MARKETS DOSS

27.8.81

MR GILL
THE GOVERNOR'S PRIVATE SECRETARY

Copies to Mr Fforde
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Mr Byatt
Mr Smith O/R
Mr Foot
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Mrs Drummond
Mr Erskine
DGPS

I should like to see daily this information - at least until I am familiar with it.

MONEY MARKETS DURING THE WEEK ENDED 26 AUGUST

General Features

The consensus among all sectors of the market is that the transition to the new arrangements last Thursday was remarkably smooth and hitch-free, and that the new system is working well. Those hiccups which have occurred have not been common knowledge. For our part, our most time-consuming activities have been, firstly, assisting the media, and other analysts not directly operating in the market, in interpreting the information which we now release about our daily forecasts and operations; and, secondly, responding to numerous queries, mostly from drawers and acceptors, about bill quality. In this latter task we are sounding the views of the discount market on some questions.

Daily conditions and operations

It was perhaps salutary that the new era should start with a firm demonstration of the potential unreliability of our daily forecast. On Thursday and Friday we were forecasting a surplus, but ended up giving assistance, following our own revisions and market evidence of tighter conditions that we foresaw. On Thursday the assistance was not, in retrospect, necessary; but on Friday we supplied less than the market in the event needed for balance, and National Westminster was hit by a late adverse swing and could only strike a positive operational balance here by a late transfer from another clearer. JGD interviewed the National Westminster treasurer and has made it clear that in the new era we do not expect late transfers to be used in this way. On Monday, we announced that we might publish revisions to our forecast at about 2pm on any day. i.e. later than originally intended.

There have been shortages each day so far this week. By far the most significant was on Monday (about £400mn); paradoxically, this caused the fewest problems, probably because the shortage was almost entirely in the discount market from the start (maturing repos).

Over the five days we have given assistance both by outright purchases and repos - preferring to concentrate now on outrights - generally in as short a maturity range as could be consistent with not exacerbating the expected tightness around 1 September. This meant, in effect, seeking to deal mainly for maturities in bands 2 and 3.

We lent at 2.45 on three days - a total of £107mn most of which to two houses only: one of these was, I believe, very short of paper in the bands we were buying, whilst the other was probably hoping to pick funds up in the market but failed - a possible reflection of the finer controls being exercised by banks on their operational balances. We also discounted 50 band 1 Treasury bills at 2.45 on Tuesday, coming from Barclays through Union, when we were not publicly operating in that band.

Rates

We have kept the rates at which we have been dealing, band for band, broadly steady. These have ranged, for outrights, from 12 11/16% in band 2 to 13% in band 3 (2 months). Repos have provided money for 2-3 weeks at 12⅝%.

Meanwhile market rates have been steady to slightly easier.

<u>Miscellaneous</u>

i.e. buying from the clearers if they found themselves unexpectedly short late in the day.

1 The discount houses have reacted strongly against any suggestion that the Bank should deal directly with the clearers. Views range from those who believe that there may not even be exceptional circumstances which justify it (Petherbridge probably belongs here) to those who take a somewhat more relaxed stance, believing that certain rare occasions may justify it (Campion perhaps).

2 While our practice of releasing our forecasts is welcomed by the majority, some people in the houses regret it, thinking that it may divert institutions' attention from making their own assessments thoroughly enough, and that it could lead to over-reliance on the Bank with the ultimate effect of pressing the Bank into feeling guilty about any swings after 2 pm and thus into becoming too accommodating - perhaps to the banks - if difficulties turn up later. Meanwhile, it is already the case that the markets (especially the inter-bank overnight) seize up a bit when awaiting our forecasts.

3 The houses appear to be in as good spirits as they have been for some time. They realise that they are twice blest at present, with the Bank more or less forbidding any reduction in liquidity and with some eligible banks having to build up for their 6%. There seems to be some evidence of money being placed by banks at somewhat longer term than hithertoo, and with call money enjoying no special status for monetary control purposes, the "callable fixture" is fading from some books.

4 The clearers are still feeling their way with the new arrangements. There is clear evidence of efforts to strengthen the administration and information systems of treasury departments, now that every penny counts every day. There is continuing talk of the possibility of shifting customers away from base-rate facilities, but I am not aware of any specific moves.

5 Some houses report that the "7 day" rule for bank bills has been forcing them short of paper to sell to us. This reference is mainly to our operations in band 2 this past week, where the houses have, of course, been unable to sell us newly drawn one month paper. I have explained, and they accept, that this is a deliberate policy directed at encouraging a steady flow of drawings regardless of our likely presence in the market.

6 A further twist of sentiment against certain local authority names (eg Lothian, Sandwell) is reported. Apparently a widening spread of institutions are declining to lend, whatever the rate.

Money Markets Division HO-G
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