# The Money and Bond Markets in January

Activity in the financial markets was considerably impeded during the early part of January by the effects of a mass transit strike in New York City which brought a halt to public subway and bus service from January 1 to January 13. The strike hampered the processing of securities transactions, slowed check-clearing operations, and handicapped the estimation and satisfaction of reserve needs. In order to alleviate some of these problems, the Federal Reserve Bank of New York requested participants in the Government securities market to avoid trading on a same-day delivery basis for the duration of the strike. On January 13, a strike settlement was reached and the financial markets quickly returned to a more normal operating basis.

The money market was generally quite firm during the early part of January when reserve distribution favored the "country" banks. This development reflected in part the usual seasonal pattern, but was accentuated by the New York City transit strike. During this period, the major reserve city banks experienced large deposit drains, amassed substantial basic reserve deficits, and bid strongly for Federal funds. In the latter part of January, however, the reserve position of the New York City banks improved and the tone of the money market eased somewhat. Treasury bill rates edged upward through midmonth, as an expanding supply of bills in the market encountered a rather modest investor demand. In the second half of the month, demand generally was strong and rates receded irregularly until late in the period when offerings expanded and bill rates rose.

Prices of Treasury notes and bonds moved higher in the first third of January in active trading which included a heavy volume of switching operations. Subsequently, activity tapered off and prices of most issues drifted irregularly lower as participants awaited the terms of the Treasury's February refunding. Late in the month, the market initially reacted favorably to the refinancing terms (see details below). Prices of outstanding intermediate-term issues moved moderately lower, however, in adjustment to the approaching increase in the supply of such issues, while prices of longer term issues also declined. Further price weakness developed as the month closed, following the resumption of United States bombing of North Vietnam. In the markets for corporate and tax-exempt bonds, prices were unchanged to slightly lower through much of the month as investors accorded lukewarm receptions to many of the period's new issues.

## THE MONEY MARKET AND BANK RESERVES

During the first two statement periods of the month, the money market functioned in the shadow of the New York City transit strike, which disrupted operations throughout the financial community. During this time, a very firm tone emerged in the money market as banks in New York City and in other reserve centers experienced fairly sizable deposit drains and mounting reserve pressures. In the statement week ended January 12, the eight principal money market banks in New York City amassed a record average basic reserve deficit of $1,358 million, while the basic reserve deficit of the thirty-eight major money market banks outside New York City was also substantial (see Table II on page 40).

To cover these deficits, the money market banks bid strongly for Federal funds and raised residual funds through borrowings from the Federal Reserve. While a good availability of Federal funds did emerge at the generally prevailing rate of 4⅝ per cent, country banks held on to a sizable volume of reserves—building up average excess reserves of more than $600 million in the week ended January 12. Average nationwide net reserve availability expanded by $349 million, as net borrowed reserves of $249 million in the statement week ended January 5 gave way to free reserves of $100 million in the week ended January 12. This sharp swing in aggregate reserve availability within the context of a generally firm money market provides another striking illustration of the inadequacy of any single statistic—such as free (or net

**Table I**

**FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1966**

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

| Factors | Changes in daily averages—week ended Jan. 5 | Jan. 12 | Jan. 19 | Jan. 26 | Net changes |
|---|---|---|---|---|---|
| **"Market" factors** | | | | | |
| Member bank required reserves* | − 337 | + 413 | + 278 | + 106 | + 460 |
| Operating transactions (subtotal) | − 55 | − 140 | + 461 | − 49 | + 217 |
| Federal Reserve float | − 347 | + 24 | + 51 | − 356 | − 628 |
| Treasury operations† | + 87 | − 56 | − 33 | − 44 | − 51 |
| Gold and foreign account | − 60 | − 11 | + 41 | − 8 | − 38 |
| Currency outside banks* | + 330 | − 14 | + 406 | + 350 | + 1,072 |
| Other Federal Reserve accounts (net)‡ | − 66 | − 81 | + 1 | + 9 | − 137 |
| Total "market" factors | − 392 | + 273 | + 739 | + 57 | + 677 |
| **Direct Federal Reserve credit transactions** | | | | | |
| Open market instruments | | | | | |
| Outright holdings: | | | | | |
| Government securities | − 24 | + 216 | − 490 | − 123 | − 421 |
| Bankers' acceptances | + 8 | — | + 1 | − 1 | + 8 |
| Repurchase agreements: | | | | | |
| Government securities | + 202 | − 101 | − 322 | — | − 221 |
| Bankers' acceptances | + 45 | − 25 | − 49 | + 35 | + 6 |
| Member bank borrowings | + 16 | + 28 | − 372 | + 134 | − 194 |
| Other loans, discounts, and advances | − 8 | − 15 | + 1 | − 2 | − 24 |
| Total | + 239 | + 104 | − 1,232 | + 44 | − 845 |
| Excess reserves* | − 153 | + 377 | − 493 | + 101 | − 168 |

| | Daily average levels | | | | |
|---|---|---|---|---|---|
| **Member bank:** | | | | | |
| Total reserves, including vault cash* | 23,267 | 23,231 | 22,460 | 22,455 | 22,853§ |
| Required reserves* | 22,954 | 22,541 | 22,263 | 22,157 | 22,478§ |
| Excess reserves* | 313 | 690 | 197 | 298 | 375§ |
| Borrowings | 562 | 590 | 218 | 352 | 431§ |
| Free reserves* | − 249 | 100 | − 21 | − 54 | − 56§ |
| Nonborrowed reserves* | 22,705 | 22,641 | 22,242 | 22,103 | 22,422§ |

| | Changes in Wednesday levels | | | | |
|---|---|---|---|---|---|
| **System Account holdings of Government securities maturing in:** | | | | | |
| Less than one year | + 601 | − 721 | − 849 | + 116 | − 853 |
| More than one year | — | — | — | — | — |
| Total | + 601 | − 721 | − 849 | + 116 | − 853 |

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 January 26.

**Table II**

**RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JANUARY 1966**

In millions of dollars

| Factors affecting basic reserve positions | Daily averages—week ended Jan. 5 | Jan. 12 | Jan. 19 | Jan. 26 | Average of four weeks ended Jan. 26 |
|---|---|---|---|---|---|
| **Eight banks in New York City** | | | | | |
| Reserve excess or deficiency(−)* | 24 | 17 | 36 | − 2 | 19 |
| Less borrowings from Reserve Banks | 170 | 289 | 66 | 61 | 147 |
| Less net interbank Federal funds purchases or sales(−) | 639 | 1,086 | 902 | − 171 | 614 |
| *Gross purchases* | *1,147* | *1,587* | *1,621* | *1,029* | *1,346* |
| *Gross sales* | *507* | *501* | *719* | *1,200* | *732* |
| Equals net basic reserve surplus or deficit(−) | − 786 | − 1,358 | − 932 | 108 | − 742 |
| Net loans to Government securities dealers | 717 | 666 | 644 | 516 | 636 |
| **Thirty-eight banks outside New York City** | | | | | |
| Reserve excess or deficiency(−)* | 25 | 28 | 23 | 17 | 23 |
| Less borrowings from Reserve Banks | 145 | 135 | 26 | 99 | 101 |
| Less net interbank Federal funds purchases or sales(−) | 507 | 696 | 956 | 938 | 774 |
| *Gross purchases* | *1,108* | *1,356* | *1,599* | *1,586* | *1,412* |
| *Gross sales* | *602* | *661* | *643* | *648* | *639* |
| Equals net basic reserve surplus or deficit(−) | − 627 | − 803 | − 959 | − 1,020 | − 852 |
| Net loans to Government securities dealers | 113 | 253 | 346 | 212 | 231 |

*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.

**Table III**

**AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS**

In per cent

| Maturities | Weekly auction dates—Jan. 1966: Jan. 3 | Jan. 10 | Jan. 17 | Jan. 24 | Jan. 31 |
|---|---|---|---|---|---|
| Three-month | 4.532 | 4.585 | 4.673 | 4.596 | 4.628 |
| Six-month | 4.718 | 4.737 | 4.770 | 4.699 | 4.740 |

| Maturities | Monthly auction dates—Nov. 1965-Jan. 1966: Nov. 23 | Dec. 23 | Jan. 25 |
|---|---|---|---|
| One-year | 4.276 | 4.731 | 4.699 |

* 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.

borrowed) reserves—as a gauge of monetary policy. A sharply contrasting picture is given by another statistic, member bank borrowings from the Reserve Banks, which changed little during the two weeks (see Table I).

With the redistribution of available reserves to the money center banks, the money market became progressively more comfortable over the week ended January 19—despite a contraction of $121 million in average nationwide net reserve availability. The basic reserve position of the major New York City banks improved markedly, though these banks remained in a deep deficit, as did the leading banks in other money centers (see Table II). However, the money market banks were able to satisfy their reserve needs readily in the Federal funds market at rates ranging from 4⅝ per cent at the beginning of the week to as low as 1 per cent at the end, and average member bank borrowings from the Federal Reserve Banks fell by $372 million to $218 million. Having built up a huge volume of excess reserves the week before, country banks reduced their average excess reserves by more than half a billion dollars to $95 million.

The money market became firmer during the final statement week of January but was less taut than it had been early in the month. The leading money market banks outside New York remained under heavy reserve pressure. They were able, however, to cover the bulk of their reserve needs in the Federal funds market where funds traded mainly in a 4¼ to 4⅝ per cent range. During this period, nationwide reserve availability held fairly steady but reserves were concentrated at country banks and in New York City. In fact, the eight major New York City banks moved into an average basic reserve surplus position of $108 million, after having run a basic reserve deficit averaging more than a billion dollars over the preceding five-week period. The comfortable reserve positions of the New York banks permitted these banks to be net suppliers of Federal funds and thus had a moderating effect on money market pressures.

Rates charged by the major New York City banks on their call loans to Government securities dealers were generally quoted in a 4¾ to 5⅛ per cent range except briefly around midmonth when rates as low as 3 per cent were posted. Rates for several types of short-term money market instruments moved upward during the period. Many of the major banks in New York City raised their offering rates on new three- and six-month negotiable time certificates of deposit by about 15 and 25 basis points, respectively. Rates on prime certificates of deposit trading in the secondary market rose by approximately 5 to 25 basis points. Offering rates on the various maturities of directly placed finance company paper and those on commercial paper rose by ⅛ of a per cent. At the end of the month, rates on commercial and finance company paper and on bankers' acceptances were generally ½ of a per cent above the rates prevailing just prior to the December increase in the Federal Reserve discount rate.

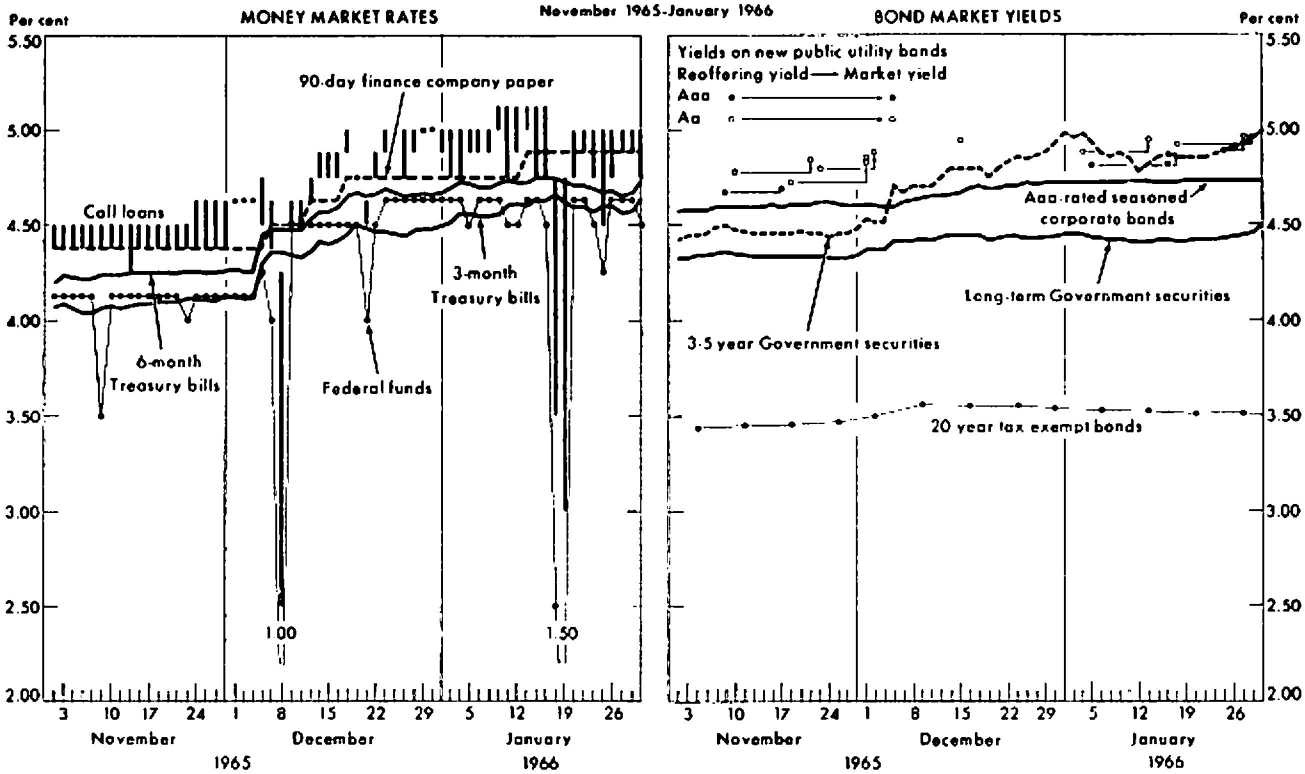
## THE GOVERNMENT SECURITIES MARKET

The effects of the early January transit crisis were particularly apparent in the market for Treasury bills, where a large proportion of transactions are normally conducted on a same-day delivery basis. Uncertainty over deliveries hampered activity and gave rise to considerable caution on the part of dealers. In addition, the supply of bills available in the market increased as commercial banks sold bills which they had held for year-end statement purposes. Moreover, the Treasury began adding $100 million to its weekly offering of three-month bills starting with the January 3 auction and also offered approximately $1.5 billion of new ten-month certificates of indebtedness on January 10 (see details below). While supplies were increasing, the demand for bills was rather limited and confined mainly to longer maturities. Some investment selling also developed, prompting professional offerings of bills. Dealer offerings were aggressively pressed upon the market, as rates on several competing money market instruments—especially new time certificates of deposit—moved upward and as higher rates on dealer borrowings tended to raise their inventory carrying costs. Against this background, Treasury bill rates edged irregularly higher through midmonth. At the regular weekly auction held on January 17, the three-month bill was sold at a record high average issuing rate of 4.673 per cent.

Subsequently, bill demand expanded—particularly for shorter maturities—partly in reflection of more comfortable conditions in the money market. Declining dealer financing costs also made professional participants less anxious sellers. As a result, bill rates edged irregularly lower from January 18 almost until the close of the month. Late in the period, some reinvestment demand for bills developed as holders of coupon issues eligible for exchange in the Treasury's February refunding switched out of "rights" into bills and other securities. Reinvestment demand proved disappointing, however, professional offerings expanded, and rates moved higher at the end of the month.

In contrast to the cautious atmosphere which was evident in the bill market early in January, a better tone developed in the coupon sector of the Government securities market during the first half of the month. Although the New York transit strike interfered with operations, fairly

SELECTED INTEREST RATES*




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.

active trading in Treasury notes and bonds was reported. Large-scale investment switching dominated activity, while outright demand for issues maturing in over one year also triggered professional short covering. The more confident atmosphere was reinforced when market participants reacted quite favorably to the Treasury's January 5 announcement that it would receive subscriptions on January 10 for approximately $1.5 billion of 4¾ per cent certificates of indebtedness dated January 19, and would permit commercial banks to pay for their allotments by crediting Treasury Tax and Loan Accounts. The new certificates, which will mature on November 15, 1966, were priced at a discount to yield 4.85 per cent. Subscriptions totaled about $10.1 billion, of which $1.65 billion was accepted by the Treasury. Subscriptions for $50,000 or less were allotted in full, while larger subscriptions were subject to a 14.5 per cent allotment but assured of a minimum award of $50,000. As the moderate amount of investment demand met limited supplies, prices of notes and bonds rose during the first third of January, with gains on most issues maturing in over one year ranging from about ⅛ to ½ a point. (The right-hand panel of the chart illustrates the decline in yields which resulted from this rise in bond prices.)

Around midmonth, investment demand contracted, there was some outright selling of short- and intermediate-term issues, and prices drifted lower. The market was little affected by the Administration's forecast of a reduced Federal deficit for the fiscal year beginning on July 1, while predictions of continued buoyancy in the economy rekindled market apprehensions that future credit demands might apply upward pressures on interest rate levels. Subsequently, market activity subsided and prices of most intermediate- and long-term issues declined irregularly as investors awaited news of the Treasury's February refunding plans.

After the close of business on January 26, the Treasury announced that it would offer holders of $28.8 billion of notes and bonds maturing from February through August 1966 the opportunity to exchange their holdings for two new note issues. Holders of the outstanding 3⅝ per cent and 3⅞ per cent notes maturing on February 15 and 1½ per cent notes maturing on April 1 were permitted to convert these securities into 4⅞ per cent notes of August 15, 1967 and/or into 5 per cent notes of November 15, 1970. In addition, holders of the 4 per cent notes and 3¾ per cent bonds coming due on May 15, as well as holders of the 4 per cent notes and 3 per cent bonds of August 15, were allowed to exchange their holdings for the new 5 per cent notes of November 1970. Of the maturing securities eligible for exchange, $13.7 billion was held by the public at the time of the announcement and $15.1 billion was held by the Federal Reserve and Government Investment Accounts. Subscription books were open from January 31 through February 2, with settlement scheduled for February 15. The terms of the refinancing were initially favorably received by market participants. Prices of outstanding intermediate- and long-term issues moved lower, however, partly in response to the forthcoming additions to market supplies. A further sharp decline in prices occurred on the final day of the month in reaction to developments in Vietnam.

### OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt bonds were generally steady to moderately lower over most of the month. Investor interest in new issues was restrained by the expanding volume of scheduled flotations and expectations that yields might edge higher in the expansive economic environment. In the tax-exempt sector, where a seasonally moderate volume of new issues had been marketed in December, new offerings encountered a good reception early in the month but were less well received later. New corporate bonds, many of which were aggressively bid for by underwriters and carried somewhat higher prices than had recently prevailed, were accorded a rather selective investor response. During the month, several corporate bond syndicates terminated price restrictions, and yields adjusted upward by 4 to 6 basis points on the sizable unsold balances.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 1 basis point to 4.74 per cent, while *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) declined by 3 basis points to 3.51 per cent (see the right-hand panel of the chart). These indexes are, however, based on only a limited number of issues and do not necessarily reflect market movements fully.