly on the previous day (Monday) the inter-bank rate climbed to 18½% in the afternoon (one of the names mentioned was Continental Illinois). On make-up day itself the rate went to 17% 'bid' about mid-morning after a quiet start, and then after lunch climbed to 30-25%. Despite our forecast of a surplus for the day, the clearers started to lose a lot of money (National Westminster at one time were reported to be £175 mn down)

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and in the end some discount houses found it very difficult to square their books. Gerrard & National and Cater Ryder both reported to Seccombes at 3 pm that they were short (to a small extent) and as a result we offered to buy bills to relieve their shortage. Gerrard & National accepted the offer and sold us £8mn bills, but Cater Ryder managed to raise the funds elsewhere. Archie Eglinton reported that the clearing banks just could not help out, even to the tune of £8mn which is an indication of the unusual course of events. It is understandable that given the small amount required and the forecast of a flat position they should not have considered it necessary to come to the Bank at 2.30 pm.

What caused the clearing banks to lose so much money suddenly? Opinions seem to vary depending on which bank one speaks to. One bank had strong suspicions that two big customers had resorted to arbitrage, while others saw typical end-quarter factors such as settlement of bills, over-cautious management of reserve asset ratios and crediting of end-year interest on accounts. Perhaps it is an indication of the fluctuations now seen in the market that National Westminster Bank which at one time was £175mn down, (and having to fund itself to some extent from the inter-bank market), found itself some £70 mn over target at the end of the day - a swing of some £250 mn. Barclays admitted it was only by good fortune that they were almost on target - they lost quite a lot in the Town Clearing but had sufficient of a cushion to preserve, in total, their RAR (at 12.8%). Of the other banks National Westminster reportedly came out at 14.2%, Lloyds at 13.0% and Midland at 12.6%. The implication is that the banks (apart from Barclays) benefitted in the Clearing and found themselves more comfortable than they expected. This could be attributable to the large level of Government disbursements coming out into the system. That apart, the likelihood that non-clearing banks were bidding for deposits to cover their lending - especially no doubt the reserve assets they were holding - is by implication quite strong since the discount houses report quite a lot of money from "outsiders" on offer on Monday and early Tuesday. On the other hand none of the Clearers envisaged any problem over RAs, but they were clearly under much more pressure in this field than they expected as a result of customers drawing on overdraft facilities, lines of credit, etc.

Ironically, the difficulties, which were not as marked as on 30 June, occurred when two factors, namely Euro-Sterling rates and the day's money position, were ostensibly neutral and leads one to wonder just what would have happened if these two factors had in fact been adverse. The inter-bank market was, as we have seen, very sensitive despite the fact that money conditions for the last week have been very comfortable. This latter feature only serves to show that external factors can have much more influence on the inter-bank rate than the Bank's own open-market operations. On the face of it, it should have been a comfortable day but the apparent lateness of funds appearing, coupled with the inevitable safety-first behaviour of the banking sector on a make-up day, combined to create temporary difficulties.

MTS
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