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MONEY MARKETS DURING THE WEEK ENDED 4 MARCH

Unprecedented shortages

There was an exceptionally large shortage on Friday, followed by an unprecedented one on Monday when PRT payments were made. Our operations to relieve these shortages were thus:

£ mn. (rounded)	Outright purchases of TBs & LA bills	Outright purchases of eligible bank bills	Repos in eligible bank bills	Lending	Total
Friday	50	320	120	140 ("2.45")	630
Monday	130	390	340	570 ("2.30")	1,430

Outright purchases of bank bills were restricted to those within one month of maturity while new-style "repos" provided, in effect, one-month money at rates bid by the houses, against the collateral of longer bills. Most of Monday's lending was for 7 or 8 days at MLR - the first "discount-window" transactions since Christmas Eve.

This huge exercise went remarkably smoothly and drew forth murmurings of praise for Seccombes and ourselves.

Our operations were minimal on the other three days.

The banks

Despite our having prepared, and communicated the availability of, substantial assistance on the acutely short days, short inter-bank rates rose sharply, with the overnight peaking at around 50% on Monday. In the event, bankers' balances were, however, moderately

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above target at the close on Monday. The big four each achieved reserve ratios of 8.2%. Nat.West., on whom the largest chunk of PRT was drawn, had anticipated well and enjoyed a satisfactory day, despite, in common with the other clearers, facing some arbitrage drawings on overdrafts (mostly soft, but perhaps including some hard) as inter-bank rates hardened; indeed, this process had begun on Friday. Lloyds reported a similar sort of day, having called quite heavily from the discount houses early on, as is Lloyds' habit when they perceive a big shortage in the system, whether or not at their own door. Midland were scarcely affected directly by PRT, but took precautionary action against secondary effects and, in the event, were pleased that they did. By contrast, Barclays largely persisted in their practice of biding their time and then adjusting through the inter-bank rather than the discount market, and arguably earned their just reward in having to pay 30% for overnight money to fulfil reserve ratio and Bank balance adjustments.

Although Tuesday and Wednesday were days of approximate balance in the money market, inter-bank rates remained comparatively firm, with the surplus scarcely visible during trading hours. On Tuesday Nat.West. had to pay 18% for overnight funds to balance its book. It seems that, once rates have been driven up, the banks feel exposed to arbitrage, and are accordingly reluctant to let go of any surplus funds which they may have, until they feel very sure that market rates are about to resume their more conventional level relative to base rates. One observer suggested that it would take something more substantial than a morning forecast from us of a "small surplus" (as communicated on both Tuesday and Wednesday), to turn sentiment to this extent. Meanwhile, the banks' caution tends to exacerbate the situation, since it contributes itself to the firmness of rates.

The immediate outlook

There is apprehension about the next few days. Friday is known to be sizeably short; substantial borrowing has to be repaid to us on Monday and Tuesday; and the banks must restore their reserve ratios to 10% on Tuesday. Although we calculate that the system can, arithmetically, generate sufficient reserve assets, there are some doubts as to whether sufficient will, in practice, materialise. Although bank bills that have been drained from the system by our operations are being replaced, it is not certain that this process will be rapid enough. For instance, one clearer, at least, is holding less than the permitted 2% of eligible liabilities as reserve assets in the form of bills. An individual bank may not perceive much benefit to itself in pushing customers towards bill finance, although the system as a whole would benefit. With the Budget imminent, many may shun the risk involved in bill dealings, but this obstacle has, to some extent, been overcome by the appearance of some 9-day bills, but the more traditionally minded baulk at this sort of practice.

Meanwhile, the houses have some spare capacity to expand their reserve asset liabilities, but with money short, the houses already paying 14% at the margin to fund their existing books, and with the uncertainty of the Budget cited as reason for taking no new chances, it is doubtful whether the houses can be looked at for providing many more reserve assets by Tuesday.

Prevailing anxieties were evidenced by the 7-day inter-bank rate which was still above 15% at yesterday's (Wednesday's) close, and is scarcely easier this morning.

Press comment during the past week, which has been generally less bullish than previously about MLR prospects in the Budget, has caused a certain amount of alarm amongst the discount houses, probably all of whom have staked their book heavily on at least a 2% reduction. (I think this may be something of an overstatement, but the downward pressure on rates has been such that no House could have avoided some exposure). A.C.

Treasury bills

There is a general feeling that the price was bid up far enough last Friday. Only one house obtained any bills then, and the houses will probably again be content to let other bulls risk their necks. With the prospect of further speculative bidding from banks, it is difficult to predict what rate will be set.

Other points

Few seriously expect MLR to be abolished yet. On the contrary, one clearing banker said that MLR would definitely have to be specifically lowered in the Budget, if, with present money market conditions, the authorities wanted bank lending rates to be brought down.

Discount house chiefs are looking forward to this afternoon's meeting with ALC.

The City of Birmingham Treasurer's Department has informed us that they expect an increase of 50% in the value of their bill issue in 1981/82 compared with 1980/81.

Money Markets Division (HO-G)
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A R Latter (4710)

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