The Money and Bond Markets in September

The money market was generally firm during the month, but the large credit demands around the mid-September corporate dividend and tax payments dates led to increased pressure on the money market in the last half of the month. Treasury bill rates generally rose 13 to 24 basis points over the month, with the upward movement gaining momentum after midmonth as dealers aggressively sought to lighten positions in the face of higher financing costs and in anticipation of the Treasury's issuance of additional bills to meet its fall cash needs. Other money market rates also rose, including those on certificates of deposit and sales finance company paper.

An atmosphere of caution continued to characterize the markets for Treasury notes and bonds during September as well as the markets for corporate and tax-exempt bonds. Prices of Treasury bonds were adversely influenced by the prospects of further strong economic advance, the heavy credit demands experienced by the banks and in the capital markets, and the relatively wide yield spread in favor of corporate bonds. Both the corporate and tax-exempt bond markets also continued under pressure during most of the month, as the volume of new issues coming into the market remained substantial. A steadier tone temporarily emerged around midmonth in the corporate market after the quick sale of a large telephone company issue and the subsequent distribution of several issues that had been moving slowly, but then market prices again edged lower. The tax-exempt market remained under pressure throughout the month, with investors responding unenthusiastically to the large volume of new issues.

THE MONEY MARKET AND BANK RESERVES

The money market remained quite firm during the month while accommodating the heavy demands placed on the short-term credit market around the corporate tax and dividend dates. Federal funds traded predominantly at 4⅛ per cent on nearly every day, although trading at 4¼ per cent increased after midmonth. Aggregate reserve availability on average was about unchanged, but the money market banks were under greater reserve pressure on average than in the previous month. These banks, however, were able to meet the bulk of their increased reserve needs in the Federal funds market, except in the period just after the midmonth tax payments when mounting reserve pressures led to a rise in member bank borrowings at the Federal Reserve Banks.

Rates posted by the major New York City banks on new call loans were mostly in a 4¼ to 4½ per cent range in the first half of the month, but rose into the 4⅜ to 4⅝ per cent range thereafter (see the left-hand panel of Chart I on page 216). Rates on several other short-term instruments also rose during the period, as corporations reduced their liquid assets to make dividend and tax payments. Both the rates posted by the major New York City banks on new time certificates of deposit and the rates on prime certificates trading in the secondary market moved higher. The major sales finance companies also raised their rates on 60- to 89-day paper by ⅛ of a percentage point at midmonth and subsequently raised their rates on 30- to 59-day paper by the same amount.

The money market was temporarily well supplied with funds as the month opened, reflecting the high level of member bank excess reserves built up through heavy borrowings earlier in the September 1 statement week. A steadily firm tone returned to the market in the first full statement week of the month, but no unusual pressures developed over the Labor Day weekend as System open market operations provided reserves in volume to counter the substantial drains that stemmed from an increase in currency outside banks over that weekend (see Table I). Banks in the money centers outside New York, however, came under sharply increased pressure during the week and were large purchasers of Federal funds. The major New York City banks were net sellers of funds to other banks as their basic reserve positions improved following a sharp reduction in loans to Government securities dealers (see Table II), while "country" banks maintained relatively low excess reserve balances in the first week of their new settlement period.

The money market banks encountered increased reserve pressures over the two-week period surrounding the cor-

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, SEPTEMBER 1965

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

Factors	Changes in daily averages—week ended					Net changes
	Sept. 1	Sept. 8	Sept. 15	Sept. 22	Sept. 29	
"Market" factors						
Member bank required reserves*	− 30	+ 105	− 79	− 559	+ 94	− 469
Operating transactions (subtotal)	+ 33	− 454	+ 515	+ 839	− 401	+ 442
Federal Reserve float	− 265	+ 125	+ 209	+ 718	− 641	+ 206
Treasury operations†	− 21	+ 69	− 83	− 39	+ 67	− 7
Gold and foreign account	− 22	− 3	+ 30	+ 26	− 12	+ 19
Currency outside banks*	+ 102	− 651	+ 233	+ 68	+ 89	− 159
Other Federal Reserve accounts (net)‡	+ 181	+ 7	+ 65	+ 76	+ 6	+ 335
Total "market" factors	+ 3	− 340	+ 430	+ 280	− 307	− 27
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 103	+ 285	− 251	− 467	+ 453	+ 103
Bankers' acceptances	...	—	− 1	—	+ 1	—
Repurchase agreements:						
Government securities	− 85	+ 63	− 141	+ 87	− 87	− 163
Bankers' acceptances	+ 19	+ 16	− 35	—	+ 10	+ 10
Member bank borrowings	− 9	− 54	+ 75	+ 69	− 74	+ 7
Other loans, discounts, and advances	− 1	—	+ 6	+ 2	− 2	+ 5
Total	+ 26	+ 291	− 317	− 308	+ 301	− 37
Excess reserves*	+ 29	− 68	+ 89	− 28	− 98	− 64
	Daily average levels					
Member bank:						
Total reserves, including vault cash*	21,578	21,415	21,533	22,114	21,924	21,723§
Required reserves*	21,145	21,040	21,119	21,678	21,584	21,313§
Excess reserves*	433	376	464	436	340	410§
Borrowings	537	483	558	627	553	552§
Free reserves*	− 104	− 108	− 94	− 191	− 213	− 142§
Nonborrowed reserves*	21,041	20,932	21,025	21,487	21,371	21,171§
	Changes in Wednesday levels					
System Account holdings of Government securities maturing in:						
Less than one year	− 269	+ 66	− 218	− 349	+ 950	+ 150
More than one year	+ 68	+ 151	—	—	—	+ 219
Total	− 201	+ 217	− 218	− 349	+ 950	+ 369

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 September 29.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS SEPTEMBER 1965

In millions of dollars

Factors affecting basic reserve positions	Daily averages week ended					Average of five weeks ended Sept. 29*
	Sept. 1	Sept. 8	Sept. 15	Sept. 22	Sept. 29	
Eight banks in New York City						
Reserve excess or deficiency(−)†	78	5	49	4	57	39
Less borrowings from Reserve Banks	81	43	29	161	3	63
Less net interbank Federal funds purchases or sales(−)	196	− 15	395	518	70	233
Gross purchases	*798*	*741*	*1,000*	*935*	*696*	*834*
Gross sales	*602*	*756*	*605*	*418*	*626*	*601*
Equals net basic reserve surplus or deficit(−)	− 199	− 23	− 375	− 674	− 16	− 257
Net loans to Government securities dealers	560	337	608	606	443	511
Thirty-eight banks outside New York City						
Reserve excess or deficiency(−)†	30	32	39	4	29	27
Less borrowings from Reserve Banks	167	168	209	237	235	203
Less net interbank Federal funds purchases or sales(−)	306	641	783	833	712	655
Gross purchases	*1,120*	*1,326*	*1,442*	*1,263*	*1,291*	*1,288*
Gross sales	*814*	*685*	*659*	*430*	*577*	*633*
Equals net basic reserve surplus or deficit(−)	− 443	− 778	− 953	− 1,065	− 918	− 831
Net loans to Government securities dealers	224	154	85	195	97	151

Note: Because of rounding, figures do not necessarily add to totals.

* 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.

Table III

AVERAGE ISSUING RATES*

AT REGULAR TREASURY BILL AUCTIONS

In per cent

Maturities	Weekly auction dates—September 1965			
	Sept. 3	Sept. 13	Sept. 20	Sept. 27
Three-month	3.898	3.887	3.905	3.983
Six-month	4.024	4.031	4.069	4.133

Maturities	Monthly auction dates—July-September 1965		
	July 27	Aug. 24	Sept. 24
One-year	3.875	4.006	4.236

* Interest rates on bills are quoted in terms of a 360-day year, with the discounts from par as the return on the face amount of the bills payable at maturity. Bond yield equivalents, related to the amount actually invested, would be slightly higher.

porate tax date. Corporations paid an estimated $4.1 billion in taxes during the month, chiefly on September 15, while the corporate dividend payments for the month were centered around September 10. Corporations relied somewhat less heavily than in 1964 on the runoff of repurchase agreements with Government securities dealers and the maturity of finance company paper to meet these payments. In partial substitution for such runoffs, they increased their direct borrowings from banks and liquidated substantial amounts of negotiable time certificates of deposit, which had been timed to coincide at maturity with the tax and dividend dates. The volume of such certificates outstanding at weekly reporting banks declined by $816 million in the week ended September 15, as against $562 million in the comparable statement week of 1964.

The increased reserve pressures on the money market banks stemming from a shift of time deposits into demand deposits and from increased borrowings for tax and dividend payments were at first cushioned by the temporary accumulation of corporate deposits that were then shifted to the ownership of the Treasury and of dividend recipients. Subsequently, as these balances were drawn down, reserves flowed from the money centers, maintaining the pressures generated by credit demands on the reserve positions of the large money market banks (see Table II). The daily average basic reserve deficits for the major money market banks rose to $1.7 billion in the September 22 statement week. Country banks built up large reserve excesses in the first week of their reserve-averaging period, not reoffering in full in the Federal funds market the reserves gained through the reserve redistribution. Accordingly, the money market banks experienced difficulty in covering their expanded needs, and average member bank borrowings from the Reserve Banks rose to $627 million.

The money market was tight early in the September 29 statement week and Federal funds traded in volume at 4¼ per cent on September 24. Subsequently, reserves moved back to the money market banks, particularly in New York City, as funds flowed from country banks at the end of their reserve-averaging period. By the end of the statement week, Federal funds traded predominantly at 1 per cent.

THE GOVERNMENT SECURITIES MARKET

An atmosphere of caution continued to pervade the market for Government securities in September. The hesitancy primarily reflected general expectations that the economy would expand well into 1966 and that the demands for credit would increase. The rising yields on corporate and tax-exempt bonds and the large calendars of future financing in these markets reinforced concern about the course of interest rates over the coming months. These downward pressures on bond prices largely obscured the lessening concern over the war in Vietnam and the improved performance of the pound sterling in the foreign exchange market.

Against this background, Treasury bill rates moved irregularly higher over the month. Investment demand was moderate and, in an atmosphere of uncertainty, tended to favor the shorter maturities. Dealer holdings of longer term bills expanded, while their financing costs rose around the tax date and thereafter. Selling by investors over the quarterly tax date was not large, but dealers were increasingly aggressive in offering bills as demand proved slow to revive after the tax date.

Rates on Treasury bills moved sharply higher following the Treasury's September 22 announcement that it would offer $4 billion of tax anticipation bills in early October—$3 billion maturing in March 1966 and $1 billion maturing in June 1966. The new one-year bill was auctioned two days later at an average issuing rate of 4.236 per cent, 23 basis points higher than the issuing rate in the August auction (see Table III). Subsequently, rates steadied temporarily and then rose again, as market participants became apprehensive that rising short-term rates might be confirmed by a shift in monetary policy. The three- and six-month Treasury bills closed the month at 4.02 and 4.19 per cent bid, respectively.

In the market for Treasury notes and bonds, prices of longer term issues declined 19/32 to 1¼ points over the month, as investors continued to switch into high-grade corporate bonds with higher yields. During most of the month, however, offerings were not pressed on the market and the upward adjustment in yields proceeded gradually, cushioned to some extent by official purchases. The decline in prices gathered some momentum toward the close of September, as selling by investors and professionals expanded. Over the month, dealers were able to reduce still further their holdings of notes and bonds.

Intermediate-term Treasury securities were initially affected less by market developments than were the long-term issues. The lower price levels on the intermediate-term issues, resulting from the August declines, attracted some investment buying in the early part of the month. Bank selling of intermediate issues increased as the month progressed, partly in response to actual or projected demands for bank credit. The upward adjustment in yields on intermediate issues was accompanied by a further flattening of the yield curve. Most high-coupon issues maturing beyond five years ended the month with a yield to maturity of about 4.35 per cent (based on bid prices).

OTHER SECURITIES MARKETS

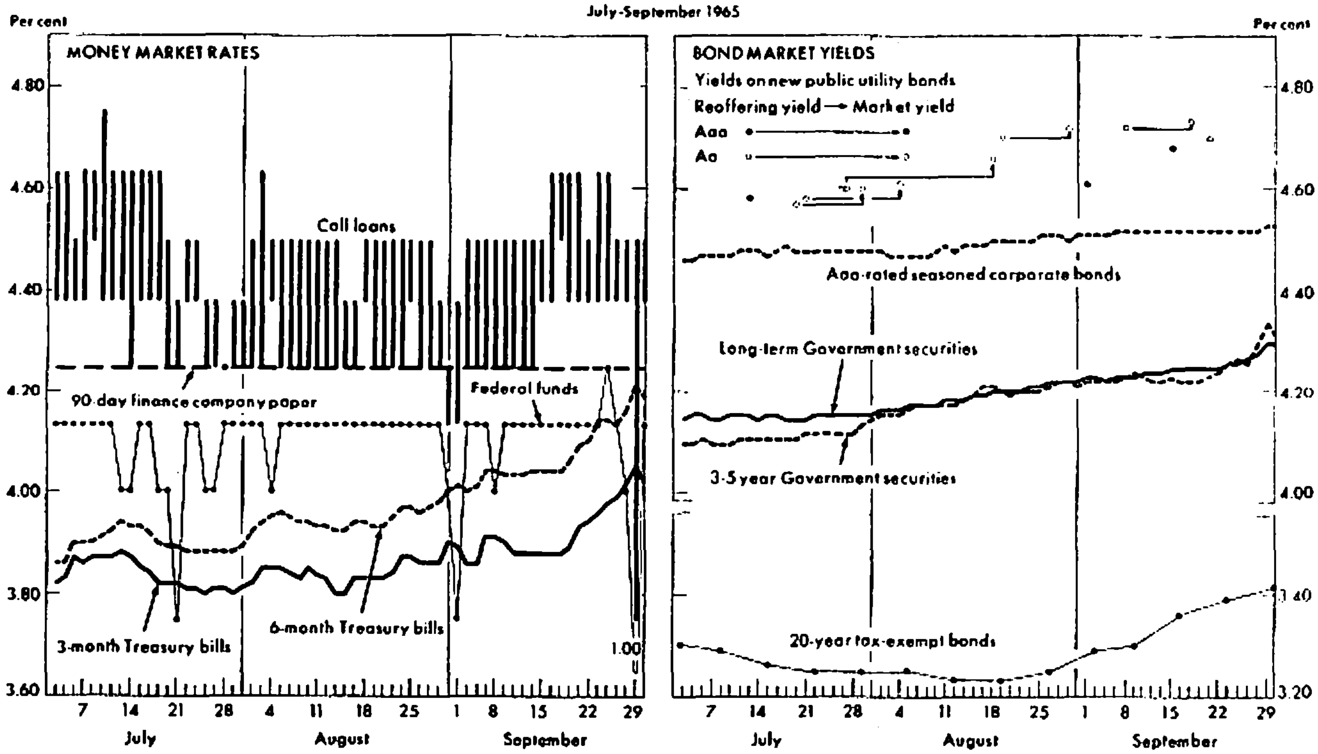
The rise in yields on corporate and tax-exempt bonds marked a continuation of the upward movement prevailing over most of the year (see Chart I). The corporate bond market, in particular, has been adjusting in 1965 to a rapid increase in corporate financing demands as investment expenditures by corporations expanded more rapidly than their internal flows of funds. A large portion of corporate needs has been accommodated by commercial bank loans, especially early in the year. Nevertheless, the volume of corporate bonds sold (either publicly or privately) has risen to almost $7.8 billion over the first nine months, compared with $6.4 billion in January-September 1964 and $8.2 billion for all of 1964. Under the influence of such a heavy volume of new corporate issues, the yields on these issues have gradually risen in spite of a continued large flow of long-term savings generated by the growing economy.

Signs of congestion began to develop in the corporate bond market as early as May. Since then, corporate bond yields have been ratchetting irregularly higher under the pressure of the corporate demand for funds. Investors, sensing the shift in demand, have shown some tendency to wait for higher yields, and changing expectations have played a major part in the 16 basis point advance in yields on new high-grade issues since May. Yields on new corporate issues have risen more rapidly than yields on long-term Government bonds, the supply of which the market judged unlikely to be increased at current rate levels. Accordingly,

Chart I

SELECTED INTEREST RATES *

July-September 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.

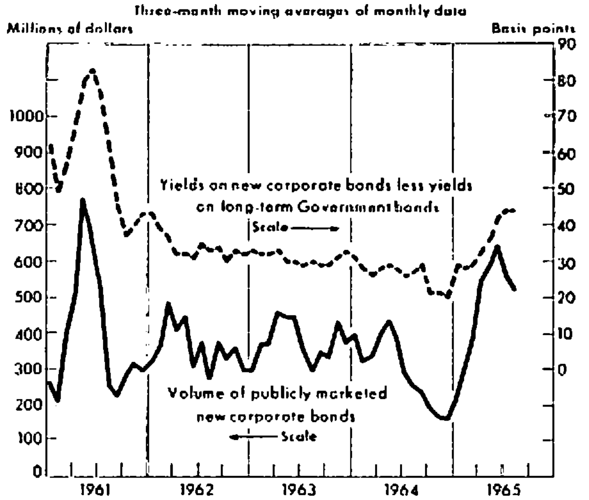
BOND MARKET YIELDS QUOTED: Yields of new Aaa- and Aa-rated public utility bonds are plotted around a line showing daily average yields of seasoned Aaa-rated corporate bonds (arrows point from underwriting syndicate reoffering yield of a given issue to market yield of the same issue immediately after 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.

Chart II

CORPORATE-GOVERNMENT BOND YIELD SPREAD AND VOLUME OF NEW CORPORATE ISSUES

Three-month moving averages of monthly data



Note: Yield spread equals average yield on new high-grade publicly offered corporate bonds, adjusted to an Aaa basis, less the yield on long-term Government bonds.

Sources: Board of Governors of the Federal Reserve System; Federal Reserve Bank of New York.

the spread between yields on new corporate bonds and those on long-term Government securities has widened (see Chart II). Although it is not unusually wide by past standards, some investment demand has been diverted from long-term Governments into the corporate sector.

Yields of new tax-exempt bonds have also risen irregularly over the year. The volume of such securities coming into the market has been large by historical standards for the past several years, and it has increased to $7.9 billion through the end of September, as against $7.4 billion for the same period in 1964. The banks' demand for such issues for their own portfolios has been considerably stronger over the first nine months of the year than in most of the previous years, but the demand of nonbank investors (including perhaps banks' purchases for their customers and trust accounts) has weakened in 1965. The lower income tax rates may well have reduced the relative attractiveness of tax-exempt issues in the case of individuals in the higher tax brackets. (For example, in comparison with common stocks, it now requires a smaller amount of expected capital gains and dividends to induce high-income individuals to divert their investment demand from tax-exempt securities into equities.)

During September, yields on both corporate and tax-exempt securities continued to move upward. New issues were floated in large volume in both markets during the month, but investors were frequently selective in committing funds. An expectation of further increases in capital spending and in corporate borrowing restrained investor demand. The prospect that banks would continue to experience heavy credit demands generated caution in the tax-exempt market. In the corporate sector, the market steadied around midmonth following the successful distribution of a large telephone issue. The market was also encouraged by the quick sellout of a large negotiated offering of a major finance company's bonds. Although several other issues met less enthusiastic receptions, prices of corporate bonds were generally steady until late in the month when prices again weakened. Over the month, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 2 basis points to 4.53 per cent.

For tax-exempt securities, investor demand was also selective, and price cutting continued as underwriters sought to distribute securities. As yields moved higher, investor buying picked up, and the tone of the market improved. Market participants remained cautious, however, and the market was edgy as the month closed. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) rose by 16 basis points over the month to 3.41 per cent (see the right-hand panel of Chart I).