MR 1/79 ph   1. Mr Norgrove   2

2. Prime Minister

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

18 September 1987

Nigel Wicks
No.10 Downing Street

Dear Nigel,

MO: BANKERS' BALANCES

... I attach a note on banker's balances held at the Bank of England, as the Prime Minister requested when she and the Chancellor discussed interest rates on 6 August.

Yours
Alex.

A C S ALLAN
Principal Private Secretary

ps1/6A

MO: BANKERS' BALANCES AT THE BANK OF ENGLAND

At the end of each day, the clearing banks settle up with each other
and with the Bank of England through their clearing accounts held
at the Bank. These "bankers' balances", which are non-interest
bearing, are a component of MO. The banks individually conduct
their day-to-day money market operations with the objective of
reaching a target credit balance on these accounts. This target is
set so as to provide the banks with a cushion against unexpected
outflows and to protect them from going into overdraft (which both
they and the Bank would regard as contrary to the understandings on
money market operations reached in 1981).

2. The average level of bankers' balances and the fluctuations
around this depend on the accuracy with which individual banks and
the Bank of England can forecast their net positions at the end of
each day. These fluctuations can be considerable, a factor
underlying the decision to measure MO (uniquely among the monetary
aggregates) as the average of Wednesday levels during each month.

3. The present target level, which has changed little since 1981,
is £187 million. Since this represents only a little more than
one per cent of the stock of MO, which is just under £16 billion,
bankers' balances can in any case have very little medium-term
effect on the aggregate. However the monthly change in MO, from
which one and twelve month growth rates are calculated, is
typically less than £100 million. The volatility of bankers'
balances therefore means that an erratic swing in their level (such
as the increase of £98 million in July) can impact heavily on the
growth rate of MO in any particular month.

BANKERS OPERATIONAL BALANCES
JANUARY 1982–JULY 1987