

28.10.80

Handwritten notes: "Make", "D", "Sole", "Fork", "copy", "file" with arrows pointing to various parts of the document.

Handwritten note: "25/10. I think this was very well conducted."

MR FFORDEN
THE GOVERNOR

Copies to The Deputy Governor
Mr George
Mr Somerset
Mr Gill
Mr Longmuir
Mr Smith

Handwritten note: "60 30/10"

Handwritten initials: "AG"

E mns

MARKET OPERATIONS ON 24 OCTOBER

Our operations on 24 October when there was a prospective market shortage of 500 and a need to replace as much as possible of that with reserve assets had been prepared by a certain amount of leaning on the Discount Market. The objective of buying outright a substantial quantity of eligible bank bills, set out in my note of 21 October, had been put to the test on Wednesday 22 October and met with a distinctly poor response, only 35 being offered. On that occasion we bid a rate of 15 7/8% for bills with between 40 and 95 days to maturity (1 December to 24 January). One-month bills were at that time on offer in the market at a rate above 16% and 15 7/8% was generally seen as an offering rate for two-month bills. The expectation encouraged by our broker was that we might hope to buy substantial quantities of December bills at that rate. It was unlikely that we would get longer bills as the three-month rate was around 15 1/4%.

The post mortem on Wednesday's operations indicated that houses were generally reluctant to offer more than modest quantities at the rates they were indicating and would regard the proper rate for larger quantities as being distinctly lower, eg 15 1/2%. During the course of Thursday we impressed on the Chairman and Deputy Chairman of the LDMA that our market operations ought not to be equated with those of a commercial buyer. They were undertaken in order to deal with imbalances in the system; it was as important to the market as to ourselves, if not more so, that they should be seen to be capable of shifting funds in large quantities without pushing rates around. For our part, we could not bid rates which appeared to be leading a downward movement from currently observed levels. This was especially so when the existing rate pattern was already incorporating

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expectations that MLR would be coming down quite soon, which it would obviously be wrong for us to fuel. When the market said that substantial sales were unlikely on our present terms if the alternative appeared to be automatic access to borrowing at 16% MLR, they were told that it would be wrong to make the assumption that funds would be available on that basis.

On Friday, our dealing position was modified so as to bid 15 7/8%, again, for December bills (ie 38 to 68 days) and to invite offers of January bills with a rate attached to them. The initial response was that, before lunch, we were offered, in addition to 112 of Treasury and corporation bills, 66 of December eligibles and- of January eligibles, 20 at 15 3/8%, 20 at 15 5/16% and 130 at 15 1/4%. I accepted those at the first two rates but declined those at 15 1/4%. 15 5/16% had been the lowest (and fairly general) offering rate for three-month bills on the Reuters screen and corresponds to a rate of interest a trifle below 16%. I could see no justification for going any lower.

After lunch I was offered 35 more Treasury and corporation bills and 5 December eligibles and, initially, 116 Januarys at 15 5/16% which I accepted and 34 at 15 1/4% and 5 at 15 1/8% which were both rejected. After I had passed the message that I was prepared to continue buying until 2.45 pm - which indicated that MLR borrowing at 2.30 pm was not available - I was offered an additional 42 Januarys at 15 5/16% which were all accepted.

Five houses came to make use of the 2.45 pm facility of whom the first, Gerrard & National, came not so much because they needed money as to test what the rate might be. Two of the visitors needed more than was available within their quota at our best rate and were charged 16 1/2% for the balance. One of them, Smith St Aubyn, was short by an amount substantially exceeding the total facility. The reason, they explained, was that they were holding virtually no December and January bills having preferred recently

to concentrate on the shorter date, ie November bills. I gave them the opportunity to search for additional money for a few minutes saying that if they still were not square they should offer to me November bills and I would bid a rate. Shortly before 3 pm, we were sold 14 November bills at 16 1/4% which was the lowest offered rate currently visible for one-month bills.

The total of outright purchases of eligible bills therefore came to 283 and the total of market operations to 430. Lending at 7 days under the 2.45 pm facility came to 97, of which roughly half was necessary to enable bankers' cash to be on target and the other half was reflected in above target balances.

I rate that performance an entirely satisfactory one by the Discount Market in the light of ^{the} distinctly short notice that they had of the type of operations we were seeking to conduct. Now that we have made the point that they should not base all their decisions on the presumption of unlimited funds at MLR I think we may rely on even more effective performance in the future; and this will be easier for them if the rates prevailing at the time of our operation have not risen significantly over the immediate preceding period. The operation was not intended to be punitive and its terms are not regarded by the market as having been unfair, though its natural consequence has been to bring down the prevailing level of rates on bank bills and to oblige them to replace paper sold to us by new paper 1/4% or more cheaper. The operation has also thrown up certain questions for ourselves over our conventions for the quality of bills which we buy. They require a separate note which I will put forward in due course.

A.L.C.

28 October 1980

ALC