The Money and Bond Markets in February

Attention in the money and bond markets during February focused on the implications of the nation's balance-of-payments problem and the official actions proposed to deal with it. The money market's tone became somewhat firmer during the month and this, combined with the publication of lower average levels of nationwide reserve availability, led many observers to conclude that a slight shift in monetary policy had taken place. In the firmer money market atmosphere, Treasury bill rates edged upward and at the end of the month the three-month bill was bid at 3.99 per cent, just under the discount rate.

In the market for Treasury notes and bonds, caution arising from the balance-of-payments problem and the situation in Vietnam led to a gradual decline in prices through mid-February. Thereafter, prices steadied and moved narrowly. Prices of corporate and tax-exempt bonds also receded during the month, as investors resisted the lower yield levels that had developed on new issues in January.

THE MONEY MARKET AND BANK RESERVES

The tone of the money market gradually became slightly firmer during February, reflecting in part the decline in nationwide reserve availability from the levels prevailing in December and January. Rates posted by the major New York City banks on call loans to Government securities dealers rose a bit and generally fluctuated between 4⅛ per cent and 4½ per cent. At the same time, offering rates for new time certificates of deposit issued by the leading New York City banks, and the range of rates at which such certificates traded in the secondary market, edged higher during the month. On February 4, dealers in bankers' acceptances raised their rates by ⅛ of a percentage point making the new offering rate on ninety-day unendorsed acceptances 4⅛ per cent. In the course of the month, the major sales finance companies increased their offering rates on various categories of directly placed paper by ⅛ to ¼ of a percentage point. At the end of the period they were offering 4⅛ per cent on 30- to 59-day paper and 4¼ per cent on 60- to 270-day paper. Toward the end of the month, commercial paper dealers raised their rates by ⅛ of a percentage point, making the new rate on prime four- to six-month paper 4⅜ per cent (offered).

As the month opened, the money market continued to exhibit about the same steady tone that had prevailed toward the end of January. System open market operations about offset the effects of a withdrawal of reserves stemming from movements in market forces. Although reserve positions at major money market banks as a group came under slightly increased pressure, these banks were able to cover a good part of their reserve needs in the Federal funds market where funds were readily available at 4 per cent. Subsequently, as nationwide reserve availability contracted, pressures on the reserve positions at these banks mounted, and the over-all tone of the money market became slightly firmer. Banks bid strongly for Federal

funds and, on two days, funds traded predominantly at 4⅛ per cent. Total member bank borrowings at the Reserve Banks bulged over the February 5-7 week end, helping to produce a temporary abundance of excess reserves, and Federal funds became available below the discount rate toward the close of the February 10 statement week. A portion of these funds was purchased by "country" banks and carried into the second week of their statement period.

Over the midmonth statement week, nationwide reserve availability declined further as System open market operations more than offset the reserves provided by market factors. The money market was quite firm, but member bank borrowings from the Reserve Banks declined when the large reserve excesses built up by the country banks a week earlier were redistributed. In the latter part of the month, member bank borrowings from the Reserve Banks once again rose substantially as many banks sought to avoid accumulating reserve deficiencies over the three-day Washington's Birthday week end. These heavy week-end borrowings again led to an overabundance of reserves toward the end of the statement week, and country banks were once more buyers of Federal funds late in the February 24 reserve averaging period at rates below the discount rate.

Over the month as a whole, market factors drained $450 million of reserves while System open market operations provided $329 million. The weekly average of System outright holdings of Government securities increased by $384 million from the final statement week in January through the last week in February, while average System holdings of Government securities under repurchase agreements declined by $12 million. Average net System holdings of bankers' acceptances, both outright and under repurchase agreements, fell by $43 million during the period. From Wednesday, January 27, through Wednesday, February 24, System holdings of Government securities maturing in less than one year rose by $1,631 million, while holdings of issues maturing in more than

Table I

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, FEBRUARY 1965

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

Factor	Daily averages—week ended				Net changes
	Feb. 3	Feb. 10	Feb. 17	Feb. 24	
"Market" factors					
Member bank required reserves*	— 101	+ 205	+ 78	+ 84	+ 286
Operating transactions (subtotal)	— 380	— 687	— 3	+ 354	— 716
Federal Reserve float	— 230	— 139	+ 68	+ 190	— 111
Treasury operations†	+ 50	+ 5	— 91	+ 97	+ 61
Gold and foreign account	— 27	— 116	— 97	+ 3	— 237
Currency outside banks*	— 14	— 320	+ 131	+ 84	— 119
Other Federal Reserve accounts (net)‡	— 158	— 117	— 13	— 21	— 309
Total "market" factors	— 481	— 482	+ 75	+ 438	— 450
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 435	+ 304	— 45	— 370	+ 384
Bankers' acceptances	+ 2	+ 1	— 2	— 2	— 1
Repurchase agreements:					
Government securities	+ 1	+ 32	— 76	+ 31	— 12
Bankers' acceptances	+ 14	+ 8	— 20	— 44	— 42
Member bank borrowings	+ 75	+ 194	— 110	+ 167	+ 317
Other loans, discounts, and advances	— 4	—	—	—	— 4
Total	+ 522	+ 600	— 263	— 217	+ 642
Excess reserves*	+ 41	+ 118	— 188	+ 221	+ 192
Daily average levels of member bank:					
Total reserves, including vault cash*	21,401	21,314	21,048	21,185	21,237§
Required reserves*	21,019	20,814	20,736	20,652	20,805§
Excess reserves*	382	500	312	533	432§
Borrowings	278	472	353	520	406§
Free reserves*	104	28	— 41	13	26§
Nonborrowed reserves*	21,123	20,842	20,695	20,665	20,831§

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 four weeks ended February 24, 1965.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS FEBRUARY 1965

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended				Average four weeks ended Feb. 24*
	Feb. 3	Feb. 10	Feb. 17	Feb. 24*	
Eight banks in New York City					
Reserve excess or deficiency(—)†	12	15	16	19	16
Less borrowings from Reserve Banks	69	51	131	100	88
Less net interbank Federal funds purchases or sales(—)	377	489	579	283	432
Gross purchases	*925*	*1,061*	*1,066*	*811*	*966*
Gross sales	*548*	*573*	*487*	*528*	*534*
Equals net basic reserve surplus or deficit(—)	— 434	— 525	— 695	— 364	— 505
Net loans to Government securities dealers	770	615	619	364	592
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)†	10	24	21	18	18
Less borrowings from Reserve Banks	106	233	77	225	160
Less net interbank Federal funds purchases or sales(—)	285	197	168	141	198
Gross purchases	*941*	*755*	*1,000*	*895*	*898*
Gross sales	*656*	*557*	*832*	*754*	*700*
Equals net basic reserve surplus or deficit(—)	— 381	— 406	— 223	— 348	— 340
Net loans to Government securities dealers	437	335	307	209	322

* Estimated reserve figures have not been adjusted for so-called "as of" debits and credits. These items are taken into account in final data.
† Reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.

one year contracted by $1,673 million. This shift in the maturity structure of Federal Reserve holdings largely reflected the passage of time.

THE GOVERNMENT SECURITIES MARKET

The cautious atmosphere which had developed in the market for Treasury notes and bonds toward the end of January continued in the early part of February. Growing awareness and discussion of the nation's balance-of-payments problem and of possible measures to deal with it —including the possibility of a shift in monetary policy— led to a cautious approach to investment decisions on the part of market participants. In this atmosphere, market professionals became increasingly eager to lighten inventories recently enlarged by the Treasury's January advance refunding and the February cash financing. Thus, a modest but general decline in prices of coupon issues took place, with offerings concentrated in the 2½ per cent wartime issues and the recently issued securities. Moderate investment demand was present throughout the period.

Subsequently, the market atmosphere improved for a time, following press reports suggesting that higher long-term interest rates would not be used in combating the balance-of-payments deficit. The President's February 10 message to Congress presenting a program to deal with the balance-of-payments deficit was received favorably by the market. However, increasing concern over the implications of unfolding developments in Vietnam, combined with a further drain on the United States gold stock and lower levels of free reserves published for the February 10 statement week, served to renew the market's caution. As a result, prices of most intermediate- and long-term issues edged irregularly lower from February 9 through midmonth, when a steadier tone reemerged in the market.

For most of the remainder of the month, the lower price levels generated some professional short covering and attracted additional investment demand. The improved market tone also reflected a reiteration of the Administration's view that long-term borrowing costs are not likely to rise significantly this year. Toward the end of the month, renewed hesitancy appeared in the market, based partly on official indications that monetary policy would be employed, as necessary, to correct the balance-of-payments deficit. However, moderate investment demand remained in evidence, and the distribution of recently issued Treasury securities continued.

The market for Treasury bills also had a hesitant undertone in early February, as market participants expressed uneasiness over the possibility of a shift in monetary policy to deal with the balance-of-payments problem. While moderate investment demand persisted throughout this period, widespread uncertainty generated an expansion in offerings from professional and other sources and bill rates moved irregularly higher through February 5. Offerings then contracted, and bill rates held generally steady from February 8 through midmonth in quiet trading. In the latter part of the month, the continuation of lower levels of net reserve availability tended to confirm the feeling among market participants that there had been a slight firming in monetary policy. Dealers in Treasury bills were willing sellers as rates edged higher but there was good demand, especially from public funds. Toward the end of the month, the approach of the March corporate dividend and tax dates contributed to the caution evident in the market.

At the last regular weekly auction of the month, held on February 19, average issuing rates were 3.989 per cent for the new three-month issue and 4.043 per cent for the new six-month bill—14 and 10 basis points higher, respectively, than the average rates at the final weekly auction in January. The February 23 auction of $1 billion of new one-year bills resulted in an average issuing rate of 4.062 per cent, compared with 3.945 per cent on the comparable issue sold a month earlier. The newest outstanding three- and six-month bills closed the month at bid rates of 3.99 per cent and 4.04 per cent, respectively.

OTHER SECURITIES MARKETS

Some apprehension was also present in the markets for corporate and tax-exempt bonds in February. Prices declined in both sectors during this period, with a continuing heavy flow of new tax-exempt flotations and rather large inventories of older tax-exempt issues contributing to the hesitant atmosphere in that sector. Declines in corporate bond prices were accompanied by the termination of syndicate price restrictions on a number of recent issues, with resultant yield increases of about 3 to 9 basis points. In the tax-exempt market, dealers' advertised inventories reached a record level of $827 million on the final business day of the month, and a heavy atmosphere prevailed. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds declined by 1 basis point to 4.41 per cent while the average yield on similarly rated tax-exempt bonds rose by 7 basis points to 3.03 per cent. (These indexes are based on only a limited number of issues and therefore do not necessarily reflect market movements fully.)

The volume of new corporate bonds publicly floated in February amounted to an estimated $185 million, compared with $160 million in January and $270 million in

February 1964. The largest publicly offered new corporate bond issue during the month consisted of $60 million of Aa-rated 4½ per cent first and refunding mortgage bonds maturing in 1990. The bonds which will not be refundable for five years were reoffered to yield 4.44 per cent and encountered some investor resistance. Syndicate price restrictions on this issue were terminated late in the month, and prices subsequently adjusted to somewhat lower levels. New tax-exempt flotations in February totaled about $850 million, as against $735 million in January 1965 and $740 million in February 1964. The Blue List of tax-exempt securities advertised for sale closed the month at a record $827 million, compared with $679 million on January 29. The largest new tax-exempt bond flotation during the period was a $100 million issue of state water bonds reoffered to yield from 2.90 per cent in 1975 to 3.58 per cent in 2012. The bonds, which were Aa-rated, were well received. Other new corporate and tax-exempt bonds publicly offered during the period were accorded mixed investor receptions.

FIFTIETH ANNUAL REPORT

The Federal Reserve Bank of New York has just published its fiftieth *Annual Report,* reviewing the economic and financial developments of 1964. It was transmitted to member banks by Alfred Hayes, President of the Bank, on March 1. The sixty-page *Report* tells of solid progress on the domestic front. However, the United States balance-of-payments deficit was again too large and remains a serious problem. Monetary policy during 1964 is described as essentially easy. The four major sections of the *Report* are: "Progress in 1964 and the Challenge of the Future", "The United States Economy and Financial Markets in 1964", "The International Economy in 1964", and "This Bank's Operations".

Copies of the *Annual Report* are available from the Publications Section, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045.