The Money Market in July

Financial markets were heavily influenced in July by expectations of, and reactions to, official moves designed to deal with the persistent deficit in the United States balance of payments. Discussion of the likelihood of an imminent increase in the discount rate—touched off by market advisory letters and newspaper stories—grew in intensity during the first half of the period. Expectations of such a move were reinforced prior to midmonth by news of further gold losses and by official testimony before a Congressional committee that an upward adjustment in short-term rates could play a significant role in combating the payments problem by discouraging outflows of short-term funds. Against this background, the July 16 announcement that the Board of Governors of the Federal Reserve System had approved an increase of ½ per cent to 3½ per cent in the discount rate of the Federal Reserve

Bank of New York and of six other Federal Reserve Banks was greeted with little surprise. The rate change, which was the first since the rate was reduced to 3 per cent in August 1960, became effective at these seven banks on July 17, at three others on July 19, and at the remaining two Federal Reserve Banks on July 24 and July 26.

The Board of Governors also announced on July 16 that it had increased to 4 per cent the maximum interest rates that member banks are permitted to pay under Regulation Q on time certificates and other time deposits with maturities of ninety days to one year. Since January 1962, the rate ceilings had been 3½ per cent on maturities of six months to one year, and 2½ per cent on those of ninety days' to six months' duration. Maximum rates remain unchanged at 1 per cent on time certificates and deposits maturing in less than ninety days and at 4 per cent on maturities of one year or more. No changes were made in the maximum rates that member banks are permitted to pay on savings deposits. In announcing the changes in the discount rate and in maximum rates on time certificates and deposits, the Board stated that:

> Both actions are aimed at minimizing short-term capital outflows prompted by higher interest rates prevalent in other countries. Preliminary information indicates that short-term outflows contributed materially to the substantial deficit incurred once again in the balance of payments during the second quarter of this year.
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> Recently, market rates on United States Treasury bills and other short-term securities have risen to levels well above the 3 per cent discount rate that had prevailed for nearly three years, making it less costly for member banks to obtain reserve funds by borrowing from the Federal Reserve Banks rather than by selling short-term securities.
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> The increased discount rates will reverse that circumstance, making it once again more advantageous for member banks seeking reserve funds to obtain them by selling their short-term securities rather than by borrowing from the Federal Reserve Banks. Sales so made should have a bolstering effect on short-term rates, keeping them more in line with rates in other world financial markets.
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> Meanwhile, the increase in the maximum rates of interest payable on time deposits and certificates with maturities from ninety days to one year will permit member banks to continue to compete effectively to attract or retain foreign and domestic funds for lending or investing.
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> These actions to help in relieving the potential drain on United States monetary reserves associated with the long-persistent deficit in the balance of payments do not constitute a change in the System's policy of maintaining monetary conditions conducive to fuller utilization of manpower and other resources in this country.

On July 18, President Kennedy announced new Administration plans for reducing the balance-of-payments deficit. In order to help stem the outflow of long-term capital, the President urged enactment of an "interest equalization tax" on purchases by Americans of new or outstanding foreign securities (other than those of less developed countries) from foreign issuers or owners. The proposed tax would not apply, however, to acquisitions of securities maturing in less than three years, nor would it apply to direct investments abroad or to loans by commercial banks. (Subsequently, an understanding was reached with the Canadian Government under which the Treasury would include in the draft legislation a provision permitting the President to exempt new Canadian issues as needed to maintain an unimpeded flow of trade and payments between the two countries, while the Canadian authorities stated that it was not their intention to increase Canada's official international reserves through the proceeds of borrowings in the United States.) The President also announced plans for further substantial reductions in Federal expenditures abroad, and said that the United States had been granted a $500 million stand-by arrangement by the International Monetary Fund to facilitate dollar repayments to the Fund by other countries during the coming year.

These various developments related to the balance-of-payments problem exerted a significant influence in the financial markets. Treasury bill rates rose steeply early in the month in response to expectations of a discount rate advance. Around midmonth, rates receded somewhat, however, as demand expanded at the higher yield levels. When the long-expected discount rate change went into effect on July 17, rates adjusted moderately higher in early trading but subsequently receded in the face of growing market scarcities in a temporarily easier money market. In the closing days of the month, the money market firmed again and bill rates edged higher, closing around the highs of the month. In the market for Treasury coupon-bearing issues, prices moved moderately lower during the first half of the month in a cautious atmosphere generated by anticipations of a discount rate move. After the discount rate increase and the President's message, however, bond prices rose in generally quiet trading, as the market became increasingly convinced that the main impact of

official actions would be on short-term rates. In the market for corporate and tax-exempt bonds, prices drifted lower in the first half of July, reflecting chiefly the same factors affecting the Government bond market. However, in the latter part of the month, prices of these securities rose as investors stepped up their buying, evidently with confidence in the near-term outlook for long-term interest rates; the revision of Regulation Q was an important additional factor contributing to strength in the tax-exempt market.

The Treasury announced on July 16 that it was considering the use of monthly auctions of one-year Treasury bills, in the interest of a more orderly scheduling of its short-term debt maturities. Under such a program, the outstanding quarterly series of one-year bills—which currently are dated to mature on January 15, April 15, July 15, and October 15—would gradually be retired as they were replaced by monthly issues. These issues would, according to the Treasury, probably amount to $1 billion each, although they might be varied in size to meet both market conditions and Treasury cash needs.

On July 24, the Treasury announced that holders of $6.6 billion of securities maturing on August 15 would be given the opportunity to exchange their holdings for a new 3¾ per cent note dated August 15, 1963 and due to mature on November 15, 1964. No cash subscriptions were to be received for the new notes, which were offered at par. Subscription books were open from July 29 through July 31.

On August 2, the Treasury announced that over $6.3 billion of the $6.6 billion of maturing securities had been submitted in exchange for the new 3¾ per cent notes, including about $2.2 billion of the $2.5 billion held by the public. Attrition amounted to $268 million, or 10.8 per cent of public holdings.

BANK RESERVES AND THE MONEY MARKET

The money market remained generally firm in the first half of July, with Federal funds trading almost entirely at 3 per cent. Reserve distribution continued to favor banks outside the money centers, while money market banks sought to cope with large and persistent reserve deficiencies through heavy purchases of Federal funds and through expanded borrowing at the Federal Reserve Banks. After the discount rate increase became effective in seven Federal Reserve Districts, the money market firmed up briefly but then became progressively easier in the statement week ended July 24 as reserves shifted markedly in favor of banks in the money centers. In considerable measure, this shift stemmed from earlier steps taken by the New York City banks to improve their liquidity positions, and from heavy borrowing by banks in Federal Reserve Districts where the cost of borrowing remained at 3 per cent. Funds thus flowing to the money centers were augmented by the usual transfer of funds which occurred over the July 24 "country" bank reserve-settlement date. In the final statement week of the month, the money market firmed again and Federal funds traded mainly at 3⅜ to 3½ per cent. Paralleling movements in rates on Federal funds, rates posted by the major New York City banks on new and renewal call loans to Government securities dealers were generally quoted within a 3⅜ to 3¾ per cent range through July 19, declined over the next few days to a 2½ to 3 per cent range, and then firmed at 3½ to 3¾ per cent in the final days of the month.

In the wake of the sharp rise in bill yields, the discount

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

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

Factor	Daily averages—week ended					Net changes
	July 3	July 10	July 17	July 24	July 31	
Operating transactions						
Treasury operations*	+ 46	− 159	+ 89	+ 43	− 8	+ 11
Federal Reserve float	− 203	+ 75	+ 203	+ 61	− 640	− 510
Currency in circulation	− 295	− 225	+ 49	+ 152	+ 137	− 282
Gold and foreign account	− 34	− 49	− 22	− 24	− 11	− 140
Other deposits, etc.	− 20	+ 33	+ 48	—	− 16	+ 45
Total	− 506	− 425	+ 367	+ 233	− 547	− 878
Direct Federal Reserve credit transactions						
Government securities:						
Direct market purchases or sales	+ 648	+ 230	− 560	− 252	+ 357	+ 614
Held under repurchase agreements	+ 18	+ 172	− 241	− 103	+ 42	− 111
Loans, discounts, and advances:						
Member bank borrowings	+ 95	− 6	+ 77	− 88	− 160	− 91
Other	—	—	+ 1	—	− 1	—
Bankers' acceptances:						
Bought outright	− 2	+ 1	—	—	− 1	− 2
Under repurchase agreements	+ 8	− 2	+ 3	− 6	—	− 2
Total	+ 762	+ 396	− 628	− 450	+ 237	+ 407
Member bank reserves						
With Federal Reserve Banks	+ 256	− 29	− 161	− 217	− 320	− 471
Cash allowed as reserves†	− 66	− 120	+ 238	− 25	+ 37	+ 64
Total reserves†	+ 190	− 149	+ 77	− 242	− 283	− 407
Effect of change in required reserves†	− 139	+ 182	+ 54	+ 119	+ 61	+ 277
Excess reserves†	+ 51	+ 33	+ 131	− 123	− 222	− 130
Daily average level of member bank:						
Borrowings from Reserve Banks	329	323	400	312	143	301‡
Excess reserves†	430	463	594	471	249	441‡
Free reserves†	101	140	194	159	106	140‡

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 July 31.

rate change, and the revision in maximum rates on time deposits and certificates, rates on several other short-term money market instruments were adjusted upward during the month. Rates on ninety-day unendorsed bankers' acceptances rose by ¼ per cent to 3⅝ per cent (bid); rates on prime four- to six-month commercial paper increased by ¼ per cent to 3⅝ per cent (offered); and rates on various maturities of sales finance company paper generally rose by ⅛ per cent. Following the establishment of a 4 per cent ceiling under Regulation Q for member bank time deposits maturing in ninety days to one year, commercial banks generally raised the rates they offer on negotiable time certificates of deposit. New York City banks posted rates of 3⅜ to 3½ per cent on three- to six-month maturities, 3½ to 3⅝ per cent on six-month to one-year maturities, and 3½ to 3¾ per cent on certificates maturing in one year or more. Time certificates of deposit outstanding at the New York City banks rose $146 million over the last two weeks of the month.

Market factors absorbed reserves on balance from the last statement period in June through the final statement week in July, as reserve drains—primarily reflecting a contraction in float, an expansion in currency in circulation, and movements through gold and foreign accounts—more than offset a contraction in required reserves and an expansion in vault cash. System open market operations during the month partially offset the net reserve drains produced by market factors. System outright holdings of Government securities increased on average by $614 million from the last statement period in June through the final statement week in July, while holdings under repurchase agreements declined by $111 million. From Wednesday, June 26, through Wednesday, July 31, System holdings of Government securities maturing in less than one year rose by $667 million, while holdings maturing in more than one year increased by $204 million.

THE GOVERNMENT SECURITIES MARKET

The Government securities market was pervaded by an atmosphere of caution in the first half of the month, when market participants became increasingly convinced that an increase in the discount rate might soon be announced as part of the official efforts to reduce the balance-of-payments deficit. The most pronounced reaction occurred in the market for Treasury bills, where offerings from both dealer and investor sources expanded and rates moved sharply higher early in the month. By July 9, the newest three- and six-month issues had risen 24 and 27 basis points from end-of-June levels to 3.23 per cent and 3.33 per cent (bid), respectively, the highest rates in three years. Against this background, the market approached with some wariness the July 9 auction of $2 billion of one-year bills to replace a like amount of bills maturing on July 15. A few days earlier, rates as low as 3.25 per cent had been discussed in the market, but, as the bidding approached, rates as high as 3.65 per cent were reportedly anticipated on the new issue. A good interest developed at the higher rate levels, however, and an average issuing rate of 3.582 per cent was established, up 52 basis points from the rate set in the April auction of $2.5 billion of one-year bills.

The market steadied after the special auction, as bank and nonbank demand for outstanding bills began to expand and encountered developing scarcities, particularly of short-term maturities. Rates moved lower for several days, rose temporarily on July 17 in response to the discount rate announcement, and then edged down again through July 25. Bank demand rose further in the easy money market, and nonbank customers also increased their buying once the uncertainties of the anticipated discount rate rise were out of the way. A cautious undertone persisted, however, with market participants uncertain that lower rate levels—particularly in the ninety-day area—could be sustained in view of the 3½ per cent discount rate. This cautious atmosphere, reinforced by a renewed firming in the money market, became increasingly evident in the closing days of the month, and bill rates edged higher in the final days of the period. The newest three-month bill closed the month at 3.27 per cent (bid) as against 2.99 per cent at the end of June, while the newest six-month bill was quoted at 3.40 per cent (bid) as against 3.06 per cent at the close of the preceding month.

The market for Government notes and bonds in the first half of July also responded in some degree to expectations of a higher discount rate, but the reaction was comparatively mild as most market observers felt that official actions to deal with the balance of payments through monetary and other financial policies would have their main impact on the short-term area. Indeed, while a very brief decline in prices followed the changes in the discount rate and in Regulation Q ceilings, the market for notes and bonds tended to strengthen over the balance of the month. Various official statements tended to reinforce the market view that System actions were aimed at bolstering short-term rates while not impeding domestic economic expansion. Sentiment was further strengthened by the President's July 18 request for a tax on foreign securities, which the market thought might reduce the supply of securities offered in United States capital markets and, at the same time, might to some extent ease the burden placed on monetary policy by the balance-of-payments problem. Another encouraging

influence in the long-term market was the fact that the Treasury confined its August refunding offering to the short-term area, while additional strength was derived from the prospective reinvestment in intermediate-term Treasury issues of the proceeds of a large tax-exempt bond offering. The largest gains centered in selected long-term issues and in the 2½ per cent wartime issues which had given ground earlier in the month. Over the month as a whole, prices of short- and intermediate-term issues ranged from 3/32 higher to 20/32 lower, while longer term maturities were 10/32 higher to 5/32 lower.

The market reacted favorably to the Treasury's offering of a fifteen-month 3¾ per cent note in exchange for the 2½ per cent bonds and the 3½ per cent certificates maturing on August 15. "Rights"—the maturing issues eligible for conversion—moved up by 3/64 to 2/32 in early trading, while the "when-issued" securities were quoted at premium bids of from 4/32 to 5/32. Only a modest amount of trading activity in the refunding issues occurred, however, largely because public holdings of the maturing $6.6 billion of securities amounted to only $2.5 billion.

OTHER SECURITIES MARKETS

Prices of seasoned corporate and tax-exempt bonds edged moderately lower on limited volume during early July, as investors remained cautious and selective in view of persistent reports of possible increases in short-term interest rates. Dealers were able to make some progress in reducing inventories of recent issues by cutting prices, while new flotations were marketed at slightly higher yields. Following the various official announcements noted above, activity expanded and a firmer tone emerged in both sectors. The corporate sector was buoyed by a seasonal scarcity of new issues and by the market's feeling that the authorities were largely concerned with boosting short-term rates. At the same time, the tax-exempt sector was encouraged by expectations that commercial bank demand might be stimulated if an expansion in time deposits resulted from the change in Regulation Q. Consequently, prices of both corporate and tax-exempt bonds moved higher in the latter half of July. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 6 basis points to 4.29 per cent, while the average yield on similarly rated tax-exempt bonds declined by 2 basis points to 3.08 per cent.

The total volume of new corporate bonds reaching the market in July amounted to approximately $345 million, compared with $455 million in the preceding month and $220 million in July 1962. New tax-exempt bond flotations totaled $800 million, as against $990 million in June 1963 and $590 million in July 1962. The Blue List of tax-exempt securities declined by $128 million during the month to $515 million on July 31. New corporate and tax-exempt bond issues floated during the period generally were accorded fair to good receptions by investors.