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MONEY MARKET REPORT: BANKING SEPTEMBER 1981 - FINAL

1 The month divided into two distinct phases - the period up to 11 September, and the last three days when a steep rise in interest rates was engineered.

2 Throughout the month daily conditions were on the whole readily manageable, despite even the petroleum taxes on 1 September, and there was a remarkably smooth transition to the new arrangements introduced on 20 August.

3 Most days required some official operations to balance out shortages, and on no occasion in the month was it necessary to sell bills to mop up surpluses. No formal intervention was needed on 1 September (there was a small private "2.45" deal), since the £2 bn petroleum tax payments were almost entirely offset by maturing Treasury bills (from the £1 bn special issues) and CTD surrenders.

4 Outright purchases of bills were mainly in bands 1 and 2 (ie paper within one month of maturity), but ahead of 1 September there were some purchases in band 3, since band 2 was running a bit dry and the Bank did not wish to buy band 1 paper which would have matured before 1 September. The Bank did, however, buy some bills in band 1 privately on 25 August, to ease one institution's particular position. Before 1 September the Bank also lent through sale and repurchase agreements (repos) as part of the tax-date preparation. The Bank did not do repos again until 11 September, when this technique appeared to be the most suitable way of meeting quite a large shortage without moving beyond band 2 for outrights.

5 Apart from on 14 September (see below) there was no formal discount-window lending, but the Bank lent privately to the houses on seven days. Such instances occur, for example, when houses have had their offers of bills to the Bank rejected on rate grounds and have to borrow at penal rates to get square. In one instance the Bank had not operated in the bill markets despite having indicated that there could be a small shortage; banks held back funds to guard their balances against any late movements and one house was unable to square its book on any reasonable terms.

6 These instances possibly indicated some teething problems with the new arrangements, but relatively minor ones. As expected, overnight interbank rates have tended to be more volatile towards the end of each day than before, as banks seek to employ any surplus funds (which can no longer be "averaged") or as they fight on a short day to preserve their operational balances at the Bank which no longer embody the obligatory cushion contained in the 1 1/2% target. Any such late volatility in inter-bank rates is of no great importance in a policy context.

7 Up until 11 September the Bank's dealing rates (ie the rates which were accepted from the offers made) were concentrated on 12 11/16% for maturities up to one month, with some bank bills taken 1/16% higher and some Treasury bills 1/16% lower. This was consistent with the existing target range for very short rates. Any higher dealing rates would have quickly put market rates to a point where strong pressure on banks' base rates would have developed. The market became fixed on this very narrow range of dealing rates and specific action from the Bank would have been needed to engineer any departure from that point. The irony, in having establishled already a sort of de facto MLR, did not pass unnoticed. Meanwhile the rate for repo lending was moved up close in line, to 12 1/2% on 11 September as opposed to 12 1/8% on the previous occasions, before the end of August, when the Bank was anxious to secure a smooth passage for 1 September. On balance, market rates for terms beyond one month eased very slightly during this period. For example, the three-month inter-bank rate was a fraction below 14% in the week ending 11 September, compared to a fraction above in the second half of August.

8 The rate structure changed abruptly on 14 September when the authorities decided that short rates should move up to a new level. The Bank informed the market that it would not be conducting bill operations but would lend at 2.30: in the event the Bank lent overnight at 13 3/4%. This move was reflected by a marking up of rates across the board, and the new stance was confirmed by the Bank's purchase of short-dated bills at 14% the following day. The banking month closed with the three-month inter-bank rate at 14 3/4%, the clearers having raised their base rates to 14%.

9 It is difficult to discern the extent of any arbitrage over the September make-up day. In the preceding week there were probably occasional incentives for hard arbitrage at seven days via overdrafts; more persistently there was some relative attraction to borrowers in the one-month bill rate, which could have induced hard arbitrage of a type which would not be exposed to the risk of a rise in base rates during the arbitrage period.

10 On 16 September the Bank's holdings of eligible bank bills stood at £1.3 bn (of which £0.1 bn held against repos) and those of local authority bills £0.1 bn. Holdings of Treasury bills outside the Bank stood at £1.9 bn. There remained, therefore, ample scope for buying out future shortages.

11 The daily publication of the Bank's money market forecast was generally welcomed, although not all observers immediately appreciated fully the margins of error which pertained. Table 1 shows the actual forecast figure which the Bank had at the time of its final operating decision each day (row 1a); this does not necessarily correspond to the published forecast, since the latter is given only in multiples of 50 and is not revised unless the figure first shown, at the start of the morning, appears to be more than 50 astray. The numbers in row 1a can be compared with the outturn (row 2). On only 5 days was the discrepancy greater than 50. Operational decisions are guided by the reported position of the market and by the level of overnight rates, in addition to the prevailing forecast, and on only one occasion (7 September) did a wrong view appear to lead to a substantially different operating decision to that which might have been followed on the basis of the true position.

Money Markets Division
7 October 1981

ANALYSIS OF DAILY OFFICIAL MONEY MARKET OPERATIONS IN BILLS: BANKING SEPTEMBER

T = Treasury bills;
L = Local authority bills;
B = Bank bills;
R = Repos
Numbers immediately after letters denote the following maturity bands:
1 = 1 to 14 days
2 = 15 to 33;
3 = 34 to 63;
4 = 64 to 91.
Subsequent figures are amounts (£ millions) of official purchases of paper, unless asterisked (= official sale).
Rates shown are approximate rates (yield basis) at which funds provided or taken (range shown were significant).

| Date | Operations | Inter-bank rates: Overnight, day's range | Inter-bank rates: 3 months, middle |
|---|---|---|---|
| August | | | |
| 20 | R2 56 @ 12.1 | 9.0-12.9 | 14.2 |
| 21 | L2 35 @ 12.8, B2 63 @ 12.8, B3 20 @ 13.3 | 11.8-12.8 | 14.1 |
| 24 | T2 22 @ 12.7, L2 2 @ 12.8, B2 230 @ 12.8, T3 14 @ 13.1, B3 50 @ 13.2, R2 103 @ 12.1 | 11.3-12.6 | 14.1 |
| 25 | ≠T1 30 @ 12.8, ≠B1 45 @ 12.8, T2 3 @ 12.8, L2 19 @ 12.8, B2 50 @ 12.8, T3 29 @ 13.1, L3 4 @ 13.1, B3 10 @ 13.2 | 12.0-14.0 | 14.0 |
| 26 | T2 5 @ 12.7, L2 1 @ 12.8, B2 101 @ 12.8 | 12.0-13.0 | 14.0 |
| 27 | No bill operations | 9.0-12.7 | 14.0 |
| 28 | T2 18 @ 12.7, L2 16 @ 12.8, B2 77 @ 12.8 | 9.0-13.0 | 14.1 |
| September | | | |
| 1 | No bill operations | 12.5-14.0 | 14.0 |
| 2 | No bill operations | 10.0-12.6 | 13.9 |
| 3 | No bill operations | 4-12.6 | 13.8 |
| 4 | B1 5 @ 12.7 T2 4 @ 12.7, L2 29 @ 12.8, B2 152 @ 12.8 | 8-12.8 | 13.7 |
| 7 | No bill operations | 11.5-50 | 13.6 |
| 8 | T1 10 @ 12.7, L1 40 @ 12.7, B1 154 @ 12.7, T2 9 @ 12.7, L2 9 @ 12.8, B2 86 @ 12.8 | 11.9-14.0 | 13.7 |
| 9 | T1 2 @ 12.7, B1 83 @ 12.7 T2 4 @ 12.7, L2 2 @ 12.8, B2 67 @ 12.8 | 11.0-12.6 | 13.8 |
| 10 | No bill operations | 11.0-20 | 13.8 |
| 11 | R1 & 2 255 @ 12.5, T2 14 @ 12.7, L2 45 @ 12.8 | 8.0-14.0 | 13.8 |
| 14 | No bill operations | 12.8-20 | 14.0 |
| 15 | B1 118 @ 14.0, T2 3 @ 14.0, B2 58 @ 14.0 | 10.0-14.5 | 14.7 |
| 16 | No bill operations | 11.0-14.5 | 14.7 |

≠Private, unpublished deals.

# RECONCILIATION

(Banking months)

## Monetary Review

| | August | September (forecast) |
|---|---|---|
| **Influences** | | |
| CGBR | +458 | +605 |
| National savings | -197 | -230 |
| CTDs | + 24 | +670 |
| Other Exchequer | + 75 | - |
| | +360 | -165 |
| BGS | -588 | + 35 |
| Note circulation | + 39 | + 30 |
| Reserves | - 98 | - |
| Other, including customers (residual) | + 62 | - |
| Total influences | -225 | -100 |
| **Operations** | | |
| Commercial bills | +918 | |
| LA bills | +136 | |
| Treasury bills | -804 | |
| Market advances | - 65 | |
| Total operations | +185 | +110 |
| Total | - 40 | + 10 |

## Money Market Report (categories as in Table 1)

| | August | September |
|---|---|---|
| **Influences** (other than bankers' balances) | | |
| Balance of Exchequer receipts and disbursements (ex post) | + 673 | + 76 |
| BGS | - 571 | + 78 |
| Notes | - 5 | + 14 |
| Aggregate of daily predetermined money market transactions (as defined in Table 1) | -4,175 | -2,330 |
| Other (residual) | - 393 | - 250 |
| Total influences | -4,471 | -2,412 |
| **Operations** | | |
| Treasury bills | - 281 | + 198 |
| LA bills | + 85 | + 168 |
| Eligible bank bills | +1,239 | +1,369 |
| Repos | +3,280 | + 412 |
| Lending | + 99 | + 367 |
| Total operations | +4,422 | +2,514 |
| Total | - 49 | + 102 |