The Money and Bond Markets in April

The money market became firmer in April, and interest rates on many short- and long-term instruments moved irregularly upward. Bank reserve positions were under pressure during the month, as a continuing strong demand for credit pressed against a somewhat lower average level of nationwide net reserve availability. Reserve needs of the money center banks in particular expanded sharply during the first three weeks of April, which included the midmonth Federal income tax date. As a result, Federal funds were widely sought at rates generally above the discount rate and member bank borrowings from the Federal Reserve increased. For the first time, a significant amount of trading in Federal funds took place at 4⅞ per cent, ⅜ of a per cent above the discount rate. Toward the end of April, reserve distribution shifted in favor of the money center banks and market conditions became a little less taut.

Treasury bill rates, which had already begun to back away from their March lows in the final week of that month, continued to adjust upward on balance during April. A fairly good demand for bills persisted during the month, but dealers were willing sellers through most of the period as they hesitated to allow positions to build up in the face of high financing costs.

In the bond markets, prices retreated in April from the higher levels to which they had climbed in March. Market participants reacted to the continued heavy flow of financing in the capital markets, including the market for Government agency issues, as well as to uncertainties over the possibility of a tax increase and the future course of interest rates. Trading activity in Treasury notes and bonds was quite light on most days of the month. By the end of the period, the upward drift in yields had erased a good part of the March decline. The Treasury's announcement in late April of the terms of its May refunding was in line with expectations and thus had little effect on overall market sentiment, although investor response to the offering was quite restrained.

THE MONEY MARKET AND BANK RESERVES

A noticeably firmer tone emerged in the money market during April. While the level of nationwide net borrowed reserves fluctuated somewhat on a week-to-week basis, the average for the month as a whole—$281 million (see Table I)—was higher than the $209 million (revised) average in March. Member bank borrowings from the Federal Reserve also expanded during April—rising by $93 million on average—as banks with reserve deficits turned increasingly to the "discount window" to fill residual reserve needs which had gone unsatisfied in the Federal funds market.

Against the background of a contraction in nationwide reserve availability, there was a pronounced tightening in

Table I

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

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

Factors	Changes in daily averages—week ended				Net changes
	April 6	April 13	April 20	April 27	
"Market" factors					
Member bank required reserves*	−137	−17	−191	−5	−350
Operating transactions (subtotal)	−332	+170	+651	−157	+332
Federal Reserve float	−104	+232	+307	−168	+247
Treasury operations†	+257	+194	−132	−191	+128
Gold and foreign account	−37	+15	+11	+13	+2
Currency outside banks*	−441	−312	+367	+211	−175
Other Federal Reserve accounts (net)‡	−8	+41	+99	−4	+128
Total "market" factors	−469	+153	+460	−162	−18
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+274	+8	−486	+145	−59
Bankers' acceptances	−1	+1	—	—	—
Repurchase agreements:					
Government securities	+145	−111	−34	—	—
Bankers' acceptances	−21	−4	−6	+43	+12
Member bank borrowings	+115	−20	+82	−43	+134
Other loans, discounts, and advances	—	—	+1	+3	+4
Total	+512	−126	−445	+149	+91
Excess reserves*	+44	+27	+15	−13	+73
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	22,358	22,402	22,608	22,600	22,492§
Required reserves*	22,025	22,042	22,233	22,238	22,135§
Excess reserves*	333	360	375	362	357§
Borrowings	623	603	685	642	638§
Free reserves*	−290	−243	−310	−280	−281§
Nonborrowed reserves*	21,735	21,799	21,923	21,958	21,854§
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+655	−124	−1,084	+746	+193
More than one year	—	—	—	+24	+24
Total	+655	−124	−1,084	+770	+217

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 April 27.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS APRIL 1966

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended				Average of four weeks ended April 27*
	April 6	April 13	April 20	April 27*	
Eight banks in New York City					
Reserve excess or deficiency(−)†	15	37	8	75	34
Less borrowings from Reserve Banks	54	28	157	113	88
Less net interbank Federal funds purchases or sales(−)	107	863	822	334	532
Gross purchases	*964*	*1,377*	*1,310*	*981*	*1,158*
Gross sales	*856*	*514*	*488*	*647*	*626*
Equals net basic reserve surplus or deficit(−)	−146	−854	−970	−372	−586
Net loans to Government securities dealers	658	1,067	1,002	840	892
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)†	16	46	21	8	23
Less borrowings from Reserve Banks	203	164	160	59	147
Less net interbank Federal funds purchases or sales(−)	445	338	406	239	357
Gross purchases	*1,357*	*1,390*	*1,359*	*1,289*	*1,349*
Gross sales	*912*	*1,052*	*954*	*1,050*	*992*
Equals net basic reserve surplus or deficit(−)	−633	−456	−544	−290	−481
Net loans to Government securities dealers	268	353	489	472	396

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—April 1966			
	April 4	April 11	April 18	April 25
Three-month	4.531	4.618	4.664	4.630
Six-month	4.719	4.763	4.754	4.730

Maturities	Monthly auction dates—February-April 1966		
	February 23	March 24	April 26
One-year	4.945	4.739	4.773

* 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.

the reserve positions of banks in the central money market during the first three weeks of April (see Table II). City banks experienced a substantial increase in their total loans and investments during this period. In part, this reflected an increase in bank holdings of securities and a sharp rise in securities loans, as dealers—including dealer banks—expanded their inventories. In addition, the deposits initially created at the money center banks as the counterpart of loans made for the settlement of early-month business needs subsequently became widely dispersed throughout the banking system.

In order to cover their mounting reserve deficiencies, the money market banks bid aggressively for Federal funds. Reflecting both the strong demand and reduced supply, the bulk of transactions in this market was completed at a 4¾ per cent rate during the month, ⅛ of a per cent above the rate which had predominated in March. Early in the month and for a few days following the midmonth tax date, a substantial volume of funds was transferred at 4⅞ per cent, marking the first period in which Federal funds had traded at a ⅜ of a per cent "premium" over the Federal Reserve discount rate.

Money market pressures became particularly strong shortly after midmonth. The April 15 tax date itself passed smoothly as banks in the central money market benefited from an inflow of corporate deposits accumulated to cover tax checks written on that day. Following the tax date, however, reserve needs began to intensify in the money center banks. The Treasury initially used part of the tax checks it received drawn on the commercial banks to build up its deposits at the Federal Reserve Banks since these balances had fallen to abnormally low levels. As a result, Treasury redeposits of tax receipts in commercial bank Tax and Loan Accounts lagged behind the pace expected in the market. Meanwhile, bank loans continued to remain at a high level, particularly loans to nonbank financial institutions and to securities dealers needing alternative sources of financing to replace corporate repurchase agreements that had matured. With banks unable to cover all their needs in the Federal funds market, borrowings from the Reserve Banks on the final day of the April 20 statement week swelled to $1,587 million.

In the final statement period of the month, the tautness of the money market relaxed somewhat. The money market banks, managing their reserves very cautiously in the wake of the extreme pressures which had existed at the end of the preceding week, borrowed heavily early in the period both in the Federal funds market and from the Federal Reserve. Following the April 23-24 weekend, the excess reserves accumulated by the city banks in this way, together with a supply of excess reserves from "country" banks, piled up in the money market. As a result, the effective rate on Federal funds declined from 4⅞ per cent at the beginning of the statement period to 3 per cent at the close when funds were offered at rates as low as ¼ per cent.

Although the money market banks experienced substantial reserve pressures during much of the month, they were quite successful in replacing the large volume of time certificates of deposit reaching maturity at rates that were little changed from March. Indeed, the volume of such certificates outstanding at the weekly reporting member banks actually climbed in April. There were reports that a considerably broader list of customers was entering the C/D market than in earlier months, with public funds in particular playing a growing role.

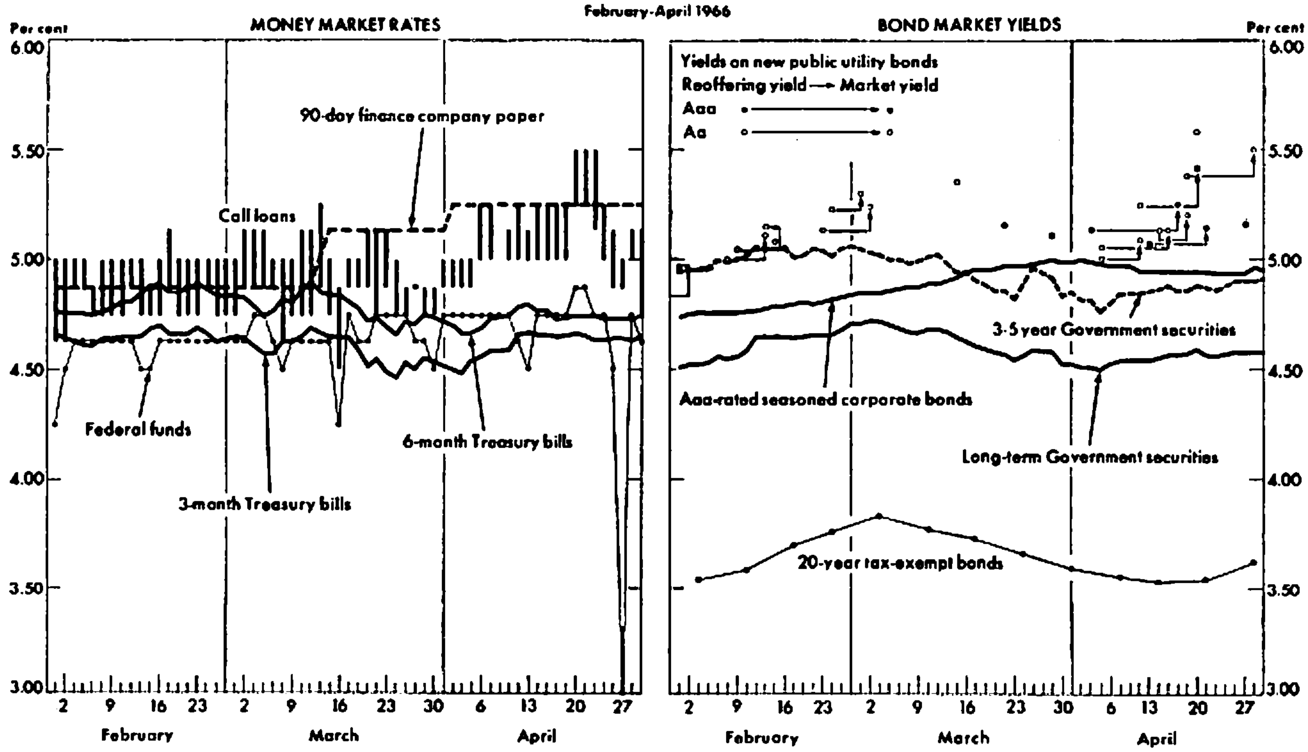
THE GOVERNMENT SECURITIES MARKET

Following the strong March recovery in the bond markets during which prices of Treasury coupon issues had advanced sharply, prices of intermediate- and long-term coupon issues fell back irregularly in April. (The right-hand panel of the chart on page 112 illustrates the rise in yields which accompanied this decline in prices.) Activity was generally quite light and was dominated by professional participants. Although a cautious atmosphere developed at a number of points during the period, price changes on most days were relatively modest and the market showed signs of resistance to any pronounced downward price movement.

In the early days of the month, Government bond traders were encouraged by the fairly good tone then prevailing in the corporate sector, as well as by comments from the Secretary of the Treasury that any potentially unhealthy aspects of bank credit growth might better be remedied by judicious bank lending policies than by further increases in interest rates. Subsequently, a note of hesitancy appeared in the coupon sector when participants increasingly focused on the heavy calendar of Government agency offerings, the softening tone in the corporate sector, and the uncertain political situation in Vietnam. In addition, the market was affected by the announcement on April 12 that the Federal Housing Administration was increasing from 5½ per cent to 5¾ per cent the maximum interest rate permitted on mortgages it insures. (The Veterans Administration also made the same rate change on mortgages it guarantees.) Against this background, professional offerings of coupon issues were augmented by limited investment selling, including bank offerings, and prices of notes and bonds generally edged lower from April 6 through midmonth.

SELECTED INTEREST RATES*

February-April 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 on new Aaa- and Aa-rated public utility bonds are plotted around a line showing daily average yields on seasoned Aaa-rated corporate bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); daily averages of yields on 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 on 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.

Over the following few days, reports of a large rise in gross national product during the first quarter of 1966 apparently led some professional traders to feel that the chances for a Federal tax increase to combat inflationary pressures might be strengthening. Investor interest in coupon issues remained light, however, and prices continued to drift irregularly lower. In the final statement period of the month, prices fluctuated narrowly and activity was quite light. Considerable uncertainty developed over the prospects for a tax increase, and participants awaited news of the terms of the Treasury's May refunding.

After the close of business on April 27, the Treasury announced that it would offer holders of $9.3 billion of notes and bonds maturing on May 15 the right to exchange them for new eighteen-month 4⅞ per cent notes dated May 15, 1966 and maturing on November 15, 1967. The new notes were priced at 99.85 to yield about 4.98 per cent. Subscription books were open from May 2 through May 4, with payments and deliveries scheduled for May 16. Market participants viewed the exchange as routine. With initial interest in the offering restrained, trading in the refunding issues was quite moderate on the final two business days of the month. During the same period, prices of outstanding issues edged lower.

In the market for Treasury bills, the basically firm undertone which had been evident in March generally carried over into the first part of April when a fairly strong demand persisted. Rates on the very short-dated bills did move up in the opening days of the month, however, as dealers anticipated a heavy expansion in the available market supply of bills following the March 31 quarterly commercial bank statement date and the April 1 Cook County, Illinois, personal property tax date. However, offerings expanded less than expected and were readily absorbed. At the same time, a good demand for longer bill maturities emerged from a broad spectrum of investors, and rates on most of these issues edged lower through April 5 (see the left-hand panel of the chart).

A more cautious atmosphere developed in the bill sector during the following week. Increased dealer offerings were prompted by the emerging higher level of inventory financing costs and by expectations that market pressures would heighten over the April 15 corporate tax date. In this setting, bill rates moved higher from April 6 through April 13. Subsequently, the rather moderate bill sales from corporations raising funds for their midmonth tax payments and from other sources were absorbed without strain, and dealer offerings tapered off. A fairly strong demand for bills reemerged after midmonth, including large purchases by state and local government funds. At the same time, traders began to anticipate the appearance of some reinvestment demand for bills from sellers of "rights" to the Treasury's May refunding. Against this background, bill rates edged irregularly lower from April 14 through April 28. Bill rates rose again at the close of the month, however, when reinvestment demand connected with the refunding proved disappointing and dealer offerings expanded. Over the month as a whole, bill rates were generally 4 to 25 basis points higher, with the largest increases reported in the shortest maturities.

A substantial volume of new securities was sold in April by agencies of the United States Government, including the Federal Intermediate Credit Bank, the Federal Home Loan Banks, and the Federal Land Banks. Agency offerings totaled approximately $1.9 billion, of which a substantial $660 million represented new money. Yields on the agency issues were generally attractive, compared with rates on competing market instruments. However, in anticipation of a heavy future calendar of such issues, investors tended to proceed with caution before committing their funds. While the offerings eventually found buyers, dealer inventories of agency issues bulged quite substantially at times.

OTHER SECURITIES MARKETS

In the market for corporate bonds, prices were generally steady to slightly higher during the first statement week in April. Dealer inventories remained at relatively low levels during this period and, as a result, underwriter bidding for new corporate offerings was quite aggressive. At the lower reoffering yields, however, investor demand became selective. Subsequently, additions to the calendar of scheduled offerings were made and the volume of current corporate bond flotations expanded. Against this background, the new offerings encountered considerable investor resistance. Syndicate price restrictions were removed fairly quickly on most of the recent corporate issues, after which yields were adjusted higher by as much as 10 to 15 basis points before attracting some investor demand. (The right-hand panel of the chart illustrates this rise in yields.)

In the tax-exempt sector, prices held generally steady through midmonth. New issues were accorded mixed investor receptions. Later in the period, however, the volume of new offerings and the calendar of scheduled tax-exempt flotations expanded, and investors became more reluctant to commit their funds at the prevailing price levels. As a result, dealers in tax-exempt bonds made little headway in reducing their unsold balances of recent issues—even after making price concessions. By the end of April, the Blue List of dealers' advertised inventories of tax-exempt issues had risen by $190 million to $523 million. The largest new tax-exempt flotation of the month, a huge $242 million New York City offering of various-purpose bonds, reached the market on April 28. Reoffered to yield from 3.60 per cent in 1967 to 4.16 per cent in 1996, the issue was accorded a good investor reception.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds declined by 4 basis points to 4.95 per cent, while *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) rose by 3 basis points to 3.62 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.