From: Thursday, March 27, 2008 3:53 AM
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Subject: Money markets - what is happening to O/N USD rates?

On the 18th March the Fed reduced the funds rate by 75bp from 3.00% to 2.25%, but O/N money at least in the Far East and Europe trading sessions is trading much higher than the new target. Yesterday the O/N Libor fixed at 2.9475 and Fed Funds opened at 2.75%.

The pressure started to build a few days before the last rate cut, on Monday 17th March the O/N Libor fixed at 3.8625 from 3.05375 the previous Friday. That was the weekend when Bear Stearns hit the headlines and the Fed cut the discount rate on Sunday by 25bp narrowing the spread to the funds rate to 25bp.

Yesterday was typical of recent trading patterns for O/N. At the start of the day in Tokyo it was trading in a range of 2.80/70, by the time London opened we were up to 2.95/90 and it stayed there through the 75am Libor fixing. Fed Funds opened in NY at 2.75, O/N drifted lower during the afternoon to 2.75/65 and at the London close we were trading at 2.60. It continued to drift lower in NY and closed at 1.00%. This morning we are starting 3.10/3.00.

We have seen this behaviour before and typically it occurs when money market liquidity conditions are most stressed. Confidence in counterparty risk is low and those that have liquidity want to hold on to it. This type of hoarding behaviour leads to a strong bid for liquidity at the start of a day and then a flood of money into the market at the close.

That demand for $ liquidity at the start of the session also spills over into other currencies via the FX swap market, O/N EUR cash is 4.20/15 despite an extra 50 billion cash injection from the ECBs weekly MRO earlier this week.

Liquidity conditions in term maturities remains very poor, there is very little cash to support where Libors are being set and the few lenders in the market are increasingly more name sensitive.