The Money and Bond Markets in August

The money market was somewhat firmer during August, after having eased slightly in the latter part of July. Federal funds traded mainly at 4⅛ per cent, and the major reserve city banks were under reserve pressures as reserve distribution swung in favor of the "country" banks. Treasury bill rates moved higher in the early part of the month when professional offerings outweighed a rather modest investment demand. Subsequently, rates generally edged lower through midmonth. In the latter part of the month, demand tapered off—as often happens in August—and bill rates rose against a background of general market uncertainty.

Prices of Treasury notes and bonds declined irregularly in August, with prices of some issues dipping to their lowest levels in five years. Market participants warily appraised the potential effects of recent international political and economic developments, including those in Vietnam, as well as the possible consequences for interest rates of the very strong summer performance of the economy. There was also some selling of long-term Government bonds by institutional investors who were switching into new corporate issues as the yield spread in favor of the latter remained relatively wide. A cautious atmosphere was also evident in the corporate bond market during most of the period. The volume of new issues was larger than usual for August and their yields rose above comparable July levels, while prices of recent issues were also marked lower. In the tax-exempt sector, where a better tone had emerged in July, bond prices edged higher in early August and then held steady until late in the month when a more cautious tone developed.

THE MONEY MARKET AND BANK RESERVES

Over-all net reserve availability fluctuated in a narrow range in August around the average level prevailing in the preceding several months, but the tone of the money market turned somewhat firmer than in the latter part of July. In part, this reflected the fact that available reserves were lodged at banks outside the main money centers during most of the period. The effective rate on Federal funds was more consistently at 4⅛ per cent during August than in earlier months. (See left-hand panel of the chart on page 185.) Offering rates for new time certificates of deposit issued by leading New York City banks tended to rise slightly, as did the range of rates at which such certificates traded in the secondary market. Rates posted by the major New York City banks on new call loans to Government securities dealers were generally in a 4¼ to 4½ per cent range, while rates on renewal call loans were most frequently quoted in a 4¼ to 4⅜ per cent range. Investor demand for bankers' acceptances absorbed a limited supply during most of the month at the lower rates prevailing since late July. However, when supply expanded sharply near the end of the month, dealers raised their rates by ⅛ of a percentage point, making the rate on ninety-day unendorsed acceptances 4⅜ per cent (bid) and 4¼ per cent (offered).

Table I

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

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

Factors	Daily averages—week ended Aug. 4	Aug. 11	Aug. 18	Aug. 25	Net changes
"Market" factors					
Member bank required reserves*	− 125	+ 216	− 3	+ 71	+ 159
Operating transactions (subtotal)	− 271	− 504	+ 553	− 47	− 269
Federal Reserve float	− 234	+ 40	+ 290	− 78	+ 18
Treasury operations†	− 27	− 111	+ 194	− 57	− 34
Gold and foreign account	− 64	− 43	− 37	+ 17	− 127
Currency outside banks*	− 148	− 389	+ 99	+ 160	− 283
Other Federal Reserve accounts (net)‡	+ 200	+ 35	+ 5	− 100	+ 140
Total "market" factors	− 396	− 288	+ 550	+ 24	− 110
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 104	+ 356	− 222	− 66	+ 172
Bankers' acceptances	− 1	+ 1	− 1	+ 1	—
Repurchase agreements:					
Government securities	+ 283	− 105	− 293	+ 64	− 51
Bankers' acceptances	—	—	—	—	—
Member bank borrowings	+ 65	+ 72	− 125	+ 55	+ 67
Other loans, discounts, and advances	—	+ 3	− 1	− 1	+ 1
Total	+ 451	+ 328	− 642	+ 53	+ 190
Excess reserves*	+ 55	+ 40	− 92	+ 77	+ 80
Daily average level of member bank:					
Total reserves, including vault cash*	21,777	21,601	21,512	21,518	21,602§
Required reserves*	21,399	21,183	21,186	21,115	21,221§
Excess reserves*	378	418	326	403	381§
Borrowings	544	616	491	546	549§
Free reserves*	− 166	− 198	− 165	− 143	− 168§
Nonborrowed reserves*	21,233	20,985	21,021	20,972	21,053§

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 August 25, 1965.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS AUGUST 1965

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended Aug. 4	Aug. 11	Aug. 18	Aug. 25	Average of four weeks ended Aug. 25
Eight banks in New York City					
Reserve excess or deficiency(−)*	11	9	13	5	10
Less borrowings from Reserve Banks	115	167	4	52	85
Less net interbank Federal funds purchases or sales(−)	− 78	6	239	− 45	31
Gross purchases	*753*	*773*	*857*	*668*	*763*
Gross sales	*831*	*767*	*618*	*713*	*732*
Equals net basic reserve surplus or deficit(−)	− 26	− 164	− 230	− 2	− 106
Net loans to Government securities dealers	684	372	531	459	512
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)*	23	20	18	22	21
Less borrowings from Reserve Banks	120	170	209	192	173
Less net interbank Federal funds purchases or sales(−)	516	548	441	433	485
Gross purchases	*1,250*	*1,204*	*1,194*	*1,085*	*1,183*
Gross sales	*734*	*657*	*754*	*652*	*699*
Equals net basic reserve surplus or deficit(−)	− 613	− 698	− 632	− 603	− 637
Net loans to Government securities dealers	251	172	190	203	204

Note: Because of rounding, figures do not necessarily add to totals.
* Reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.

The money market had a firm tone during the first statement week of the month, which included the subscription period for the Treasury's August refunding.[1] System open market operations supplied a substantial volume of reserves (both through outright purchases and repurchase agreements), largely offsetting the reserve drains stemming from movements in "market" factors, and nationwide net reserve availability was little changed from the preceding week. However, the basic reserve positions of the major New York City banks swung from a sizable surplus the week before to a deficit when these banks met a large portion of the expanded loan requirements of Government securities dealers, businesses, and sales finance companies. These banks bid strongly for Federal funds, largely at 4⅛ per cent, and also stepped up their borrowings from the Federal Reserve Bank.

During the statement period ended August 11, reserve distribution increasingly favored the country banks at the start of their biweekly reserve computation period. A large unsatisfied demand for Federal funds led to heavy member bank borrowings from the Federal Reserve Banks over the weekend. Partly as a result of the excess reserves built up in this way, the supply of Federal funds became somewhat more ample in the latter part of the statement week. Subsequently, the money market readily accommodated the flows of money and securities associated with the August 13 settlement for the Treasury's August refunding. In addition, average member bank borrowings for the August 18 statement week declined when the availability of Federal funds increased toward the end of the period as the country banks worked down their excess reserves.

The money market remained quite firm over the rest of the month. Federal funds were in limited supply before the weekends beginning on August 20 and 27, and a modest volume of Federal funds traded at 4¼ per cent. While there was only a limited willingness to pay this rate, its appearance also seemed to impede the flow of Federal funds as it reduced the inclination to sell below the 4¼ per cent rate. This contributed to the tendency for borrowings from the Reserve Banks to increase over both weekends and for Federal funds to be more readily available thereafter.

Over the month as a whole, market factors absorbed $110 million of reserves, while System open market operations provided $121 million. The weekly average of System outright holdings of Government securities rose by $172 million from the final statement week in July through the last week in August, and average System holdings of Government securities under repurchase agreements decreased by $51 million. Average net System holdings of bankers' acceptances, both outright and under repurchase agreements, remained unchanged on balance during the month. From Wednesday, July 28, through Wednesday, August 25, System holdings of Government securities maturing in less than one year rose by $1,868 million, while holdings of issues maturing in more than one year declined by $1,899 million. This shift in the maturity structure of the System Account portfolio reflected primarily a movement of issues into the shorter maturity area with the passage of time. This effect was only partially offset by the August 13 exchange of Treasury refunding issues, which decreased the amount of shorter maturities while adding to the longer maturities in the System's portfolio.

THE GOVERNMENT SECURITIES MARKET

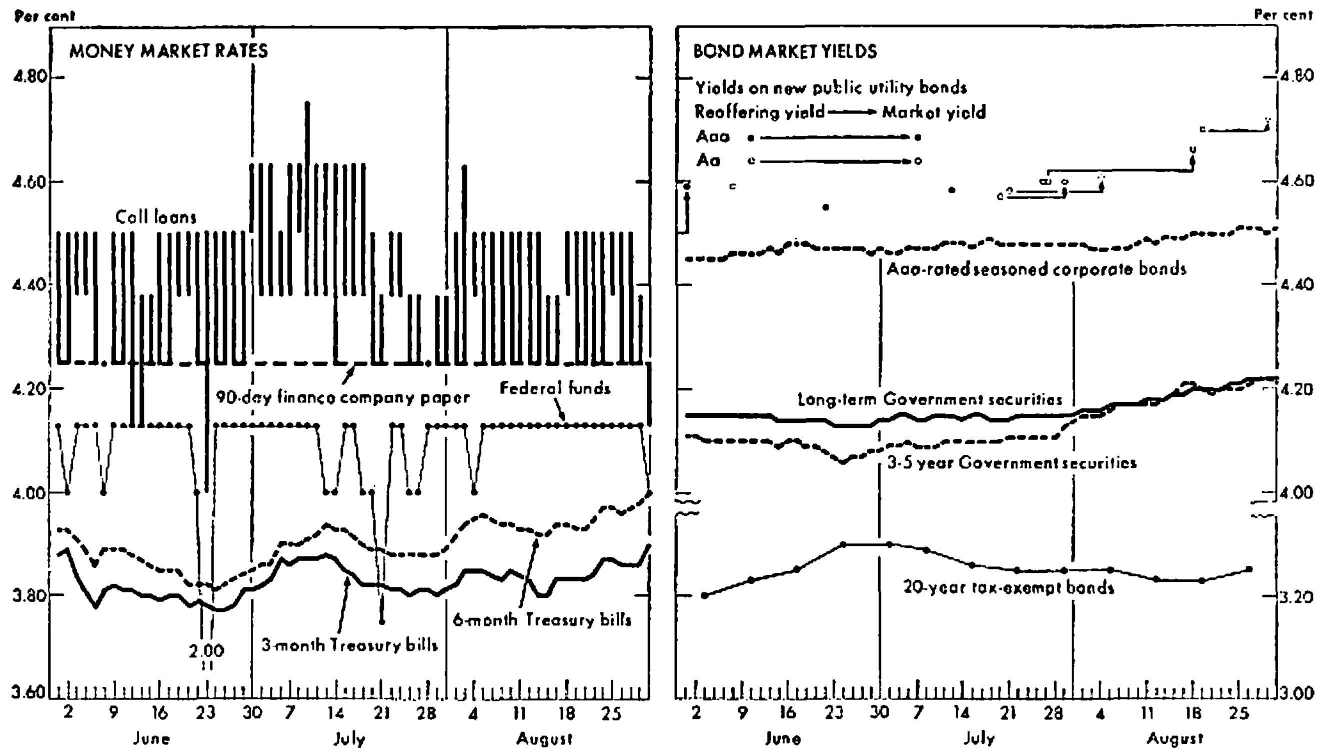
As the month opened, there was continuing disappointment among Government securities dealers with the limited reinvestment demand for bills arising from the Treasury's August refunding of coupon issues. Bill demand from other sources was also light and quite selective, and dealers sold at rising rates to reduce their bill positions. Announcement of a large Federal Home Loan Bank flotation of short-term notes also contributed to the cautious atmosphere, since these instruments were viewed as potentially competitive with Treasury bills. Against this background, bill rates edged irregularly upward through August 5. (See left-hand panel of the chart.) As higher rate levels emerged, a fairly good investment demand appeared —including some commercial bank and public fund buying, dealer offerings contracted, and the tone of the bill market gradually improved. Some scarcities developed, particularly in the shorter maturity areas, and bill rates moved downward from August 6 through midmonth. Subsequently, however, investment demand receded, as is often the case in August. Dealer concern over the future course of interest rates increased, professional offerings expanded, and bill rates edged irregularly upward during the remainder of the month.

At the last regular weekly auction of the month, held on August 30, average issuing rates were 3.886 per cent for the new three-month issue and 3.991 per cent for the new six-month bills, about 8 and 12 basis points respectively above the average rates at the last weekly auction in July. The August 24 auction of $1 billion of new one-year bills

[1] For the details of the refunding, see this *Review*, August 1965, p. 164.

SELECTED INTEREST RATES*

June-August 1965



Note: Data are shown for business days only.

* MONEY MARKET RATES QUOTED: Daily range of rates posted by major New York City banks on new call loans (in Federal funds) secured by United States Government securities (a point indicates the absence of any range); offering rates for directly placed finance company paper; the effective rate on Federal funds (the rate most representative of the transactions executed); closing bid rates (quoted in terms of rate of discount) on newest outstanding three- and six-month Treasury bills.

BOND MARKET YIELDS QUOTED: Yields of new Aaa- and Aa-rated public utility bonds are plotted around a line showing daily average yields of seasoned Aaa-rated corporate bonds (arrows point from underwriting syndicate reoffering yield of a given issue to market yield of the same issue immediately after it has been released from syndicate restrictions); 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 twenty seasoned twenty-year tax-exempt bonds (carrying Moody's ratings of Aaa, Aa, A, and Baa).

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, and The Weekly Bond Buyer.

produced an average issuing rate of 4.006 per cent, as against 3.875 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 3.90 per cent and 4.00 per cent, respectively.

In the market for Treasury notes and bonds, a heavy atmosphere prevailed throughout the month. Prices of many outstanding issues slipped to their lowest levels of the year, and in some cases to new five-year lows. (The right-hand panel of the chart shows the rise in yields which accompanied this decline in bond prices.) Uncertainty over the viability of prevailing interest rate levels heightened, as market participants focused upon the Vietnamese situation, the related possibility of increased defense spending, the strong domestic economic outlook, and the status of the pound sterling. In addition, the persistence of a relatively wide yield spread between Treasury and corporate bonds restrained investment interest in longer term Government securities and led to some switching into corporate issues. In this environment dealers sought aggressively to reduce their considerable inventories and prices moved lower, especially in the long-term sector of the market. However, there was little selling by banks and other investors of intermediate issues until late in the month when some such selling did materialize. As the month progressed, the lower prices attracted some institutional buying which, together with official account buying, produced a significant decline in bond inventories over the course of the month.

Results of the Treasury's August refunding operation, announced after the close of business on August 6, indicated that about $7.0 billion of the maturing Treasury notes eligible for exchange would be converted on the August 13 payment date into the two refunding issues offered by the Treasury. Subscriptions totaled about $5.1 billion (including about $2.1 billion from public subscribers) for the new 4 per cent notes of February 1967 and approximately $1.9 billion (including about $0.8 billion from public subscribers) for the reopened 4 per cent bonds of February 1969. Approximately 7.4 per cent of the maturing securities held by the public was not exchanged. Although the attrition was less than had been anticipated, the refunding results had virtually no effect on prices of outstanding coupon issues.

Bond prices steadied temporarily on August 10, when reports that the British trade gap had narrowed in July encouraged the market and sparked limited professional short covering. Investment demand did not expand significantly, however, and a cautious tone quickly reappeared. The market was also adversely affected by the cancellation of a large scheduled tax-exempt flotation, the proceeds of which were to have been reinvested in Treasury bonds, and by the increase in the German Federal Bank's discount rate from 3½ per cent to 4 per cent. Thus, prices resumed their downward trend from August 11 through August 17.

Market sentiment improved slightly over the next several days. The Government's August 17 announcement of a small surplus in the United States balance of payments during the second quarter of 1965 — the first quarterly surplus since 1957 — was favorably received. Market participants also began to recognize that measures undertaken by the United Kingdom to defend the pound sterling were beginning to take effect. Investment demand for coupon issues expanded moderately, some professional short covering took place, and offerings were more readily absorbed. A weaker tone reappeared in the latter part of the month, however, and prices again moved lower in response to expanded offerings from professional and investment sources.

OTHER SECURITIES MARKETS

Caution was also the watchword in the corporate bond market in August. The volume of new flotations was fairly large for a month that is normally very quiet, and yields on new issues rose above the levels available on comparable securities in July. Prices of seasoned corporate bonds declined irregularly in response to many of the same factors affecting the Government securities market. Several slow-moving recent issues were released from syndicate price restrictions and adjusted upward in yield by approximately 3 to 7 basis points. (See right-hand panel of the chart.) Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 3 basis points to 4.51 per cent.

In the tax-exempt sector, on the other hand, the steady tone which had emerged in the latter part of July carried over into early August. Prices of tax-exempt bonds were unchanged to slightly higher, and dealers made some further headway in cutting the volume of unsold bonds on their shelves in the early part of the month. Later in the month an easier undertone began to appear when commercial banks reportedly became less active buyers and when participants contemplated a fairly heavy calendar of high-grade issues scheduled to be marketed in September. Over the month as a whole, the average yield on *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) remained unchanged at 3.25 per cent. (See right-hand panel of the chart.)

The volume of new corporate bonds publicly floated in August amounted to an estimated $410 million, compared with $535 million in July 1965 and only $175 million in August 1964. The largest publicly offered new corporate bond issue of the month consisted of $75 million of A-rated utility company convertible debentures maturing in 1980. The debentures were reoffered to yield 2.89 per cent and were accorded only a fair reception. The syndicate marketing this issue terminated late in the month, and the price subsequently declined about 2 points —increasing the yield to about 3.08 per cent. New tax-exempt flotations totaled about $645 million, as against $980 million in July 1965 and $705 million in August 1964. The Blue List of tax-exempt securities advertised for sale closed the month at $768 million, compared with the revised level of $746 million at the end of July. The largest new tax-exempt bond flotation during the month consisted of $132 million of Aaa-rated housing authority bonds. The bonds were reoffered to yield from 2.30 per cent in 1966 to 3.40 per cent in 2006 and were accorded a good reception. Other new corporate and tax-exempt bonds publicly offered during the period were accorded mixed investor receptions.