The Money Market In May

The money market became somewhat firmer during May. Federal funds traded almost entirely at 3 per cent, and in the last half of the month the demand for Federal funds at that rate often exceeded their availability. Average member bank borrowings from the Reserve Banks—at $190 million—were accordingly somewhat higher than in other recent months. Rates posted by the major New York City banks on call loans to Government securities dealers were quoted predominantly within a 3¼ to 3½ per cent range. Treasury bill rates moved up moderately after midmonth in the firmer money market atmosphere.

On May 15, approximately $9.0 billion of the $9.5 billion of Treasury notes and certificates eligible for conversion in the May refunding were exchanged for the two issues included in the offering. Subscriptions for the new 3¼ per cent certificates of May 1964 and for the reopened 3⅝ per cent notes of February 1966 totaled $5.7 billion and $3.3 billion, respectively. Only $0.5 billion of the three maturing issues was redeemed for cash, with redemptions by the public amounting to about 8½ per cent of its maturing holdings.

Prices of outstanding Treasury notes and bonds moved irregularly higher in the first half of May, as the market reacted favorably to the short-term offerings in the Treasury's May refunding. Demand was also buoyed by the market's feeling that there would be no further Treasury financing operations in the immediate future, by the lowering of the Canadian bank rate on May 7, and by a feeling that interest rates would change little over the near term, whatever might be their movement over the longer term.

Prices receded in the latter half of the month, however, when news of further business improvement and the continuing large balance-of-payments deficit, combined with market discussion of a possible shift in monetary policy, once again turned the attention of market observers to the possibility of a rise in interest rates. Prices of corporate bonds moved fractionally higher during May in the face of a relatively light calendar of new offerings, but prices tended lower toward the close of the period. In the tax-exempt sector, where the volume of new issues continued heavy, prices held generally steady in the first half of the month but weakened in the latter part of May. Both markets were restrained, however, by the sluggish distribution of two large, fully priced new issues reoffered during the period.

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MAY 1963

In millions of dollars; (+) denotes increase, (−) decrease in excess reserves

Factor	Daily averages—week ended May 1	May 8	May 15	May 22	May 29	Net changes
Operating transactions						
Treasury operations*	+ 33	− 3	− 69	+ 114	+ 266	+ 341
Federal Reserve float	− 397	+ 23	− 74	+ 423	− 453	− 478
Currency in circulation	+ 104	− 174	− 178	+ 37	− 15	− 226
Gold and foreign account	+ 24	− 18	− 20	− 34	+ 13	− 35
Other deposits, etc.	− 14	+ 12	+ 8	− 166	+ 10	− 150
Total	− 249	− 161	− 332	+ 379	− 179	− 542
Direct Federal Reserve credit transactions						
Government securities:						
Direct market purchases or sales	+ 57	+ 407	+ 98	− 237	− 4	+ 321
Held under repurchase agreements	+ 162	+ 75	− 118	− 122	—	—
Loans, discounts, and advances:						
Member bank borrowings	− 63	+ 16	+ 89	+ 82	− 15	+ 109
Other	− 1	+ 1	− 1	− 7	− 23	− 31
Bankers' acceptances:						
Bought outright	− 1	− 2	+ 1	+ 1	− 1	− 2
Under repurchase agreements	—	—	—	—	—	—
Total	+ 154	+ 558	+ 70	− 342	− 43	+ 397
Member bank reserves						
With Federal Reserve Banks	− 95	+ 397	− 262	+ 37	− 222	− 145
Cash allowed as reserves†	+ 22	− 335	+ 205	− 14	+ 110	− 12
Total reserves†	− 73	+ 62	− 57	+ 23	− 112	− 157
Effect of change in required reserves†	− 33	− 107	+ 154	− 29	+ 90	+ 75
Excess reserves†	− 106	− 45	+ 97	− 6	− 22	− 82
Daily average level of member bank:						
Borrowings from Reserve Banks	94	110	199	281	266	190‡
Excess reserves†	407	362	459	453	431	422‡
Free reserves†	313	252	260	172	165	232‡

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for five weeks ended May 29.

BANK RESERVES

Market factors absorbed reserves on balance from the last statement period in April through the final statement week in May. Reserve absorption, primarily resulting from a contraction in float, from a routine Treasury interest payment to the Federal Reserve Banks on May 15, and from an expansion in currency in circulation, more than offset the release of reserves stemming from reductions in required reserves and in Treasury deposits with the Federal Reserve Banks. System open market operations only partially compensated for the net reserves absorbed by market factors. System outright holdings of Government securities increased on average by $321 million from the last statement period in April through the last statement week in May, while holdings under repurchase agreements were unchanged over the month as a whole, leaving the balance in that account at zero. Net System holdings of bankers' acceptances declined by $2 million. From Wednesday, April 24, through Wednesday, May 29, System holdings of Government securities maturing in less than one year rose by $3,462 million, while holdings maturing in more than one year fell by $2,910 million.

THE GOVERNMENT SECURITIES MARKET

Prices of Treasury notes and bonds continued to rise gently in early May from their mid-April lows on fairly broad investment demand. Market confidence was bolstered by the favorable response accorded the Treasury's May refinancing operation, in which the two issues offered in exchange were of relatively short maturity, and by market expectations that debt-limit considerations would prevent further Treasury financing in the near future. The May 7 reduction from 4 per cent to 3½ per cent in the Canadian bank rate reinforced this improvement in atmosphere, as did the more optimistic sentiment in the corporate bond market. Against this background, prices of intermediate and longer term Treasury obligations moved generally higher through midmonth, with only a brief interruption from May 8 through May 10, when reports were received of the poor reception accorded a large utility issue and of a renewed outflow of gold. Prior to the midmonth settlement date for the Treasury's refinancing operation, a fairly broad volume of switching activity developed featuring demand for the reopened 3⅝ per cent notes of 1966 and also for the 4⅛ per cent bonds of 1989-94 sold by the Treasury in April. By mid-May the price of the 4⅛'s had risen almost to the 100¾ level at which the underwriting syndicate had originally reoffered the bonds.

A weaker tone was evident in the last half of the month, as market participants pondered the implications for interest rates of reports indicating further advances in business indicators and a continuation of a large balance-of-payments deficit during the first quarter. Market discussion of the future course of monetary policy also contributed to a more hesitant tone. There was some selling by investors and others late in the month—particularly after the publication of reserve statistics for the week ended May 22, which indicated reduced levels of reserve availability in a period marked by persistent firmness in the money market. The decline in bond prices was moderated by Treasury buying for trust fund accounts. Over the month as a whole, prices of outstanding intermediate and longer term issues ranged from $^{13}/_{32}$ lower to $^{10}/_{32}$ higher.

In the market for Treasury bills, activity was relatively light during May. Bill rates held in a fairly narrow range until late in the month when they rose to close generally 7 to 10 basis points above the rates prevailing at the end of April on comparable maturities. Early in the month, demand centered on short May and June maturities while there was some selling of late July and early August issues. Over the midmonth period, a substantial volume of longer term bills was purchased by corporations and public funds while some offerings of near-term issues appeared from commercial banks. Rates moved up moderately after the middle of the month partly because the somewhat firmer money market conditions in the last half of the month led to higher dealer financing costs. A fairly good interest was evident at the regular weekly auctions held during the month. In the first two auctions in May, the Treasury sold $100 million more of bills than were maturing, as it had through the preceding month. At the final auction of the month, held on May 27, average issuing rates were 2.974 per cent for the new three-month issue and 3.055 per cent for the new six-month issue—8 and 7 basis points, respectively, higher than the rates established in the last auction in April, and the highest auction rates since mid-1962. The three-month bill closed the month at 3.00 per cent bid, the highest closing quotation since 1960.

OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt bonds moved narrowly in May and the views of investors and underwriters frequently diverged as to the appropriate levels of rates for new issues. In the corporate sector, prices strengthened slightly through most of the month under the influence of moderate investment demand and a light calendar of prospective offerings. Tax-exempt bond prices, on the other hand, continued to be restrained by a heavy volume of new financing, which pushed the Blue List of advertised dealer offerings to successive new highs. Both markets were also adversely affected by investor resistance to the downward movement in yields on new issues as typified by the month's two largest new issues which were rather fully priced. Investors were slow to acquire these new bonds and turned instead to other recent, lower rated flotations that offered higher returns. Prices moved lower in both the corporate and tax-exempt bond markets toward the close of the month, as concern over the outlook for interest rates spread from the Government securities market. Over the month as a whole, prices of corporate bonds were little changed while prices of tax-exempt bonds were down slightly. The average yield on Moody's seasoned Aaa-rated corporate bonds was unchanged at 4.23 per cent at the close of May, while the average yield on similarly rated tax-exempt bonds was also unchanged, at 3.00 per cent.

The total volume of new corporate bonds reaching the market in May amounted to approximately $535 million, compared with $345 million in the preceding month and $240 million in May 1962. The largest new corporate issue publicly marketed during the month consisted of $250 million of 4⅜ per cent (Aaa-rated) telephone company debentures maturing in 1999, reoffered on May 7. Underwriters bid aggressively for the debentures—which are not redeemable for five years—but investors gave the issue a poor reception. It was reported that more than half of the issue remained unsold at the end of the month. New tax-exempt flotations during the month totaled approximately $830 million, as against $810 million in April 1963 and $865 million in May 1962. The Blue List of tax-exempt securities rose by $65 million during the month to $696 million on May 31, after reaching an all-time peak of $770 million on May 16. The largest new tax-exempt offering during the period was a $122 million state public power system revenue bond issue. The offering consisted of $59.6 million of serial bonds, reoffered to yield from 2.25 per cent in 1967 to 3.25 per cent in 1986, and $62.4 million of 3¼ per cent term bonds maturing in 1996 and reoffered to yield 3.35 per cent. Like the $250 million corporate flotation, this issue was enthusiastically bid for at the underwriting level but moved very slowly when reoffered to investors.