

# The French « Money Market »

## 1. Definition of the " Money Market ", (" marché monétaire " and " marché hors banque ").

The chief function of the so-called « money market » in France is to enable the banks to cover their cash requirements or to employ their excess liquid resources by buying Government securities or commercial bills from other banks or lending to other banks against such securities.

The expression « money market » (« marché monétaire ») is relatively new, although for a long time past the banks have dealt in short-term money with each other. Before the 1914 war these dealings as a whole resulted in the establishment of a « marché hors banque », which meant the inter-bank market outside the Bank of France. Terrel and Lejeune, whose « Traité des opérations commerciales de banques » was before the first world war the only French book on banking matters (1), define the « marché hors banque » as follows: « the banks have come to offset between themselves the surpluses of the supply over the demands for money reaching them, or in other words the surplus of their resources over their lendings. Since their commercial bill holding, being rediscountable, is the easiest of their assets to mobilise and to transfer, it is their commercial bills which they use for the purpose of such offsetting. The name " marché hors banque " or private market is given to the whole of such business taking place outside the Bank of France ».

This definition of the « marché hors banque » would apply quite closely to the present « marché monétaire » as regards the object in view, namely the offsetting between banks of the supply and demand for money.

(1) Courcelle-Seneuil's book « *Les opérations de banque* » had been published in 1852 and was beginning to be out of date, despite successive revisions by André Liesse.

The difference comes in the means used, these being much more varied for the present « marché monétaire » or money market than for the former « marché hors banque ». There is a further difference inasmuch as the « marché hors banque » used to have a rate known as the rate « hors banque », or private rate (2), which was lower than the discount rate of the Bank of France. Since liberation on the other hand the rates in the money market have nearly always been higher than the official discount rate (3).

The change in the market's name took place between 1928 and 1939. It was due to a number of reasons. In the first place the « marché hors banque » had changed its character, having grown in size while fresh types of business were being done in it. In addition the authorities responsible for monetary policy wanted to set up in Paris a wide market for short-term money, not merely French but also international; and for this purpose the name « money market » was more suitable than the old « marché hors banque ».

## 2. Establishment of the Money Market.

Up till 1926 the « marché hors banque » worked on the same lines as before 1914. The business done took the form of discounting bank acceptances and prime commercial bills; the bills discounted had to bear first-class signatures, to be of not less than a certain

(2) Writers before 1914 used to say that movements in the private rate or rate « hors banque » entailed changes in that of the Central Bank. When the rate « hors banque » rose above the official rate the Central Bank would have to raise the latter, but would lower it when the rate « hors banque » was much below bank rate.

(3) In his latest Report the Governor of the Bank of France has explicitly defined afresh the term « marché hors banque ». According to him this term means transactions in the money market at a rate « hors banque », that is to say below bank rate, and he regretted that there is no such market. I shall revert to this point in Section 6.

amount, and to have at least forty-five days to run. The rate of discount was generally  $1/8\%$  to  $1\%$  below that of the Bank of France. The banks also used to grant each other unsecured day-to-day loans, the lending bank giving the borrowing bank a transfer order on the Bank of France, while the borrower would give the lender in exchange a transfer order dated the following day for the same amount plus interest. In view of the self-centred attitude of the French banks these unsecured lendings never resulted in creating a large market. Some of the big banks were in principle unwilling ever to be borrowers, but lent within certain limits to smaller institutions which gravitated into their orbit. The result was to form small one-way markets in water-tight compartments. During the 1914 war and after 1920 this market did grow to some extent as the result of business in National Defence Bonds, in the form of buying and selling them as well as of « pensions » for 15 days to a month (4).

In 1926 the recovery of the franc began. French money was brought home from abroad and foreign money was brought into France, being used first to speculate on a rise of the franc and afterwards on the stock exchange. The result was a glut of money and a fall in bank rate from  $7\frac{1}{2}\%$  on 31st July, 1926 to  $3\%$  on 30th January, 1931 (5). The rate for National Defence Bonds similarly fell from  $5\%$  on 13th April, 1927 to  $2\frac{1}{2}\%$  on 29th June, 1932. The banks found themselves holding large quantities of hot money, while the drop in rates caused some of them to take Government securities and to carry them by borrowing on the money market. Thus bases were created which had never before existed for the business of money market, and the authorities did all they could to help it to become organised.

(4) The « pension » of securities consists of two simultaneous transactions, namely a spot sale and a forward purchase.

(5) The rate « hors banque » fell in the same proportion. « During 1932 » — said the President of the Banque de Paris et des Pays Bas — « the average market rate of discount was  $1.28\%$ . This was the lowest rate "hors banque" not only since the war but also since long before 1914. The 1931 rate, which was thought exceptionally low, had been  $1.57\%$ . In 1930 it had been  $2.32\%$  and in 1929  $3.45\%$ . Between 1889 and 1913 it varied between  $3.81\%$  and  $1.77\%$  ».

With a view to developing the market in day-to-day-loans, and to avoiding payment of tax on the interest received, it was decided that such loans should in future take the form of « pensions » against Defence Bonds and afterwards of Treasury Bills. As this made the business completely secure the lenders no longer needed to trouble about the standing of borrowers; and the market, previously in separate compartments, became general. Next the Caisse des Dépôts et Consignations, in order to support the market, granted to the banks « pensions » for periods of one to three months at rates which varied, for one-month's money, between  $\frac{1}{2}\%$  and  $1\%$  below the rate at which the bonds were issued. The rates thus charged by the Caisse for « pensions » at one and three months were slightly higher than those current in the market. Thereafter the large banks established in 1928 a rediscounting institution known as the Compagnie Parisienne de Réescompte under the aegis and with the full support of the Bank of France. At first the new institution served as a go-between for the Bank of France in the latter's buying of bank acceptances in the market for account of foreign Central Banks. But the Compagnie Parisienne de Réescompte soon came to hold a place of its own on the money market, acquiring a large holding of public securities which it put on « pension » there, while also acting as intermediary between banks for similar business. In addition the Bank of France in 1929 took some important decisions designed to enable the banks to arrange their cash positions more easily. Under its « B » scheme of discount it allowed the banks to present bills of large amount for discount up to 3 p.m.; and under its scheme « D » it granted the banks seven-day « pensions » against bank acceptances of commercial origin and based on proper consideration. These two facilities, which greatly helped the banks, were afterwards replaced by others. When the money market became wider, the « B » scheme was dropped; and scheme « D » was replaced by one under which the banks were allowed to take « pensions » against eligible bills up to  $10\%$  of their discount ceilings at bank rate plus  $1\frac{1}{2}\%$ .

These various arrangements encouraged

many banks to build up a large holding of Government securities which they carried on the money market, making their profit through the difference between the interest they earned on the securities and what they paid for borrowing, as well as through arbitrage deals and other buying and selling.

Still, the money market could not continue its expansion unless it had a stand-by in case money became tighter. There was of course such support in the shape of the « pensions » at 15 days, one month and three months which, as we have seen, the Caisse des Dépôts et Consignations granted against Defence Bonds. But the banks were not sure that in case of a monetary crisis the Caisse would give all the loans they wanted. Borrowing from it moreover entailed a certain amount of red tape. And the Caisse lent only against National Defence Bonds, not against the Treasury Bills which were brought out at the end of 1932. With a view therefore to helping both the money market and the placing of Treasury Bills a more elastic method had to be found, and the task of handling the matter had to be given to the Bank of France, which was after all responsible for looking after the money market.

It was Mr. Tannery who had started the system of loans against National Defence Bonds when he was in charge of the Caisse des Dépôts et Consignations. When he was appointed Governor of the Bank of France he took steps to enable the money market to mobilise Government securities quickly and for brief periods. Hence the introduction in February, 1935 of the system of loans for five to thirty days on public securities having less than two years to run, the rate charged being in general the bank rate. A « ceiling » was fixed for each bank; and thus the banks could operate with easy minds, knowing how much help the Bank of France could give them. At the same time the Bank of France decided to discount Treasury Bills at less than 90 days, whereas previously it had discounted only National Defence Bonds.

These measures were severely criticised by some of the Regents of the Bank of France, who saw in them the seeds of inflation and monetary misfortunes.

Some violent economic and political crises certainly did hit the Paris market from 1935 onwards. The arrangement for thirty-day advances then enabled the market, without red tape or trouble, to obtain the necessary cash in time against National Defence Bonds and Treasury Bills.

By way of completing this work of organisation a Decree Law of 1938 authorised the Bank of France to buy negotiable short-term public securities and rediscountable private bills, within the limits and on the terms fixed by the General Council, and to resell such securities and bills without endorsing them. The Decree Law stated that the object of these transactions would be to act upon the volume of credit and to regulate the money market (6).

The introduction of « open market » operations was badly received. People who in theory favoured open market policy expressed the fear that it would be used to cloak borrowing by the Government from the Bank of France, and would give rise to inflation. These fears turned out to be largely groundless, since the amount of the securities and bills which the Bank took in this way never reached more than a small percentage of the money supply.

Between 1929 and 1938 some further rediscount companies were set up, and by their operations widened the money market. Thus the Banque de Paris, Lazards and Morgans set up the Caisse Générale de Réescompte. The Banque d'Escompte was established by private interests; and the Banque de Gérance Mobilière, which used to manage the funds of the Bank of Algeria, was bought by the Union des Mines during the occupation period. Two more rediscount companies were also set up during the occupation. One was founded by the Schneider group's Banque des Pays du Nord, and was afterwards absorbed by the Union Européenne and Worms & Cie. This was the Société Privée de Réescompte (7). The other, the Union d'Escompte, was esta-

(6) This Decree Law introduced into France the open market operations which had been in use for many years in Great Britain, the United States and Germany.

(7) Afterwards this firm was bought up by the group controlling the Caisse Générale de Réescompte.

blished by the Société du Gaz Lebon and the Chantiers et Ateliers de St. Nazaire.

As from 1st May, 1945 the Bank of France set up a Caisse de Dépôts et de Virements de Bons du Trésor. Thenceforth the Treasury Bills which banks bought or took on subscription were represented no longer by physical securities but by current account entries in the books of the new Caisse. There are in fact two kinds of Treasury Bills. One kind are the bills « on current account » held by the banks; the others are the bills « on vignettes », also called « on forms », which belong to private individuals or companies. The starting of this current account system greatly helped the banks by removing the risk of theft and by simplifying their work. Later of course, when a minimum limit for the banks' holdings of Treasury Bills was introduced, the system enabled the Control Commission to check from day to day that the limit (the so-called « plancher ») was being maintained.

The functions of the Caisse des Dépôts et Virements were extended in 1947 to include acceptances of the Crédit National.

Since this last decision no further change has been made in the structure of the money market. Let us now consider it in further detail.

### 3. Structure of the Money Market.

The structure of the money market is formed by the following four elements:

#### (a) The Bank Brokers.

These act as intermediaries between the various banks, and also between banks and rediscount companies. There is no obligation to use their services, and much of the business on the money market is done without their taking part. They are 60 in number, and are grouped in two syndicates.

They take a brokerage of 0.16% per annum on the transaction, and also deal in foreign exchange.

#### (b) The Rediscount Companies.

As I have already indicated, the rediscount companies specialise in money market busi-

ness, that is in subscriptions to new issues and in buying, selling and lending against public and private securities and bills. The banking laws of 13th and 14th June, 1941 divided credit transactions into two classes. Lendings out of deposits are the preserve of the banks, while loans out of moneys borrowed for periods of more than two years may be granted by financial institutions which, before the enactment of these banking laws, were called banks too. The Comité Permanent d'Organisation Professionnelle refused to allow the rediscount companies to describe themselves as banks. They were accordingly classified as financial institutions, and therefore could not take deposits. In 1945 however it was made possible for them to register themselves as banks. Some of them were in fact permitted to do so; but the amount of their deposits was fixed at a very low figure so as to prevent them from competing with the ordinary banks. Others were refused registration. Others again preferred to continue calling themselves financial institutions, doubtless in order to avoid being supervised by the Control Commission and having to publish in the official bulletin periodical statements of their position as required by law.

The present position thus is that the following are classed as banks: the Compagnie Parisienne de Réescorpte; the Banque d'Escompte; and the Union d'Escompte.

The following are classed as financial institutions: the Caisse Centrale de Réescorpte; the Société Parisienne de Réescorpte; and the Caisse de Gestion Immobilière, formerly the Banque de Gérance Immobilière.

Only the balance sheets and returns of the banks are published, while those of financial institutions are not. I can therefore give figures only for half the rediscount houses. The capital, reserves and balance sheet totals of these were as follows on 31st December, 1954:

(Millions of francs)

	Capital	Reserves	Balance Sheet Total
Caisse Parisienne de Réescorpte . . . . .	281	18	77,160
Banque d'Escompte . . . . .	50	5	11,514
Union d'Escompte . . . . .	125	6	7,894

It will at once be seen that there is a certain maladjustment between the capital resources of these firms and their balance sheet totals. This however is not dangerous in view of the business which they do.

The combined balance sheet for these three rediscount houses is given in the compilation « Bilans des Banques », published by the Control Commission, as follows:

(In millions of francs as at 31st December, 1954)

ASSETS	
Cash, Public Treasury, Banks of Issue . . . . .	27
Banks and correspondents . . . . .	68
Bill holding . . . . .	6,852
Current accounts . . . . .	18
Secured advances . . . . .	808
Advances and sundry debtors . . . . .	2,245
Securities . . . . .	270
Sundry accounts . . . . .	1,125
Premises . . . . .	38
« Ventes à encaisser » . . . . .	52,356
« Papier en dehors » . . . . .	32,758
	96,570
LIABILITIES	
Cheque accounts . . . . .	18
Current accounts . . . . .	256
Banks and correspondents . . . . .	4,928
Items in course of collection . . . . .	5
Sundry creditors . . . . .	1,760
Time liabilities . . . . .	11
Sundry accounts . . . . .	3,816
Reserves . . . . .	29
Capital . . . . .	456
Profits during the year . . . . .	167
Profits brought forward . . . . .	2
« Achats à régler » . . . . .	85,115
	96,570
ITEMS OUTSIDE BALANCE SHEET	
Guarantees . . . . .	153
Bills discounted and in circulation . . . . .	5,915

From this combined balance sheet it will be seen that on the 31st December 1954 the three rediscount houses had granted 52 billion francs (8) of « pensions » in their capacity of intermediaries; that they held 32 billion public or private securities or bills, which they

(8) 1 billion = 1,000,000,000.

were carrying on the market; and that they had discounted at the Bank of France or elsewhere about 6 billion francs of bank acceptances or commercial bills — the Treasury Bills discounted not being included in this total because they were circulating without the rediscount houses' endorsement. By doubling these figures one ought to arrive at the approximate position of all the rediscount houses together, thus:

« Pensions » granted by them  
as intermediaries . . . . . 104 billion  
Carried on the money market 64 »  
Bills rediscounted . . . . . 12 »

Since at the same date the banks were holding 2,000 billion of public and private securities and bills, part of which would not be mobilisable, one may say that the rediscount houses do a fair business on the money market.

The principle on which the rediscount houses work is to carry for a certain period, by borrowing short-term money on the market, public securities which have a certain period to run. The result is that the rediscount houses have a large holding of public securities against which they borrow (through « pensions ») either from day to day or at longer periods. The first source of their profit is the difference between the interest which they receive and that which they pay. The second source is arbitrage deals on their holdings; and the third is the difference of interest rates when they are acting simply as *del credere* agents, for instance by borrowing money and promptly relending it. If the market becomes tight the rediscount houses can sell to the Bank of France their public securities at less than 90 days, and within their limit for 30-day advances they can borrow there against their public securities having less than two years to run. The Bank of France in fact acts for them as a safety-valve.

The same operations can of course be done by all banks, and in fact all banks do them more or less. The rediscount houses differ in being able to work only on the money market; and the Bank of France favours them by letting them run a substantial amount of

30-day advances, and by passing through them its open market operations. It follows that for money market business the rediscount houses are in a better position than the ordinary banks.

The rediscount houses have four functions. First they act as intermediaries between the lending and borrowing banks. Some of the banks do not want to let the others know whether they are borrowers or lenders in the market. By using a rediscount house as a go-between they can remain anonymous. Thus the rediscount houses are reservoirs of money, always well supplied, into which the banks can put money or from which they can draw it off.

Next the rediscount houses run a large holding of public securities which they provide as collateral for lenders of money. In addition they even out the money market by constant arbitrage between maturity dates. And finally they act as a go-between for the Bank of France in its money market operations.

To quote the words of the report of one of the rediscount houses, «The growth of discount business and Treasury Bill arbitrage is helping to establish a body of rates, making it easier to sell and to place public securities».

«We believe», says another of them, «that we may regard ourselves as one of the rediscount companies most constantly found in the market providing the counterpart to supply and demand in all circumstances».

The business of the rediscount houses depends in a certain degree on factors outside them: for instance on the large banks which provide them with money, and on the Bank of France which fixes the maximum limit for their 30-day advances and for their open market «pensions».

#### (c) *Advances at 30 days* (9).

I have already pointed out that these advances are essential to the market. The

(9) Before the form of the Bank of France return was changed on 5th January, 1950 this item was called «Advances at not more than 30 days on public securities running for not over two years». This clearly indicated the nature of the transactions which the item covered. For the sake of brevity the title was changed to «Advances at 30 days».

minimum period for them is actually five days, because the Bank of France must not intervene directly in the market for day-to-day money, and it penalises banks which ask it for loans for a single day so that they shall ask for such advances only in the last resort. The maximum limit of thirty days was imposed on the banks to prevent them from using such advances for carrying their Treasury Bills. It may however be pointed out that there is nothing to prevent a bank, when its advance expires, from bringing further bills as security for a fresh advance. The public securities admitted as collateral are Treasury Bills, and since 1940 acceptances of the Crédit National (10), although such acceptances are going out of use. As will be shown in Section 5, the amount of the 30-day advances is relatively small. Apart from rare occasions it always has been. Transactions of this kind in fact play their part as a safety-valve, and normally the banks avoid resorting to them even though the rate charged is in general lower than that charged between banks. It is specially fixed by the Bank of France, being usually the same as bank rate. Sometimes it has been fixed  $\frac{1}{2}\%$  lower in order to avoid raising the rate for Treasury Bills, since the rate for 30-day advances has to be below the Treasury Bill rate to ensure proper working of the money market.

#### (d) *Open Market Operations.*

I have already said that open market operations were started in France in 1938. In point of fact the Bank of France did not wait for the Decree Law of June, 1938 before acting to regulate the money market. It was however able to act only by using certain funds, so that its interventions were limited in extent and rather precarious. Nor did they appear in the weekly return. The Decree Law of June, 1938 provided a proper basis for these operations, and for their entry in

(10) The Law of 22nd December, 1940 laid down that public expenditure was to be met partly in acceptances of the Crédit National at one year in a proportion which was several times varied. The Decree of 30th January, 1955 abolished this provision; and consequently the Crédit National's acceptances, which are similar to public securities, are in course of disappearing.

the weekly bank return under the heading «Negotiable bills purchased in France».

In discount and advance business the Central Bank acts passively as an anvil, while the banks are the hammer. In the open market on the other hand the Central Bank becomes active, taking the hammer from the banks. In France however the principles of open market policy were wrongly applied from the outset. The Bank of France allowed the banks a quota of three-month «pensions» to be taken against Treasury Bills in the open market, which amounted to handing the hammer back to them. The banks used this facility to carry part of their Treasury Bill holding at the Central Bank on favourable terms. This practice lasted until 1944. Afterwards however the true open market policy was falsified in other ways. For various reasons the Bank of France decided that it would no longer discount Treasury Bills and Crédit National acceptances at three months, but that these should go to its Money Market Department. The Bank of France also gave the banks a certain right to obtain short-term «pensions» from that Department against bank acceptances as well as against acceptances or unconditional guarantees of the Caisse des Marchés. In 1951 it again recognised this right, making it subject to an upper limit and at the same time declaring its readiness to take from the Money Market Department outside the «ceiling» any acceptances for mobilising foreign trade transactions due to be liquidated within six months. The bank item «Negotiable bills purchased in France» therefore covers highly varied and dissimilar transactions (11), including the open market operations, the amount of which thus remains unknown to the public. The Governor of the Bank of France indirectly deprecated these practices, although in a somewhat ambiguous manner, when he wrote in his last Report: «The need to cover its deficit has also caused the Treasury

(11) These also include certain disguised borrowings by the Government from the Bank of France. The Government's last quarterly repayment of 20 billion francs to the Bank on 16th September, 1955 was made out of subscriptions by the nationalised banks to Treasury Bills, which were afterwards taken by the Bank of France in open market. This transaction was similar to the one in 1924 which caused the most violent reproaches to be heaped on the then Governor of the Bank of France, Mr. Georges Robineau.

to issue bonds on tap, giving net yields higher than what it costs the banks to mobilise them. Such issues encourage the banks to borrow at the Bank of France, or at least to remain indebted there, more than they need for maintaining strictly their minimum holdings of public securities. This fact, coupled with the Bank's legal obligation to buy Treasury Bills offered to it at no more than three months, limits our possibilities of manoeuvre».

However that may be, open market operations have done a good deal to even out the extremes of supply and demand in the money market, thus giving a certain stability to the market for short-term funds. The rates for money in that market are governed by the marginal principle. If for instance at any given moment some hundreds of millions can change hands at 3%, but a demand for some tens of millions is not met and the would-be borrower has to offer  $3\frac{1}{2}\%$ , then the latter rate will prevail. That is what was constantly happening before the 1939 war on the money market, when open market operations had not yet been introduced into France.

It should be mentioned that the operations of the Bank of France are not very large in amount. Knowledge that the Central Bank may intervene, or that it is beginning to do so to a small extent, is enough to bring the market to heel and to restore its balance.

#### 4. *Securities dealt with on the Money Market.*

Before 1914 the «marché hors banque» worked with private bills, that is with acceptances of banks or of first-class industrial or commercial firms. From 1940 to 1952 on the other hand the money market worked almost entirely with public securities. The following are the principal securities in which dealings take place on the money market:

(1) Treasury Bills (12). These are two-year bills carrying interest at  $3\frac{3}{4}\%$ , issued free of commission for the «current account»

(12) In December, 1954, Treasury Bills and Crédit National acceptances together reached a total of 2,062 billion francs, or 36.6% of the entire public debt, against 11.4% in December,

bills and subject to a commission of 0.40% for the bills « on vignettes » taken by private subscribers. The price of subscription is reckoned on 715 days and the real rate, after allowance for the Bank of France rediscounting the bills when they have three months left to run, works out at 3.80%. Recently the Treasury, when it needed fresh funds for a few days, issued six-month bills bearing 3.20% interest, and there is talk of a further similar issue at the close of the year.

(2) Bills issued by the State Railways Company, the S.N.C.F. They run for 45 days, 6 months, 9 months and one year.

(3) Commercial bills, including bank acceptances. Loans against them (« pensions ») are made on schedules; that is to say the bills are not physically delivered to the lender, but are held for his account by the borrower.

(4) Bills originating from sales for which credits are arranged. Here again the deal takes place without physical delivery.

The « pensions » are made from day to day with notice in advance for fixed periods of 15 days, one month, and three months. The sales on credit terms are for a period of six months, or are arranged in a more complicated manner (13).

Only the Treasury Bills are actually sold, the other securities and bills being dealt in merely with « pension » operations. Transactions in renewable bills of the Caisse des Marchés de l'Etat, as well as acceptances or unconditional or conditional guarantees, are rare.

1938. Out of the total the banks held 532 billion, the Bank of France 220 billion, various public institutions including the Caisse des Dépôts et Consignations 462 billion and the public 848 billion, this latter amount constituting the real floating debt. On 31st July, 1955 Treasury Bills amounted to 2,140 billion, or 37% of the Government's entire debt.

(13) Recently some minor changes have been made in transactions of this type. The financing institution sells its bills originating from instalment sales to a bank, to which however it delivers in representation of these bills a 90 day bill which is payable to order and is renewable. The bank then refinances the bill through the « pension » system or sells it on the money market at a rate varying from 3½ to 4%. The banks handle only bills that can be rediscounted at the Bank of France when they are not renewable, i.e. when the customer must pay within 90 days. These bills must be drawn exclusively for the following articles: automobiles, industrial and agricultural equipment, household goods, motor-cycles and scooters, bicycles and motorized bicycles, furniture, pianos, and heating equipment.

Many of the sales of Treasury Bills are arbitrage transactions. The amount of day-to-day « pensions » against Treasury Bills is greater than against other securities, while the opposite is the case as regards « pensions » for different periods. Most of the business is done through brokers.

The Bank of France acts through the rediscount houses, lending as a rule against Treasury Bills. The Caisse des Dépôts et Consignations is also almost always in the market, where it grants « pensions » for periods of 15 days. The rate for its « pensions » is of course above that charged by the Bank of France, being at present 3 5/8%.

### 5. Course of the Money Market since Liberation.

During the occupation, as bank lendings had almost ceased, the banks' money found its way into short-term Treasury securities. There was accordingly a great deal of business in the money market, based entirely on Treasury Bills and acceptances of the Crédit National. Money was plentiful, and rates for it were tending downwards; and this enabled the banks to earn substantial profits by taking large holdings of Treasury securities which they carried on the money market.

The position of the money market changed when the large banks, which had been providing it with day-to-day loans, were nationalised. Not only did they then cease putting money into the market, for reasons which are outside the scope of this article, but in addition they began to take the available funds off the market at rates higher than those offered by other borrowers. This reduction in the flow of money into the money market coincided with an increase in the demand for bank loans on the part of industry, which after the liberation needed to repair and to modernise its plants. Besides this the uncertainty about the currency prevented normal formation of bank deposits. Thus banks found their resources declining while the need for them was rising. This shortage of funds of course hampered the working of the money market, which might well have dried up if the Bank of France and the

Caisse des Dépôts et Consignations had not provided it with the necessary resources in various ways.

In October, 1951, after the Bank of France had decided to grant the banks 8-day « pensions » at the penal rate of bank rate plus 1½%, this led to the formation of a regular market in day-to-day loans against commercial bills of the kind which had not been customary in Paris since 1939. In the course of 1952 a market was also established in « pensions » for long periods against bills originating from sales for which medium term credits are stipulated.

The table below (14) shows the movement in two items in the Bank of France return which reflect the help given to the money market, namely « Advances at 30 days » and « Bills purchased in France ». They are shown in relation to two other items in the return, namely « Notes in circulation » and « Bill holding ».

	On 5th January, 1950	On 6th October 1955	Percentage change
(Millions of francs)			
Advances at 30 days	16,272	12,320	- 24.28 %
Bills purchased in France . . . . .	140,647	233,739	+ 65.83 %
Notes in circulation	1,295,210	2,732,629	+ 110.97 %
Bill holding . . .	351,660	1,129,368	+ 221.15 %

To a certain extent the items « Advances at 30 days » and « Bills purchased in France » represent not active intervention by the Central Bank on the money market but recourse by banks to the Central Bank with the effect of supporting that market. Actual open market operations at the moment represent only about one-tenth of the item « Bills purchased

(14) I should have liked to give a basis of comparison further back than 5th January, 1950. Unfortunately that is impossible, because the return for that date is the oldest in which the item « Negotiable bills purchased in France » can be compared with that in the current returns. Before 5th January, 1950 the public securities at less than 90 days discounted by the Central Bank appeared in the item « Portfolio », whereas after that date they are shown in the item « Negotiable bills purchased in France ».

in France ». That having been said, it may be remarked that one of the items representing transactions of the Bank of France relating to the money market, namely the « Advances at 30 days », dropped by 24%; and the second such item, namely the « Bills purchased in France », rose by 65% while the « Bill holding » went up by 221% and the « Notes in circulation » by 110%. These figures by themselves show that the working of the money market affects the position of the Central Bank only to a very moderate degree.

### 6. The Problem of Rates.

In principle the money market must operate at a rate lower than that of the Bank of France because what it does is to arrange day-to-day loans and, theoretically, to find employment for cash surpluses which but for the money market would remain unused. But if the money market is to operate in this manner it must not be currently used by the banks as a means of procuring the funds which they need for their business. The whole question of rates in the market is dominated by this change, since the liberation, in the function to which it is directed. Basically the money market is suffering from the shortage of bank deposits, with which I dealt in the previous article in this Review (15). It is also suffering from the inroads on that market by the Treasury, which is constantly issuing increasing amounts of Treasury Bills to cover the Government's persistent budget deficit.

During the occupation the money market rate was below bank rate. In 1943, when the market rate remained for some time close to that of the Bank of France, this was described as abnormal by certain observers.

In August, 1945 the rate in the money market rose above that of the Bank of France, which was 1 5/8%. The Bank then intervened by offering day-to-day money in the market at 1 3/8%. It tried to control the use made of its loans, because it did not want them

(15) *Competition among Banks in France and the Fixing of their Rates*, June 1955, No. 33, p. 86 ff.

to be used for supporting speculation of differences in interest rates. Accordingly the Bank withdrew from the market from time to time. It was not however able to intervene in this way for very long, and the money market rate soon began to exceed that of the Bank. The immense amounts of capital required for industry began to be taken from the funds which were temporarily placed at the disposal of the money market. In addition to these demands there were still greater demands from the Treasury. The Caisse des Marchés, which received acceptances of the Crédit National, offered these acceptances on the market in large amounts and thereby helped to depress it.

There is no doubt that the stability of the currency and prices would have improved market conditions from 1952 onwards but for the fact that all the banks started a great speculation on Treasury Bills. Thinking that the rates for these would fall, they bought large amounts of them and carried them on the money market. This speculation died down at the beginning of 1955, when the Bank of France lowered its rate to 3%, while that for Treasury Bills was also reduced. Since the Crédit National ceased at the same time to give acceptances, the position in regard to money market rates became definitely better. During the second half of 1955 they remained in general below or equal to bank rate.

The problem of the money market rate was raised in the 1955 Report of the Bank of France, where the following appeared:

« Although a large part of the fresh liquid funds needed had its counterpart in the increase of the exchange reserves, the Bank of France had to give further direct or indirect help to the money market. This year again the size of the demand for money emanating from business, from the Treasury and from the public enterprises has delayed the formation of a "marché hors banque", in which money would change hands at rates below bank rate when the banks were for the moment in funds ».

Thus the Governor of the Bank of France takes the view that the demand for money on the part of business, the Treasury and

public enterprises was the determining cause of the high rate prevailing in the money market. No doubt those factors were of prime importance; but, as I have several times stated, the position was not due to them alone. A similar situation had arisen more than once between the two wars, for instance in the period from 1920 to 1926; and yet the rate in the « marché hors banque » had always been below the official rate. But at that time the market was supplied with funds by the large banks, whereas now those banks obtain money there to square their cash position. No doubt this change in their relation to the market is largely due to the inadequacy of their deposits in relation to their greater needs as compared with those between the wars. The position in that respect has appeared to improve this year, and the money market rate has ranged around bank rate. If this improvement continues the money market rate, apart from temporary fluctuations, will drop permanently below the official rate.

Some people think that in order to establish a normal rate in the money market the Bank of France will have to stop rediscounting current-account Treasury Bills, that is to say those taken by banks, when within 90 days of maturity. This would produce two results. First it would make the Treasury Bills less attractive to the banks, and consequently it would prevent them from running them on the money market to an extent which burdens the latter; and secondly it would enable the Bank of France to intervene more in the market, because it would relieve the Bank of the large amount of Treasury Bills contained in the item « Bills purchased in France ». This proposal however can only be described as impracticable, because obviously the Treasury will oppose any step which would result in reducing subscriptions to its bills.

### 7. Conclusion.

Like all things human, the working of the money market has often given rise to criticism.

One reproach is that the main object of

the money market is to find a home for the floating debt. That is partly true; but the same reproach might be addressed to the principal money markets in foreign countries also. In point of fact a large part of the improvements which were made in the money market between the two wars were designed to establish and promote a broad market in Treasury Bills. There is more truth in the reproach that the money market helps banks to speculate on movements in the Treasury Bill rate, and that this tends to raise rates in the market. Some critics have claimed that the market worked badly because of the « planchers » and « plafonds » (16) imposed on the banks, and that these constraints would have to be removed in order to restore the market's freedom. These views are utopian. The « planchers » and « plafonds » are the weapons used for controlling credit; and it is not clear at the moment how the monetary authorities could do without them, or what they would put in their place. Finally there has been criticism of the Bank of Fran-

(16) « Planchers », i. e. minimum holdings of Treasury securities; « plafonds », i. e. « ceilings » established for recourse to the Bank of Issue.

ce's actions on the market, which have been described as timid and ineffective; but open market operations were not introduced in order to enable the banks to take up imprudent positions, even on Treasury Bills, or to help them to undo those positions with advantage to themselves. It is good for the health of the market that speculations of this kind may result in losses. It might indeed be preferable for the Bank of France to be relieved of the obligation to provide funds in the open market as it at present does. That would enable the Bank to act with more power and more effect. But, as I have already said, this could be done only at the cost of prejudicing Treasury Bills, and therefore it is inconceivable that such changes can be made for a long time to come.

The money market is not a market in a vacuum, depending solely on factors peculiar to itself, which can be altered without affecting other branches of the country's economy. It must be subordinate to the national policy in financial and monetary matters; indeed the slightest manifestations of that policy may affect it.

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