The Money and Bond Markets in May

The money market retained a steadily firm tone in May. The reserve positions of the money market banks outside New York City remained under pressure, while the reserve positions of the major New York City banks became somewhat more comfortable. Treasury bill rates generally declined on good demand, although there was a temporary rise around midmonth.

Prices of Treasury notes and bonds rose moderately in the opening days of the month, when most activity was associated with the Treasury's refunding operation then in progress. After the subscription period came to a close, demand contracted and prices of outstanding issues moved slightly lower in dull trading. In part, the cautious atmosphere reflected developments elsewhere in the capital market, where prices of corporate and tax-exempt bonds eased after midmonth in the face of a large schedule of current and future offerings of new issues.

THE MONEY MARKET AND BANK RESERVES

Nationwide net reserve availability contracted slightly during May, and a firm tone persisted in the money market. The bulk of Federal funds transactions continued to take place in a 4 to 4⅛ per cent rate range (see top panel of the chart on page 123), while average member bank borrowings from the Federal Reserve increased slightly. During the month, rates posted by the major New York City banks on call loans to Government securities dealers were generally quoted in a 4¼ to 4½ per cent range. Offering rates for new time certificates of deposit issued by leading New York City banks were little changed in May, but the range of rates at which such certificates traded in the secondary market edged a bit higher. Fairly strong investment demand developed in the market for bankers' acceptances at the higher rate levels established toward the end of April, and dealers reduced their heavy inventories to a lower level than had prevailed in recent months. Rates on acceptances, however, held generally steady during the month.

System open market operations provided a considerable volume of reserves in the first statement period in May and offset a substantial portion of the absorption of reserves which was accounted for by market factors. Nevertheless, the money market was quite firm as the financing needs of Government securities dealers rose, mainly reflecting their acquisition of "rights" to the Treasury's May refunding. A considerable portion of the enlarged dealer needs was filled by the major banks outside New York City. This resulted in additional pressures on the reserve positions of these banks and in a strong demand for Federal funds, which traded predominantly at 4⅛ per cent

Table I

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

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

Factor	Daily averages—week ended May 5	May 12	May 19	May 26	Net changes
"Market" factors					
Member bank required reserves*	— 249	+ 356	+ 13	+ 42	+ 162
Operating transactions (subtotal)	— 369	— 622	+ 335	— 204	— 860
Federal Reserve float	— 126	— 84	+ 358	— 317	— 169
Treasury operations†	+ 79	— 176	— 60	+ 259	+ 103
Gold and foreign account	—	+ 14	— 46	— 23	— 54
Currency outside banks*	— 247	— 388	+ 142	+ 110	— 382
Other Federal Reserve accounts (net)‡	— 75	+ 20	— 59	— 243	— 357
Total "market" factors	— 618	— 266	+ 348	— 162	— 698
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 158	+ 64	— 19	+ 242	+ 445
Bankers' acceptances	—	— 1	— 1	— 2	— 4
Repurchase agreements:					
Government securities	+ 375	+ 232	— 328	— 105	+ 174
Bankers' acceptances	+ 48	— 36	— 9	+ 11	+ 14
Member bank borrowings	+ 133	+ 20	+ 2	— 17	+ 138
Other loans, discounts, and advances	+ 1	—	— 1	— 1	— 1
Total	+ 715	+ 279	— 357	+ 130	+ 767
Excess reserves*	+ 97	+ 13	— 9	— 32	+ 69
Daily average levels of member bank:					
Total reserves, including vault cash*	21,747	21,464	21,442	21,368	21,505§
Required reserves*	21,413	21,117	21,104	21,062	21,171§
Excess reserves*	334	347	338	306	331§
Borrowings	478	498	500	483	490§
Free reserves*	— 144	— 151	— 162	— 177	— 159§
Nonborrowed reserves*	21,269	20,966	20,942	20,885	21,015§

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 May 26, 1965.

during that period. On the other hand, the large New York City banks experienced a temporary reserve surplus with the inflow of sizable Treasury redeposits of April tax receipts, and were net sellers of Federal funds in contrast to their usual heavy net demands for such funds. Partly as a result of this situation at the New York City banks, the credit needs associated with the Treasury's refunding were accommodated without strain.

As the Treasury recalled most of the redeposited funds, reserve pressures on the money market banks both inside and outside New York City first heightened during the statement period ended May 12, and then eased moderately in the week ended May 19. Member bank borrowings from the Federal Reserve remained substantial—around $500 million—but tended to be concentrated prior to each of the two weekends, thus leading to some temporary build-up in excess reserves. Consequently, Federal funds were in relatively greater supply after the weekends and traded mainly at 4 per cent, as against the 4⅛ per cent effective rate that prevailed on each Thursday and Friday. The reserve positions of the money market banks registered some improvement in the final statement period, but the money market remained firm. Federal funds traded mainly at 4⅛ per cent, and member bank borrowings from the Reserve Banks declined only slightly.

Over the month as a whole, market factors absorbed $698 million of reserves, while System open market operations provided $629 million. The weekly average of System outright holdings of Government securities rose by $445 million from the final statement week in April through the last week in May, and average System holdings of Government securities under repurchase agreements increased by $174 million. Average net System holdings of bankers' acceptances, both outright and under repurchase agreements, rose by $10 million during the month. From Wednesday, April 28, through Wednesday, May 26, System holdings of Government securities maturing in less than one year expanded by $3,400 million, while holdings of issues maturing in more than one year contracted by $2,471 million—mainly reflecting the effects of a maturity shift.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MAY 1965

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended May 5	May 12	May 19	May 26	Average of four weeks ended May 26
Eight banks in New York City					
Reserve excess or deficiency(—)*	11	31	— 4	16	14
Less borrowings from Reserve Banks	4	29	38	—	18
Less net interbank Federal funds purchases or sales(—)	— 139	130	51	— 96	— 13
Gross purchases	*763*	*903*	*882*	*702*	*813*
Gross sales	*902*	*773*	*832*	*798*	*826*
Equals net basic reserve surplus or deficit(—)	146	— 127	— 92	112	10
Net loans to Government securities dealers	618	500	549	452	530
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	31	27	— 1	22	20
Less borrowings from Reserve Banks	144	132	131	95	126
Less net interbank Federal funds purchases or sales(—)	401	455	344	315	379
Gross purchases	*1,137*	*1,221*	*1,086*	*1,175*	*1,155*
Gross sales	*736*	*766*	*742*	*860*	*776*
Equals net basic reserve surplus or deficit(—)	— 515	— 560	— 476	— 388	— 485
Net loans to Government securities dealers	645	349	395	262	413

* Reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.

THE GOVERNMENT SECURITIES MARKET

Activity in the Government securities market in the early part of the month was largely related to the various forces set in motion by the Treasury's refunding operation (for details of the offering, see last month's *Review*). In the Treasury bill sector, there was a moderate demand from sellers of refunding rights who were seeking alternative short-term investment outlets, and this demand was augmented by continuing public fund purchases. Market supplies gradually became depleted, and bill rates generally moved lower during the first third of the month (see top panel of the chart). As the refunding approached completion, bill demand tapered off while offerings from commercial banks and dealers expanded somewhat. Therefore, rates for most issues—particularly those in the three-month maturity area—tended to move upward on limited activity from May 12 through mid-month. Subsequently, investment demand reappeared in the market—both from corporations seeking short bill maturities and from others interested in longer maturities. Rates were generally steady to lower over the remainder of the month, as the presence of this broadly based demand tended to counteract some concern about future interest rate levels.

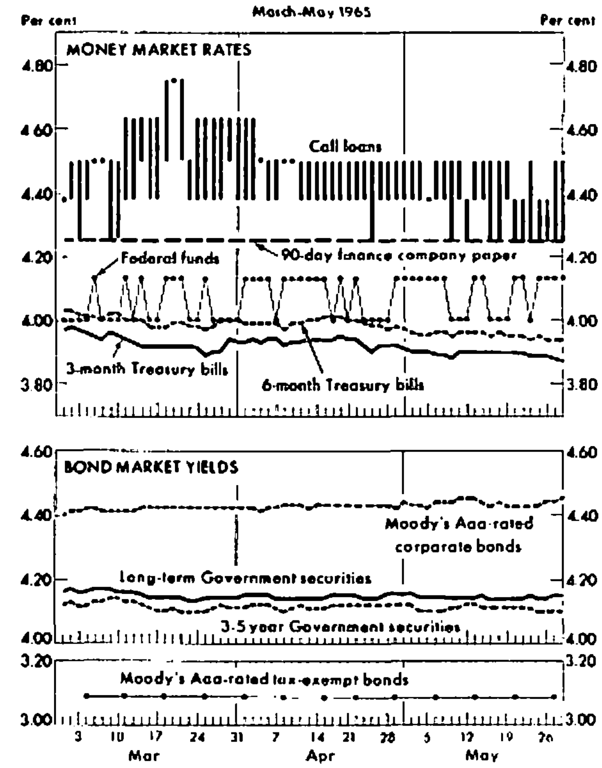
At the last regular weekly auction of the month, held on Friday, May 28 (in advance of the Memorial Day holiday on May 31), average issuing rates were 3.870 per cent for the new three-month issue and 3.924 per cent for the new six-month bill, about 5 basis points lower in each case than the average rates at the final weekly auction in April. The May 25 auction of $1 billion of new one-year bills produced an average issuing rate of 3.954 per cent, as against 3.996 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 3.87 per cent and 3.94 per cent, respectively.

In the market for Treasury notes and bonds, prices edged higher at the beginning of the month (as reflected in the decline in the composite yield of three- to five-year securities and of long-term bonds, shown in the bottom panel of the chart). Trading activity was moderate and consisted mainly of switching operations into and out of the issues involved in the Treasury's May refunding. There was some net investment demand for short-term and intermediate-term issues, while dealers readily absorbed limited offerings of long-term obligations. With the close of the May 3-5 refunding subscription period, investment activity contracted as participants paused to await the results of the Treasury operation. After the end of trading on Friday, May 7, the Treasury announced that approximately $8.0 billion, or about 94 per cent of the maturing Treasury notes eligible for conversion, had been exchanged for the two Treasury issues reopened in the refunding. Subscriptions totaled $5.9 billion (including approximately $1.6 billion from public subscribers) for the 4 per cent notes of August 1966, and $2.1 billion (including about $2.0 billion from public subscribers) for the 4¼ per cent bonds of May 1974.

Although the amount subscribed for the nine-year bonds exceeded the expectations of most market observers, the announcement of the refunding results had little initial impact on the market for outstanding coupon issues. As the month progressed, it appeared that investors had

SELECTED INTEREST RATES*

March-May 1965



Note: Data are shown for business days only.

* Rates quoted are: daily range of rates posted by major New York City banks on new call loans secured by United States Government securities and transacted in Federal funds (a point indicates the absence of any range); offering rates for directly placed sales finance company paper; the effective rate on Federal funds; closing bid rates (quoted in terms of rate of discount) on newest outstanding three- and six-month Treasury bills; daily averages of seasoned Aaa-rated corporate bonds; daily averages of yields of long-term Government securities (bonds due or callable in ten years or more), and of Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields of seasoned Aaa-rated tax-exempt bonds.

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service.

accomplished the bulk of their portfolio objectives while the subscription books were open, and had left little to do over the remainder of the period. For the rest of the month, prices of most issues declined irregularly—especially those in the longer term maturity area—when dealer offerings expanded in the face of general investor apathy. Investor activity was light as the market appraised the enlarged calendar of future debt offerings in other sectors of the capital markets.

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, prices fluctuated narrowly in the early part of May in quiet trading. In part, this inactivity reflected the fact that attention was focused on the Treasury's May refunding, but participants were also looking ahead to the heavy calendar of impending corporate and tax-exempt flotations. When several large new corporate and tax-exempt issues did reach the market in the week ended May 12, underwriter bidding was enthusiastic at slightly lower price levels than had previously predominated. The relatively attractive reoffering yields on these issues stimulated considerable investor interest, which in turn generated a stronger undertone in both sectors. Investment demand largely centered upon the new issues, however, and dealers made only moderate headway during this period in trimming their sizable inventories of older bonds. During the latter part of the month, demand contracted and a more hesitant tone emerged in the corporate and tax-exempt markets. Dealers reduced the prices of some slow-moving issues, making upward adjustments in yields of about 2 to 10 basis points. The continuing heavy volume of private placements of corporate issues, together with announcements of large offerings soon to come in various sectors of the capital market, added to the hesitancy of these markets. In addition, the tax-exempt market reacted adversely to a Supreme Court decision upholding the formula under which the earnings of life insurance companies are taxed—a formula that limits the advantage to such companies of holding tax-exempt bonds. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 1 basis point to 4.45 per cent while the average yield on similarly rated tax-exempt bonds remained unchanged at 3.09 per cent. (These indexes, shown in the bottom panel of the chart, 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 May amounted to an estimated \$675 million, compared with \$395 million in April 1965 and \$470 million in May 1964. The largest publicly offered new corporate bond issue of the month consisted of \$125 million of Aaa-rated 4⅝ per cent utility company debentures maturing in 2000. The debentures were reoffered to yield 4.50 per cent and encountered considerable investor resistance. (The marketing syndicate terminated on June 1 and the bonds subsequently traded to yield about 4.59 per cent.) New tax-exempt flotations totaled about \$895 million, as against \$920 million in April 1965 and \$625 million in May 1964. The Blue List of tax-exempt securities advertised for sale closed the month at a record level of \$872 million, compared with \$821 million at the end of April. The largest new tax-exempt bond flotation during the month consisted of \$126 million of Aaa-rated housing authority bonds. The bonds were reoffered to yield from 2.30 per cent in 1966 to 3.35 per cent in 2005, and were accorded a fairly good investor reception. Other new corporate and tax-exempt bonds publicly offered during the period were accorded mixed investor receptions.