The Money and Bond Markets in December

In early December, the money and Government securities markets continued making an orderly adjustment to the increases in late November of official discount rates abroad and at home. The markets soon steadied, however, and the atmosphere improved, particularly following substantial System purchases of Treasury bills and other Government securities. The timing and extent of these purchases were regarded in the market as indicative of an official intention to maintain credit availability and avoid a buildup of seasonal pressures. Thereafter, aided by advance preparation on the part of money market banks and timely System action, the money market handled without undue stress the heavy financial flows and enlarged credit demands stemming from midmonth corporate dividend and tax payments and from preparations for the year-end statement date. Federal funds were generally available in good volume at 4 per cent or below. Rates on Treasury bills edged higher over the midmonth period, but largely declined over the rest of the month as corporate and bank demand revived.

In the market for Treasury coupon securities, the improvement in sentiment early in December brought prices of most issues to near their highest levels of the year by December 11. Subsequently, prices of longer term issues drifted irregularly lower on talk of a possible long-term Treasury financing and also on continuing uncertainty about the pound sterling. The announcement by the Treasury on December 30 of an advance refunding operation (see below) was followed by an improvement in market atmosphere on the final day of the year, when market participants took the Treasury's decision as indicating official confidence in the market outlook and in the outlook for sterling. In fact, toward the end of the year there was growing awareness in financial markets here and abroad that the steps taken by the British authorities during the two preceding months added up to a much stronger program in defense of sterling than had been generally recognized. Corporate bond prices in December generally recovered the losses experienced in late November, while prices of tax-exempt issues rose to new highs for the year in the wake of the Federal Reserve's increase in Regulation Q ceilings.

THE MONEY MARKET AND BANK RESERVES

A relatively comfortable tone prevailed in the money market through mid-December and, although a somewhat firmer tone was evident thereafter, Federal funds were available at 4 per cent most of the time, and frequently traded at lower rates. Rates posted by the major New York City banks on call loans to Government securities dealers were largely in a 3 to 4¼ per cent range during the first third of the month; they moved up to a 4⅛ to 4⅜ per cent range around the dividend and tax period and remained in that range until the end of the month when rates as high as 4½ per cent were posted. With net reserve availability averaging somewhat higher than in recent months, member bank borrowing from the Reserve Banks averaged considerably lower, although it did expand in the last statement week of the year. Offering rates for new time certificates of deposit issued by the leading New York City banks declined somewhat during the early part of the month but rose in the latter part of the period. The range of rates at which such certificates traded in the secondary market was little changed early in the period but edged slightly higher later in the month. Rates on bankers' acceptances remained at the higher levels reached in late November, stimulating strong investment demand that temporarily depleted inventories before a supply of acceptances came into the market prior to the year-end statement date. On December 21, commercial paper dealers increased their rates on prime four- to six-month paper by ⅛ of a per cent to 4¼ per cent (offered).

The December corporate tax date and the most popular dividend payment date fell within a single statement week this year for the first time since 1959, but the banks and the money market handled with facility the large deposit and loan expansion and the shifts in the ownership of money and securities that were required. A few figures illustrate the magnitude of the task. Over the week ended December 16, demand deposits (adjusted to exclude cash items in process of collection and certain other items) at weekly reporting member banks rose $3.2 billion while their negotiable time certificates of deposit declined $408 million. Commer-

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, DECEMBER, 1964

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

Factor	Daily averages—week ended Dec. 2	Dec. 9	Dec. 16	Dec. 23	Dec. 30	Net changes
"Market" factors						
Member bank required reserves*	— 186	+ 135	— 145	— 440	— 4	— 640
Operating transactions (subtotal)	— 540	— 652	+ 222	+ 741	— 110	— 339
Federal Reserve float	— 276	+ 90	+ 124	+ 823	— 23	+ 748
Treasury operations†	— 347	— 118	— 171	+ 33	— 31	— 634
Gold and foreign account	— 119	+ 38	+ 45	— 3	— 76	— 115
Currency outside banks*	— 144	— 328	+ 81	— 153	— 49	— 593
Other Federal Reserve accounts (net)‡	+ 346	— 335	+ 135	+ 42	+ 67	+ 255
Total "market" factors	— 726	— 517	+ 77	+ 301	— 114	— 979
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 800	+ 668	— 316	— 360	— 90	+ 703
Bankers' acceptances	+ 1	+ 4	+ 2	+ 2	+ 1	+ 10
Repurchase agreements:						
Government securities	— 126	—	+ 315	— 49	+ 100	+ 241
Bankers' acceptances	— 34	+ 2	— 23	—	+ 2	— 53
Member bank borrowings	+ 216	— 253	+ 12	+ 123	+ 247	+ 345
Other loans, discounts, and advances	— 1	—	+ 26	+ 6	— 3	+ 28
Total	+ 867	+ 421	+ 18	— 280	+ 257	+ 1,273
Excess reserves*	+ 131	— 96	+ 95	+ 21	+ 143	+ 294
Daily average levels of member bank:						
Total reserves, including vault cash*	21,376	21,145	21,385	21,846	21,993	21,549§
Required reserves*	20,987	20,852	20,997	21,437	21,441	21,143§
Excess reserves*	389	293	388	409	552	406‖
Borrowings	375	122	134	257	504	278‖
Free reserves*	14	171	254	152	48	128‖
Nonborrowed reserves*	21,001	21,023	21,251	21,589	21,489	21,271‖

Note: Because of rounding, figures do not necessarily add to totals.
* These figures are estimated.
† Includes changes in Treasury currency and cash.
‡ Includes assets denominated in foreign currencies.
§ Average for five weeks ended December 30, 1964.

cial and industrial loans by these banks rose $754 million. Loans to sales finance companies increased $677 million, and loans to brokers and dealers for purchasing or carrying securities rose by $744 million. Early in the statement week the major money market banks—in New York City and elsewhere—benefited temporarily from the inflow of corporate money for dividend payments that exceeded $1.1 billion on December 10, but the heavy loan demands and certificates-of-deposit losses of December 15 brought a sharp buildup in reserve pressures. System purchases of Government securities under repurchase agreements at rates of 3.85 per cent and 3⅞ per cent were used to increase reserve availability at the point of maximum need and to reduce the pressures reflected in the higher lending rates against Government securities that were being posted by major money market banks.

Pressure on the reserve positions of the money market banks persisted throughout the remainder of the month, contributing to a somewhat firmer tone in the Federal funds market. With the System continuing to inject reserves in substantial volume through repurchase agreements against Government securities at 3⅞ per cent, however, serious strains were avoided. Member bank borrowings rose in the final statement week of the month, largely reflecting precautionary borrowing over the long Christmas holiday week end.

Over the five-week December period as a whole, nationwide reserve availability averaged $128 million, compared with $3 million (revised) in the four weeks ended November 25. System open market operations provided $901 million in reserves, on balance, over the period as the weekly average of System outright holdings of Government securities rose by $703 million from the final week of November to the last week of December, and average System holdings of Government securities under repurchase agreements increased by $241 million. Average net System holdings of bankers' acceptances, both outright and under repurchase agreements, declined by $43 million during the period. From Wednesday, November 25, through Wednesday, December 30, System holdings of Government securities maturing in less than one year rose by $382 million, while holdings of issues maturing in more than one year increased by $101 million.

THE GOVERNMENT SECURITIES MARKET

As the month opened, the Government securities market remained cautious after making an orderly adjustment to the increases in the British bank rate and the Federal Reserve discount rate announced on November 23. Opinion soon swung to the view that the discount rate increases themselves were not to be followed by a significant rise in long-term interest rates above the levels prevailing before the increases. This feeling gained adherents in the early days of the month, when substantial System purchases of Government securities suggested to market observers that reserve and credit availability would be maintained at about its level prior to the discount rate increase. At the same time, market participants were encouraged when several banks rescinded previously announced increases in their prime rates. Following these developments, prices of Government securities as well as corporate and tax-exempt bonds rose.

Reflecting the shift in sentiment, a good investment and professional demand developed for Treasury notes and bonds—particularly for the 2½ per cent wartime issues which offered an advantageous after-tax yield. This buying readily absorbed limited commercial bank offerings of intermediate-term issues, and by December 11 prices of most Treasury issues maturing after 1965 had recouped the losses suffered immediately following the discount rate increases in late November. Some coupon issues were, in fact, trading near their best levels of the year. As the rally progressed, activity receded and became more professional in character.

Just before midmonth, doubts began to appear regarding the sustainability of the higher price levels. The approach of the new year led to talk of a possible Treasury offering of longer term issues in January—perhaps through an advance refunding. Contributing to the caution was continued concern over the absence of any strong revival of confidence in the pound sterling following the announcement of major stabilization measures in Britain. Indeed, some market participants began to feel that, because of international uncertainties, the Treasury might not attempt an advance refunding in January, although other participants continued to expect an operation of this type. In this atmosphere, prices of longer term issues worked irregularly lower from December 14 onward. Activity was generally light although a fair volume of tax-swapping was undertaken by commercial banks. In the shorter term sector of the coupon market, however, a steadier tone was maintained during this period, owing to the persistence of fairly good investment demand and the possibility that some of the shorter issues might assume "rights" value should an advance refunding materialize.

After the close of business on December 30, the Treasury announced the terms of a major advance refunding operation. Holders of approximately $33.1 billion of eight outstanding coupon issues were given the opportunity to exchange them for three issues of longer maturity. The securities eligible for exchange include the 2⅝ per cent bonds of February 15, 1965, the 3½ and 4 per cent notes of November 15, 1965, the 3⅝ and 3⅞ per cent notes of February 15, 1966, the 3¾ per cent bonds of May 15, 1966, the 3¾ per cent notes of August 15, 1967, and the 3⅝ per cent bonds of November 15, 1967. The securities offered in the exchange are a new 4 per cent bond of February 15, 1970, a new 4⅛ per cent bond of February 15, 1974, and the reopened 4¼ per cent bond of August 15, 1987-92. Subscription books for the exchange were to be open from January 4 through January 8 with payment and delivery due on January 19, 1965. The Treasury also indicated that it would shortly offer $1.5 billion to $2.0 billion of June tax anticipation bills. (On January 6, it announced that the auction would take place on January 12 and be for $1¾ billion of tax anticipation bills to be issued on January 18 and to mature on June 22, 1965. Commercial banks are to be permitted to make 50 per cent of their payments for the tax bills through credit to Treasury Tax and Loan Accounts.)

The Treasury's refunding announcement caused participants to make an immediate reappraisal of market outlook. In an abbreviated trading day on December 31, the view appeared to be developing that the sterling situation must be less threatening than had been feared, since the Treasury had gone ahead with its financing plans. Prices of the "rights" issues rose as much as 4/32, while the largest decline in the longer maturities was the 19/32 drop of the reopened 4¼ per cent bonds of 1987-92. Early indications were that the offer would result in a significant amount of debt extension.

The tone of the Treasury bill market also improved early in the month. Sizable System Account purchases in late November and early December absorbed a portion of the bill inventories accumulated on dealers' shelves, strengthening the technical position of the bill market and contributing to a more comfortable money market climate. In the face of a sharp improvement in market atmosphere and developing scarcities of bills—especially in the shorter maturities—bill rates declined by about 10 basis points in the early part of the month. Over the midmonth period yields edged higher in response to moderate offerings, particularly of short-dated bills, as investors raised funds to meet corporate dividend and tax obligations and dealers sold bills returning from repurchase agreements with corporations. The availability of System repurchase agreements at rates below the discount rate helped counterbalance the upward pressure on bill yields of bank call loan rates to dealers ranging from 4⅛ to 4⅜ per cent.

Following the tax date a good investment demand developed from commercial banks building up their bill positions before the year-end statement date, and bill rates generally declined over the remainder of the month. A favorable interest developed at the December 23 auction of $1 billion of new one-year bills, which will mature on December 31, 1965. An average issuing rate of 3.972 per cent was set, compared with a rate of 4.068 per cent on the one-year issue sold a month earlier, immediately following the Federal Reserve discount rate increase. At the last regular weekly auction of the month, held on December 28, average issuing rates were 3.867 per cent for the new three-month issue and 3.957 per cent for the new six-month bill—virtually unchanged and 7 basis points lower, respectively, than the average rates in the November 30 auction. The newest outstanding three- and six-month bills closed the month at 3.82 per cent and 3.92 per cent (bid), respectively.

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, prices generally rose in fairly active trading through midmonth. Both sectors were buoyed by the favorable receptions accorded many of the new issues offered for sale during the period, as well as by market discussion that some investors might be shifting funds from equities into bonds. After midmonth an easier undertone developed in the corporate sector as a result of the talk of a Treasury refunding and international financial problems affecting the market for Government securities. Tax-exempt bond prices continued to rise, however, and closed the month at their highest levels for the year, in part because market observers interpreted the rise in Regulation Q interest rate ceilings as insuring continued large-scale commercial bank demand. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds declined by 1 basis point to 4.43 per cent, while the average yield on similarly rated tax-exempt bonds fell by 10 basis points to 2.99 per cent. (These indexes are based on only a limited number of issues.)

New tax-exempt bond flotations in December amounted to approximately $975 million, which brought the 1964 total to $9.5 billion exceeding the substantial 1963 total of $9.3 billion. The Blue List of such securities advertised for sale closed the month at $693 million, compared with $576 million on November 30. The largest tax-exempt bond issue marketed during the month was a $150 million Aa-rated state flotation consisting of $100 million of construction bonds and $50 million of school building aid bonds. Reoffered to yield from 2.20 per cent in 1966 to 3.33 per cent in 1991, the flotation was accorded a fair investor reception.

The volume of corporate bonds privately placed in 1964 amounted to $6.3 billion (estimated), a slight rise from the $6.2 billion in 1963. On the other hand, the volume of new corporate bonds publicly floated totaled only $3.6 billion in 1964, against a 1963 figure of $4.7 billion. The year-to-year decline in the over-all total probably reflects, at least in part, the large volume of funds internally generated by corporations as corporate profits rose to record levels in 1964. In December, public corporate bond flotations totaled approximately $305 million. The largest single issue was a $65 million issue of 4½ per cent first and refunding mortgage bonds maturing in 1996. The bonds, which were Aa-rated by Moody's and may not be refunded for five years, were reoffered at par. They initially encountered some investor resistance, but subsequently attracted considerable interest and were quickly sold. Most other new corporate and tax-exempt bonds marketed in December were well received.