

M. J. H. Sp?
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MONEY MARKET CONDITIONS - 1 OCTOBER

- 1 It may be worthwhile to record a few findings on the behaviour of the markets on Wednesday when despite an expected 'large' surplus (revised from a 'moderate' surplus in the morning) we provided 2.45 pm assistance to two houses on an unpublicised basis. There were other houses which encountered extreme difficulty in balancing their books, having to borrow from the banks by the back door.

- 2 The fact that we encountered a moderate surplus on Bankers' balances the next day obviously ruffled a few feathers in the discount houses. There were mutterings that one or more of the banks were deliberately holding onto money to ensure that rates remained high, but from my enquiries it does seem that a lot of money only came out in the clearing. Indeed the 4 'clearing' banks claim a total of nearly £200 mn in their favour from the Town Clearing and perhaps not coincidentally, this equates with the surplus of Government disbursements and foreign exchange deals in the market's favour.

- 3 This does not however account totally for the large discrepancy of £500 mn between the Bank's forecast of the situation at 2.15 pm and the discount houses' position at that time. However many houses had that morning lost money placed with them over make-up day while there was apparently a modest amount of purchasing of bills by the houses, as well as the resale to the market by the Bank of £117 mn of eligible bills. Furthermore there has been some resistance this week (and last) to the rates asked by some Clearing Banks for fixed and call money, and with the forecast of a surplus some houses probably turned away money on offer from the banks. All in all, they proved to be a lot shorter than expected at 2.15 pm - at a

time when the banks were seeing money still going out (perhaps partly from an unwinding of positions on make-up day), and were not therefore seeing as rosy a position as we forecast. Some money came out from the banks at a late stage but only (on the face of it) after some prodding from Seccombes about the forecast position.

- 4 The day's events raise two points, both of which revolve round our forecast -
 - (a) is there much point in providing a forecast, if the clearing banks behave in such a way as to seem to ignore what we say?
 - (b) Should we lean more heavily on the banks in a situation such as yesterday?

- 5 All the banks claim to find our forecast useful in their efforts at targetting for the day (moreover they claim that the various factors which we currently give out are essential in their efforts to reach a successful outcome). On Wednesday's evidence it would appear that they may occasionally doubt, and even ignore, our forecast if they see a different trend in the main part of the day. They believe the Bank may not always be right - and certainly we do not claim to be 100% accurate - and because of their fear of being run down too far and possibly incurring either their Chief Executive's wrath or the Bank's (if overdrawn) or both - tend to be ultra-cautious. Days like Wednesday do not seem to occur too frequently, and I am inclined to accept that there were a number of unusual factors, some of which were a spill-over from make-up day.

- 6 Seccombes' efforts to convince the banks that a surplus (large) was expected by the Bank did seem to have a little effect, but there is a limit to the effectiveness of such an approach. We could not justifiably expect individual banks to respond to an approach from the Bank, since no one bank can be sure that they will be beneficiaries of any surplus.

7 A not unrelated point which you mentioned to me recently is the question of whether we should continue to include in our morning forecast the factors which contribute to the surplus or deficit; many of the market have a pretty good idea of which factors are significant on any one day - eg the pattern of Government expenditure & revenue, repayment of market advances - and would not therefore miss them but I detect that the clearing banks take comfort, when needed, in knowing likely factors. There are of course factors which we do not mention, such as the level of gilt sales and under the current system the market can probably draw some conclusions on these factors on occasion. It is possible that the non-publication of factors would lead to the sort of difficulties the market encountered on Wednesday, but given the reporting systems within the banks on the movement of money which should form the basis of their targetting, I doubt whether this is likely any more frequently than now.

8 I suspect that, if we withdraw our elaboration of the day's forecast, there may be a few outbursts from some members of the market, but given the views which I have just read in the CLCB submission on Money Market Intervention Techniques, I think the banks will have few grounds for complaining!

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Money Markets Division
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