

Mr. Gill  
Mr. Foot

MTRS

CONFIDENTIAL

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We shall not make much progress in improving 'reverse' operations - i.e. mop-up - until the arrangements for banks' cash provide them with an incentive both to apply resources to informing themselves how much cash is available, & then to using it. When that is done, they will also have an incentive to price the services they supply to other parts of the system, e.g. non-clearing banks, more sensibly. A.C.

MR COLEBY

Copies to

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Mr Latter  
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Mrs Drummond

Yes

MONEY MARKET CONDITIONS - WEDNESDAY, 26 NOVEMBER

You asked me for the apparent reasons behind the banks' behaviour last Wednesday when surplus conditions - a higher than large surplus forecast at 9.45 a.m. - should have enabled the Bank to 'mop up' by selling Treasury Bills.

Some of the banks were seeing a lot of money going out in the early part of the day and rather than take the forecast at face value, were actually calling money from the market. The situation <sup>later</sup> showed little improvement and indeed the market, from being some £200 mn. short at mid-day, had to resort to paying 13 3/4% for their closing balances. In the meantime, the forecast had shown a small adverse swing, but even this left the position as a large surplus.

Bankers' balances were in the event £241 mn. above target that night and the respective banks gave the following explanations:

Barclays (+ 57) - a favourable (unexpected) out-turn of £40 mn. in the Town Clearing which apparently consisted of a number of items - most of it they explained as customers drawing on market-related lines and repaying overdrafts.

Lloyds (+ 67) - no satisfactory explanation other than that there were a lot of late receipts, most of which had not been notified to them till it was too late (Lloyds' balance has shown erratic behaviour for some time now).

Midland (+ 33) - felt that they had done their part by putting out £90 mn. into the discount market as well as placing funds in the inter-bank market.

ALC 3/12<sup>3</sup> EAT 3/12<sup>17</sup> SSF 4/12<sup>4</sup> MTRS 5/12<sup>4</sup>

Nat.West. (+ 70) - were still expecting to be on target at 4 o'clock that afternoon. An enquiry into the reasons for the surplus showed that many overseas banks had left funds on their accounts somewhat unusually - but apparently this happens from time to time if they are unable to find a suitably attractive home for any surplus. There is a tendency for such customers to leave money on the account to raise the average balance held - and thus reduce the level of bank charges at the year-end.

This is but one more example of the apparent difficulties which we face in dealing with a surplus. My observations can be summarised as follows:

- ✓ (a) there seems to be little incentive, as the system stands currently, for the banks to improve their information flows;
- (b) customers seem to be quite well trained in providing notice of withdrawals, but not of receipts;
- ✓ (c) the banks have a vested interest in maintaining rates for call money and inter-bank deposits, and because of the averaging process may be content to run higher balances on such a day;
- (d) there is a reluctance to act on the Bank's forecast of a surplus, until they actually see the money coming in.

I would also add that last week there was little evidence of a tight squeeze on banks' liquidity and indeed ratios were very comfortable indeed. Moreover, balances had tended to be well above target during the month as a whole.

This example highlights yet again the question of information flows which could become a much more important factor in the

monetary system in the next few years. The banks have a lot to do in this respect, just as it will be more important for Government to regulate its flows more precisely and regularly. One possible improvement for the future as far as the banks are concerned will be CHAPS II which should remove, to some extent, the present uncertainty over the size of any bank's town clearing.

*MTS*  
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