The Money and Bond Markets in March

The money market displayed a firm tone during March. Net reserve availability in the banking system was reduced somewhat during the month and, with member banks unable to cover all their reserve needs in the Federal funds market, borrowings from the Reserve Banks averaged somewhat higher than in the preceding two months. While many observers had expected a considerable buildup of tension in the money market around the mid-March quarterly corporate dividend and tax dates, the pressures turned out to be unusually mild and were weathered without difficulty.

In response to the persistent strength of loan demands and to advances in open market rates, the major commercial banks raised the rate charged prime business borrowers to 5½ per cent from 5 per cent on March 10. This move triggered further upward adjustments in several closely allied market rates, including those on commercial paper placed by dealers and directly placed finance company paper. Rates on new negotiable time certificates of deposit issued by commercial banks also moved higher during the month, as banks replaced the $4.1 billion of certificates maturing over the month as a whole. Rates on Treasury bills, on the other hand, dropped back rather sharply through much of the month from the heights to which they had risen in February. Only a modest amount of bills were returned to the market from maturing corporate repurchase agreements around the dividend and tax dates, and a persistent demand for bills pressed steadily against the very limited supply of most issues available in the market.

The tone of the bond markets improved considerably in March. Prices of Treasury coupon issues rose sharply for the first time since early January, as participants gradually took heart from the apparently growing support for Federal tax increases to combat inflationary pressures. The market was already in a very strong technical position and, as sentiment changed, professional short-covering operations were a major factor in the ensuing advance in prices. The month closed on a strong note in the wake of a statement by President Johnson that a "modest" tax increase might prove necessary. In the markets for corporate and tax-exempt bonds, a very large volume of new offerings was bought by investors at declining yields. The postponement of several large scheduled flotations also removed a good portion of the immediate supply pressures from the market. As a result, except for a brief pause after the prime rate announcement, prices of many corporate and tax-exempt bonds edged higher during the remainder of the month.

THE MONEY MARKET AND BANK RESERVES

The money market displayed a generally firm tone in March, and most Federal funds transactions took place at a 4⅝ per cent rate, with some trading occurring at rates as high as 4¾ per cent. After rising somewhat in the December-January period and falling back again in February, average nationwide bank reserve availability contracted somewhat further in March. Reserve needs, which member banks could not fully satisfy in the Federal funds market, spilled over in the form of expanded borrowings from the Federal Reserve (see Table I). System open market operations supplied $315 million of reserves from the last week of February to the final week of March, but this amount did not fully offset the reserve drains which resulted from the net effect of changes in "market" factors. On average, the major banks in New York City were in basic reserve surplus during the month (see Table II), as they first prepared for possible pressures around the dividend and tax dates, then found the pressures rather mild, and finally experienced quick repayment of loans after the dates had passed. Weekly reporting member banks had about $4.1 billion of negotiable time certificates of deposit reaching maturity during the month with some $1 billion maturing on the dividend and tax dates alone. By making their rates on new time certificates of deposit more attractive, the banks were successful in replacing the maturing certificates with new ones. Indeed, they even made progress in preparation for heavy maturities scheduled for April. As a result of these various factors, considerably less strain was experienced in the money market during the dividend and tax period than many observers had expected a few weeks earlier.

The first part of March was marked by a continua-

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MARCH 1966

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

Factors	Changes in daily averages—week ended March 2	March 9	March 16	March 23	March 30	Net changes
"Market" factors						
Member bank required reserves*	− 115	+ 138	− 73	− 263	+ 126	− 187
Operating transactions (subtotal)	+ 123	− 521	+ 176	+ 274	− 294	− 242
Federal Reserve float	− 67	− 195	− 38	+ 346	− 340	− 300
Treasury operations†	+ 53	+ 227	+ 93	− 177	− 103	+ 99
Gold and foreign account	− 6	− 22	− 23	+ 11	− 67	− 107
Currency outside banks*	+ 142	− 527	+ 39	+ 16	+ 226	− 54
Other Federal Reserve accounts (net)‡	+ 1	− 2	+ 49	+ 78	− 4	+ 122
Total "market" factors	+ 8	− 383	+ 103	+ 11	− 168	− 429
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	− 72	+ 273	− 78	− 41	+ 194	+ 281
Bankers' acceptances	− 1	—	+ 3	+ 2	—	+ 3
Repurchase agreements:						
Government securities	—	—	+ 47	− 47	—	—
Bankers' acceptances	+ 14	+ 27	+ 2	+ 17	− 30	+ 31
Member bank borrowings	− 56	+ 150	− 78	+ 66	− 94	− 12
Other loans, discounts, and advances	—	—	—	+ 1	− 1	—
Total	− 114	+ 451	− 101	− 1	+ 69	+ 304
Excess reserves*	− 106	+ 68	+ 2	+ 10	− 99	− 125

	Daily average levels					
Member bank:						
Total reserves, including vault cash*	22,116	22,040	22,121	22,394	22,169	22,168§
Required reserves*	21,823	21,685	21,758	22,021	21,895	21,836§
Excess reserves*	293	261	363	373	274	333§
Borrowings	464	614	536	602	508	545§
Free reserves*	− 171	− 253	− 173	− 229	− 234	− 212§
Nonborrowed reserves*	21,652	21,432	21,585	21,792	21,661	21,624§

	Changes in Wednesday levels					
System Account holdings of Government securities maturing in:						
Less than one year	+ 60	+ 291	+ 60	+ 110	− 34	+ 486
More than one year	—	—	+ 1	+ 9	—	+ 10
Total	+ 60	+ 291	+ 61	+ 119	− 34	+ 496

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 March 30.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MARCH 1966

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended March 2	March 9	March 16	March 23	March 30*	Average of five weeks ended March 30*
Eight banks in New York City						
Reserve excess or deficiency(−)†	19	7	79	10	9	25
Less borrowings from Reserve Banks	—	21	21	110	21	35
Less net interbank Federal funds purchases or sales(−)	− 16	− 154	194	26	− 306	− 51
Gross purchases	*1,035*	*869*	*1,166*	*1,002*	*1,013*	*1,017*
Gross sales	*1,050*	*1,023*	*972*	*976*	*1,319*	*1,068*
Equals net basic reserve surplus or deficit(−)	35	140	− 137	− 127	294	41
Net loans to Government securities dealers	405	382	519	347	462	423
Thirty-eight banks outside New York City						
Reserve excess or deficiency(−)†	25	18	45	19	25	26
Less borrowings from Reserve Banks	87	184	112	206	108	139
Less net interbank Federal funds purchases or sales(−)	660	588	512	684	530	595
Gross purchases	*1,438*	*1,318*	*1,476*	*1,534*	*1,373*	*1,428*
Gross sales	*777*	*730*	*963*	*850*	*843*	*833*
Equals net basic reserve surplus or deficit(−)	− 722	− 753	− 579	− 871	− 613	− 708
Net loans to Government securities dealers	159	90	169	186	213	163

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—March 1966: March 7	March 14	March 21	March 28
Three-month	4.620	4.718	4.576	4.555
Six-month	4.816	4.915	4.776	4.755

Maturities	Monthly auction dates—January-March 1966: January 25	February 23	March 24
One-year	4.699	4.945	4.739

* 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.

tion of the intraweekly pattern of movements that had developed during the latter part of February. In each of these weeks, signs of tautness emerged on Thursday and Friday, with Federal funds trading at a ¼ percentage point premium above the discount rate. The Federal Reserve sought to head off these pressures by injecting reserves through open market operations, but member banks still saw their reserves falling somewhat short of needs and thus tended to borrow heavily from their Reserve Banks over the weekends. Then, as excess reserves —augmented by such borrowings—spilled into the market after the weekends, a more comfortable atmosphere emerged, and the Federal Reserve sold securities to absorb the reserve surplus.

Such a pattern was particularly noticeable in the week ended March 16, which included both the dividend and tax dates. In anticipation of the possible credit demands around the tax date, member banks borrowed more than $800 million from the Federal Reserve Banks over the March 12-13 weekend. Toward the end of the period the excess reserves thus accumulated flooded the central money market. With reserves in great abundance despite the credit and deposit expansion which occurred over the tax date—as evidenced by a nearly $600 million increase in member bank required reserves during the week— Federal funds, which had traded at 4⅝ per cent and at 4¾ per cent before the weekend, went begging at ¾ of a per cent toward the close of the week.

The large credit demands of the dividend and tax period unwound at an unusually rapid pace in the statement period ended March 23. The money market banks experienced a swift reduction in their loans to Government securities dealers, and sizable repayments also occurred in other loan categories. In addition, the New York City banks continued to attract new negotiable certificates of deposit at rates ranging as high as 5½ per cent on 1967 maturities. During this period, however, the money market was quite firm. Federal funds traded mainly in a 4⅝ to 4¾ per cent range, and average member bank borrowings from the Federal Reserve rose to $602 million. Nationwide reserve availability contracted as market factors absorbed a larger volume of reserves than had generally been expected, while the injection of reserves by System Account after the weekend was hindered by scarcities in the market supply of Treasury bills and short-term coupon issues. System operations were minimal in the last statement week, and net borrowed reserves remained essentially unchanged. Weekly reporting member banks increased their loans and investments sharply, and banks in the central money market maintained comfortable reserve positions.

Just before the prime rate increase, dealers in bankers' acceptances raised their rates on several maturities by ⅛ of a per cent. Subsequent to the March 10 increase in the prime rate, a number of other money market rates adjusted upward. By the end of the month, rates on commercial paper placed by dealers were ⅜ per cent higher, and finance company paper rates had been marked up by ¼ of a per cent. In addition, most of the major New York City banks had raised their offering rates on new negotiable time certificates of deposit by ⅛ to ¼ of a per cent, with 5¼ per cent the most frequently posted rate on new three- to six-month certificates. As a result, the principal New York City banks managed to increase the volume of their certificates of deposit outstanding by almost $350 million during the five-week period ended March 30.

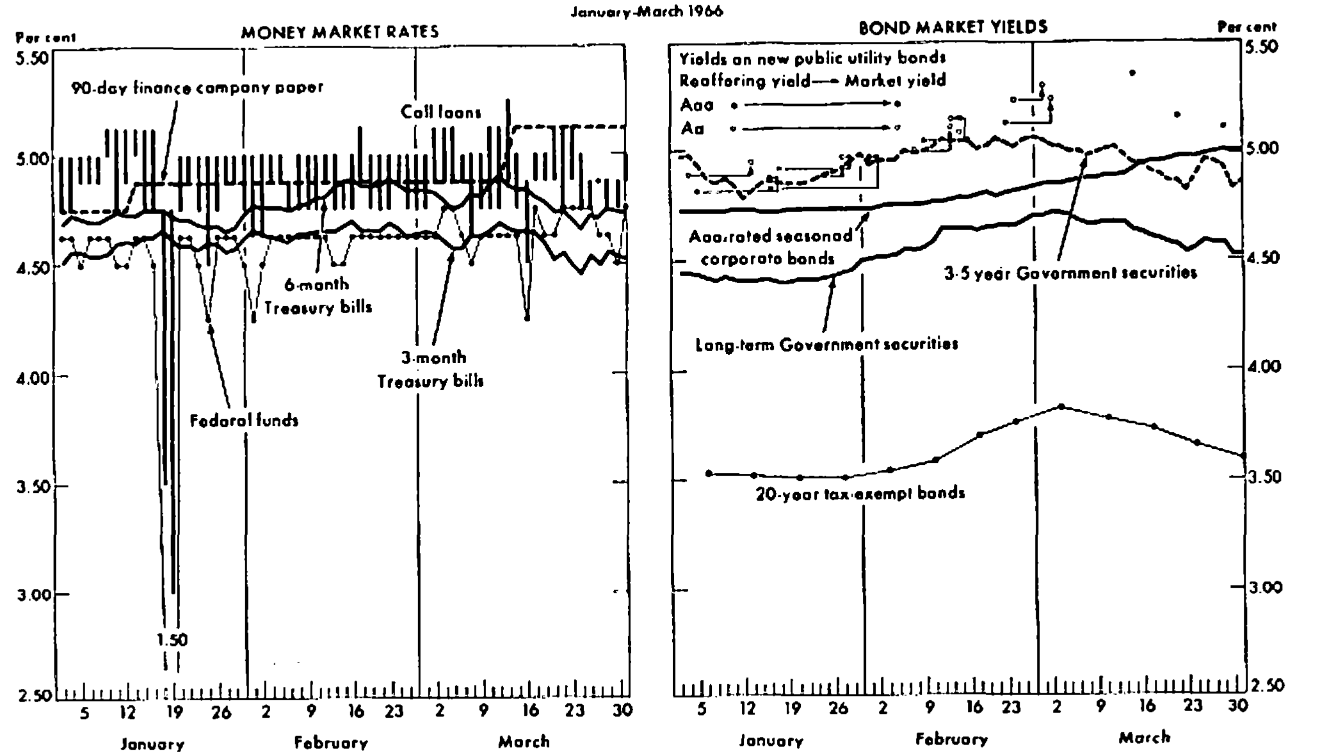
THE GOVERNMENT SECURITIES MARKET

The price decline in the coupon sector of the Government securities market that had extended over the first two months of 1966 came to a halt in early March, and a much better atmosphere emerged as the month progressed. At the beginning of the month, dealers had trimmed their inventories to very small proportions and, in fact, had a sizable net short position in issues maturing in more than one year. Then, as market sentiment changed in response to the widespread discussion in the press and elsewhere of the need for more restrictive fiscal measures to contain inflation, professionals began to cover their short positions. The coupon sector also reacted favorably to the sharp decline in stock market prices then taking place. A modest investment demand for Treasury notes and bonds also developed, primarily from institutional investors. With the market supply of most Treasury issues very thin, bond prices moved sharply upward. (The right-hand panel of the chart illustrates the decline in yields which accompanied this rise in prices.)

The advance was temporarily interrupted on March 10 and 11 when dealers cautiously marked prices of intermediate- and long-term issues lower, in reaction to the long-expected news of the prime loan rate rise and to the publication of data indicating a somewhat deeper level of nationwide net borrowed reserves. Little investor selling developed, however, and a strong market tone quickly reappeared with prices of coupon issues moving up once more. The postponement of several corporate and tax-exempt flotations—including a huge tax-exempt bond issue which had been scheduled for March 17—also encouraged the market for Government securities, as did the success of the issues that were floated, including a large issue of participation certificates sold by the Federal National Mortgage Association. These postponements

SELECTED INTEREST RATES*

January-March 1966



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, 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.

moderated the current demand for funds from the capital markets and triggered the release of funds which investors had earmarked for the purchase of the various postponed issues. The price rally in the coupon sector temporarily faltered on March 24 and 25, when the market reacted hesitantly to the latest banking statistics indicating a further decline in nationwide reserve availability and a gold outflow. Moderate investment selling stimulated increased professional offerings, and prices of most issues declined rather sharply. Subsequently, however, prices rebounded as the market reacted to the good reception accorded a $250 million American Telephone and Telegraph Company bond flotation and to President Johnson's comments on the possibility of a future tax increase.

In the market for Treasury bills, an excellent tone persisted in March, primarily reflecting an unseasonable scarcity in the market availability of many bill issues. Early in the period, rates for most issues trended lower when a broadly based buying interest—particularly from public funds—encountered limited offerings (see the left-hand panel of the chart). An undertone of caution was evident during this period, however, as traders anticipated the usual increase in the supply of bills over the approaching March dividend and tax period. In the wake of the March 10 increase in the prime loan rate and news of the contraction in nationwide reserve availability during the March 9 statement period, bill rates briefly jumped higher, largely reflecting the wary reaction of professional participants. Soon, however, bill rates dropped again, as a steady investment demand confronted growing market scarcities. Both March 10, a popular dividend payment date, and the midmonth corporate tax payment date passed without the appearance of any real pressures in the bill market. In fact, the amount of securities returned to dealers on March 10 and March 15 from maturing corporate repurchase agreements was somewhat less than in March 1965, and considerably less than in the intervening quarterly dividend and tax dates. Bill rates continued to edge lower during the remainder of the month, in response to a good demand from public funds and from commercial banks purchasing securities in preparation for the Cook County tax date and for end-of-quarter statements.

United States Government-sponsored agencies sold $2.2 billion in new securities during March, raising over $1.1 billion in new money. Rates on new issues moved higher under the weight of these offerings until around midmonth when a $410 million offering of Federal National Mortgage Association participation certificates was very well received. The Commodity Credit Corporation auctioned, on March 30, $500 million of 117-day "certificates of interest" in a pool of its price-support loans on agricultural commodities. The certificates, which were issued on April 6 and will mature on August 1, were sold at an average issuing rate of 5.194 per cent.

OTHER SECURITIES MARKETS

The deeply cautious undertone, which had permeated the corporate and tax-exempt markets during much of the year, carried over into the early part of March as investors apprehensively awaited a heavy calendar of scheduled offerings. During this period, the continuing terminations of syndicate price restrictions on slow-moving corporate and tax-exempt issues produced substantial upward adjustments in reoffering yields. These adjustments, however, generated increased investor demand and enabled dealers to make large reductions in their inventories of older bonds.

Subsequently, the successful marketing of several new corporate and tax-exempt bond issues, priced in line with the prevailing higher yields, reinforced the growing impression that yields had at last climbed to a point at which investors were prepared to commit a large volume of funds. There was also increasing evidence of developing borrower resistance to the mounting interest charges. Several offerings were canceled or postponed during the month, the most important of them being the $440 million New Jersey Turnpike issue which had been scheduled for March 17 and would reportedly have been the largest tax-exempt bond flotation in United States financial history. With both demand and supply factors contributing to an improved market tone, prices of many corporate and tax-exempt bonds edged higher during the remainder of the month. After the Turnpike issue was postponed, investors began to turn loose funds which they had stockpiled for that issue and for other postponed flotations. As a result, dealers made good progress in reducing their inventories of corporate and tax-exempt bonds, while new issues which were subsequently marketed were accorded generally good receptions. By the end of March the Blue List of dealers' advertised inventories of tax-exempt issues had declined by $200 million to $333 million. In the corporate sector, the long awaited $250 million American Telephone and Telegraph issue was marketed late in the month. The issue, which consisted of Aaa-rated 5⅛ per cent debentures maturing in 2001, was reoffered to yield 5.11 per cent and was very well received.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 15 basis points to 4.99 per cent, while, *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) fell by 17 basis points to 3.59 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.