The Money and Bond Markets in July

The money market was generally firm during July, although there was some temporary easing at the end of the statement periods. The airline strike resulted in a large bulge in Federal Reserve float around midmonth, which also eased the pressure on bank reserve positions for a short time. The Federal Reserve was able to offset the reserve effects with minimal market impact, however, using for the first time sales of Treasury bills with matched purchases of the same bills for delivery several days later. Federal funds traded at rates as high as 5¾ per cent, the first trading recorded at a 1¼ per cent "premium" over the Federal Reserve discount rate. Major New York City banks reportedly continued to pay the ceiling rate of 5½ per cent for negotiable certificates of deposit with maturities as short as thirty days. Effective July 14, dealers in bankers' acceptances raised their rates by ⅛ of a percentage point. The new rates—5¾ per cent bid and 5⅝ per cent offered for one- to ninety-day unendorsed acceptances—matched the peak rates in 1929 but were still substantially below the record levels reached in 1920. Toward the end of the month, major finance companies raised their offering rates generally

Table I

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

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

Factors	Changes in daily averages—week ended July 6	July 13	July 20	July 27	Net changes
"Market" factors					
Member bank required reserves*	— 346	+ 302	— 232	+ 66	— 209
Operating transactions (subtotal)	— 612	+ 70	+ 944	— 224	+ 181
Federal Reserve float	+ 27	+ 424	+ 795	— 450	+ 796
Treasury operations†	+ 184	— 302	— 136	— 71	— 225
Gold and foreign account	— 54	+ 62	— 14	— 12	— 18
Currency outside banks*	— 748	— 142	+ 209	+ 219	— 462
Other Federal Reserve accounts (net)‡	— 20	+ 27	+ 90	+ 95	+ 192
Total "market" factors	— 958	+ 373	+ 712	— 155	— 28
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 786	+ 72	— 969	+ 189	+ 78
Bankers' acceptances	+ 2	— 3	— 5	— 10	— 16
Repurchase agreements:					
Government securities	+ 4	— 1	— 3	—	—
Bankers' acceptances	+ 3	— 54	— 100	—	— 151
Member bank borrowings	+ 80	— 9	— 187	+ 40	— 91
Other loans, discounts, and advances	—	— 6	—	+ 2	— 3
Total	+ 849	+ 2	—1,265	+ 231	— 183
Excess reserves*	— 109	+ 375	— 553	+ 76	— 211
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	23,173	23,245	22,924	22,934	23,069‖
Required reserves*	22,823	22,520	22,752	22,686	22,695‖
Excess reserves*	350	725	172	248	374‖
Borrowings	827	818	631	680	739‖
Free reserves*	— 477	— 93	— 459	— 432	— 365‖
Nonborrowed reserves*	22,346	22,427	22,293	22,254	22,330‖
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 846	— 335	— 442	+ 27	+ 96
More than one year	+ 81	—	—	—	+ 81
Total	+ 927	— 335	— 442	+ 27	+ 177

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 July 27.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JULY 1966

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended July 6	July 13	July 20	July 27	Average of four weeks ended July 27*
Eight banks in New York City					
Reserve excess or deficiency(—)†	93	22	86	—	50
Less borrowings from Reserve Banks	161	116	104	16	99
Less net interbank Federal funds purchases or sales(—)	962	1,105	705	310	771
Gross purchases	*1,426*	*1,512*	*1,429*	*1,136*	*1,376*
Gross sales	*464*	*407*	*724*	*826*	*605*
Equals net basic reserve surplus or deficit(—)	—1,030	—1,199	— 722	— 326	— 819
Net loans to Government securities dealers	474	383	285	190	333
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)†	44	38	42	15	35
Less borrowings from Reserve Banks	230	362	237	252	270
Less net interbank Federal funds purchases or sales(—)	688	787	1,038	848	840
Gross purchases	*1,573*	*1,609*	*1,698*	*1,539*	*1,605*
Gross sales	*885*	*822*	*660*	*689*	*764*
Equals net basic reserve surplus or deficit(—)	— 874	—1,111	—1,233	—1,085	—1,076
Net loans to Government securities dealers	149	131	312	94	172

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—July 1966: July 1	July 11	July 18	July 25
Three-month	4.731	4.876	4.996	4.818
Six-month	4.915	4.999	5.095	4.919

Maturities	Monthly auction dates—May-July 1966: May 25	June 23	July 26
One-year	4.966	4.697	4.964

* 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.

⅛ of a percentage point to 5⅝ per cent for 30- to 270-day paper which they placed directly with investors.

Treasury bill rates rose sharply during the first half of July, as demand slackened somewhat and a steep rise in bank call loan rates widened the adverse spread between bill yields and dealer financing costs. Widespread expectations of further increases in interest rates, and market discussion of a possible increase in the Federal Reserve discount rate, contributed to the uneasiness in the Treasury bill market. After midmonth, however, bill rates backed down from record high levels as strong demand pressed against limited market supplies. Demand from various investment sources was augmented by dealer buying late in the month in anticipation of demand for bills stemming from the Treasury's approaching refunding. Such demand proved disappointing, however, and bill rates moved higher on the last two days of the month.

In the bond markets, prices penetrated their late-February, early-March lows during the first half of July, when uncertainty over the future course of interest rates dominated the markets. Around midmonth, however, prices of Treasury, corporate, municipal, and Government agency debt securities began to recover as the belief spread that prices might have bottomed out. Prices of intermediate- and long-term Treasury issues declined on the final two days of the month in reaction to the Treasury's offer of a 5¼ per cent coupon—the highest in forty-five years—in its August refunding. (For details of the refunding announcement, see below.)

THE MONEY MARKET AND BANK RESERVES

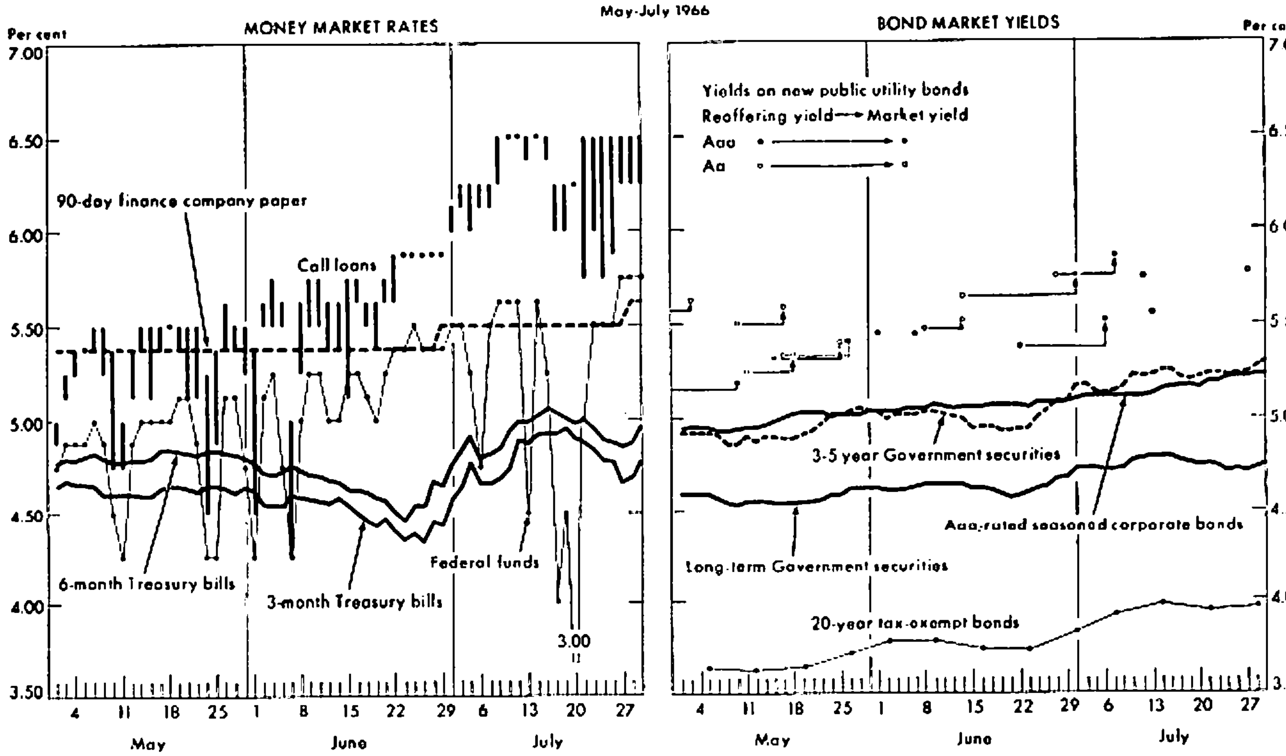
The money market remained firm during most of July, though periods of relative ease did emerge occasionally. Week-to-week fluctuations in net reserve availability were unusually wide during July, partly reflecting the effect of a strike against five major airlines which normally account for about 70 per cent of the nation's air mail service. The resulting delays in transport gave rise to an abnormal increase in Federal Reserve "float", the amount of checks credited to member bank reserve accounts (according to a specified time schedule) but not yet presented for payment. The uneven dispersal of these reserves throughout the banking system apparently contributed to the heavy pressure on banks in the major money centers during the first three weeks of the month. The basic reserve deficit of the forty-six major reserve city banks averaged $2,056 million during the three weeks ended July 20, more than double the average level during the five statement weeks ended in June. These banks bid aggressively for Federal funds on several days, driving the "effective" rate up to 5⅝ per cent for the first time and to 5¾ per cent late in the month. Occasionally, however, Federal funds traded at considerably lower rates, as banks approached the ends of their reserve-averaging periods with more reserves than anticipated. (See the left-hand panel of the chart on page 176 for a record of the daily effective rates on Federal funds.)

In the statement week ended July 6, nationwide net borrowed reserves rose to $477 million, while member bank borrowings from the Reserve Banks averaged $827 million, the highest weekly average levels since February 17, 1960. The money market was very firm until the final day of that week, when it became quite comfortable. The temporarily easy tone of the money market is a phenomenon which frequently arises at the end of the statement weeks in periods of monetary restraint. Banks often adopt a cautious approach to the management of their reserve positions, bidding strongly for Federal funds and sometimes borrowing from their Reserve Banks early in the statement week. As the end of their reserve-averaging period approaches, banks sometimes discover that they had overestimated their reserve needs earlier and have accumulated excessive reserves. When banks attempt to sell their excess reserves, the Federal funds market tends to become temporarily easier. Such a situation is most likely to arise on those alternate Wednesdays which mark the end of reserve-averaging periods for both reserve city and "country" banks. On Wednesday, July 6, Federal funds went begging at rates as low as 1 per cent, member bank borrowings from the Reserve Banks dropped to $260 million, and the forty-six major reserve city banks found themselves with more than $1 billion of unused reserves.

Nationwide net reserve availability rose sharply in the week ended July 13, as float bulged due to the airline strike, and then fell back sharply in the week ended July 20, after the Federal Reserve System moved to absorb the redundant reserves through open market operations. It was expected that float would rise substantially in the wake of the airline strike, which began at 6 a.m. on Friday, July 8, but the timing and magnitude of the bulge were uncertain. As it turned out, the money market was quite taut during the statement week ended July 13 until the end of the week, largely because of the substantial buildup in excess reserves at country banks that typically takes place about the second week in July. Federal funds traded at the historically high effective rate of 5⅝ per cent on Friday through Tuesday, and some funds traded at 5¾ per cent. Not until Wednesday morning did the full effect of the strike upon float become apparent and the money market begin to ease significantly. Nationwide net borrowed reserves declined to $93 million on average for the

SELECTED INTEREST RATES*

May-July 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, 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.

week from $477 million in the week before, but member bank borrowings from the Reserve Banks averaged $818 million, about the same as a week earlier. The reserves created by the rise in float added to the excesses in country banks, which built up average excess reserves of $663 million during the week. Banks in major money centers, on the other hand, remained in deep basic reserve deficits, bidding strongly for Federal funds and covering sizable residual reserve needs through recourse to the Federal Reserve "discount window".

Federal Reserve open market operations absorbed a large volume of reserves in the statement week ended July 20, when float remained abnormally large due to the continuing airline strike. Despite a sharp contraction in nationwide net reserve availability to $459 million of net borrowed reserves, however, the money market grew considerably more comfortable as the excess reserves accumulated by country banks the week before spilled into the major money centers during the second half of the biweekly country bank reserve-settlement period. Indeed, following the buildup of reserves in the previous week, country banks in the aggregate actually ran a slight average reserve deficiency during the week ended July 20, the first such deficiency on record. Federal funds traded predominantly at 5¼ per cent or higher before the weekend but, as the funds began to pour into the market, rates fell to as low as ½ of 1 per cent on Wednesday. Average borrowings from the Federal Reserve declined to $631 million for the week.

The money market was again firm during the week ended

July 27 and became rather tight at the end of the week. Federal funds traded predominantly at 5½ per cent over most of the week but at 5¾ per cent—a record effective rate—on the final day. Net borrowed reserves were little changed from the previous week, but the distribution of reserves shifted, reducing the pressure on the major New York City banks considerably and on the other money market banks to a lesser extent. While borrowing by banks outside the major money centers rose somewhat, overall member bank borrowings from the Federal Reserve remained well below the level of the first half of the month.

THE GOVERNMENT SECURITIES MARKET

Prices of Treasury notes and bonds declined during the first half of July, in continuation of a trend which developed late in June when several money market rates—including the prime lending rate of commercial banks—were scaled upward. Apprehension over the future course of interest rates prompted a nervous atmosphere in the Treasury securities market until mid-July. At that time yields ranged to 5.34 per cent in the intermediate-term sector and 4.98 per cent on long-term bonds, as much as 15 basis points higher than at the year's previous peak around the end of February. About midmonth, however, market participants began to feel that the sell-off had perhaps been overdone and that existing rate levels might prove viable. Prices moved sharply higher in professional trading, and market sentiment swung to the belief that investors might be receptive to an issue of as long as four to five years' maturity in the Treasury's August refunding.

After the close of the market on July 27, the Treasury announced that it would offer holders of notes and bonds maturing on August 15 the right to exchange them for either of two new issues: 5¼ per cent one-year certificates maturing on August 15, 1967, and 5¼ per cent four-year nine-month notes maturing on May 15, 1971. In addition, holders of certificates, notes, and bonds maturing on November 15 were offered the four-year nine-month notes in exchange prior to maturity. A total of $14.9 billion of securities was eligible for the exchange, about $8.1 billion of which was held by the public and $6.8 billion by the Federal Reserve and Government Investment Accounts. Subscription books were open from August 1 through August 3, with payments and deliveries scheduled for August 15. Both of the new issues were priced at par, and the 5¼ per cent coupon represented the highest rate paid by the Treasury on a coupon-bearing direct obligation since 1921. The market reacted favorably to the terms of the offering.

A brief technical rally in the market for Treasury coupon-bearing securities was sparked on July 5 and 6 by reports casting doubt upon the sustainability of the North Vietnamese war effort and by President Johnson's comments that the deficit in the Federal administrative budget for fiscal 1966 had turned out much smaller than expected. The atmosphere of optimism was quickly dispelled, however, following news reports that the Warsaw Pact nations had agreed to send volunteers to Vietnam if requested by the Hanoi government. Further caution in the bond market was generated by the weekly banking statistics published on Friday, July 8—which revealed a reduction in reserve availability and continued strength of business loan demand—and by growing discussion of the likelihood of new pressures on the British pound. By the time the British bank rate was raised from 6 per cent to 7 per cent on Thursday, July 14, the move had largely been discounted. The market remained nervous, however, as many participants expected an announcement of an increase in the Federal Reserve discount rate that night. When the discount rate remained unchanged, sentiment emerged that yields were perhaps near their peaks, and dealers withdrew offerings and sought to cover short positions. The market for Treasury notes and bonds reversed direction, and prices moved generally upward until the announcement of the August refunding, which stimulated offerings by dealers in anticipation of switching by investors out of outstanding issues into the new notes. As a result of this largely professional pressure, prices of most issues declined on the final two days of the month, except for the "rights" issues, some of which moved higher. Over the month as a whole, prices of most issues maturing beyond one year showed declines ranging from ⅛ to more than a full point, though there were a few scattered fractional price increases.

Rates for Treasury bills moved sharply higher over the first half of the month, as the special factors that had added to demand in June disappeared. Dealers became aggressive sellers, as they faced steeply higher costs of financing their inventories in the wake of the late June increase in the prime rate and other money market rates. The major New York City banks, whose reserve positions were under heavy pressure, raised their rates on dealer loans generally to a range of 6 to 6½ per cent, about ⅝ of a percentage point higher than the range which generally prevailed in June. Uncertainty over movements in interest rates, including the Federal Reserve discount rate, as well as the heaviness of the Government agency and corporate bond markets, contributed to the nervous atmosphere of the Treasury bill market. Against this background, dealers and investors bid very cautiously in the first two regular weekly bill auctions of the month, on July 1 and 11, and the resulting wide ranges of prices of accepted tenders in turn aggravated the nervousness of the market. The rate on the three-month bills in the July 18 auction was set at a record-high 4.996 per cent (see Table III) and, at the higher rate levels, bidding was more enthusiastic than in the two previous auctions. Bill rates moved lower over the July 18-27 interval, as active investment demand reemerged and pressed against market scarcities in many maturities. The average issuing rate set on the three-month bills in the weekly bill auction held on July 25 was about 18 basis points lower than the average rate set a week earlier. Toward the end of the month, dealer buying was stimulated by anticipation of demand for bills by sellers of rights who chose not to exchange for the Treasury's new offerings. As it turned out, such demand proved disappointing, and bill rates moved up rather sharply on the last business day of the month under the pressure of aggressive dealer selling. Over the month as a whole, rates for Treasury bills rose about 5 to 25 basis points.

A heavy atmosphere also dominated the market for Government agency securities during the first half of the month. Rising money market rates and the prevailing uncertainties over the course of interest rates led to price declines throughout the list. Prices of intermediate- and long-term issues recovered under the pressure of a quite strong demand after midmonth, but still closed generally ¼ to 1¼ points lower for the month, while prices of short-term issues rose slightly. New agency issues marketed during the interval totaled $1,744 million, of which $485 million represented the raising of new money. At historically high yields, the new issues encountered mixed investor receptions. In the face of near-term uncertainties over market conditions, one issue scheduled to be priced on Thursday, July 14, was postponed until after the weekend.

Investor interest in two new issues of the Federal Home Loan Banks, offered on July 12, was particularly disappointing. The offering, which replaced a $500 million maturity and raised $285 million in new money, consisted of $535 million of one-year 5¾ per cent bonds offered at par and $250 million of eighteen-month 5¾ per cent bonds discounted to yield 5.80 per cent. The issues quickly traded below their original offering price and contributed to a marked deterioration in market sentiment. An offering of the Banks for Cooperatives scheduled for pricing Thursday, July 14, was priced on Monday, July 18, for offering the following day, to yield a record 5.90 per cent. The $266 million issue was an immediate sellout at this rate. On July 21, the Federal Intermediate Credit Banks were able to offer $298 million of nine-month debentures with a 5⅞ per cent coupon. The debentures, which were offered at par, were accorded an excellent reception. The Tennessee Valley Authority auctioned $50 million of 120-day discount notes on July 26 at an average rate of 5.661 per cent, up only 3 basis points from the rate on a comparable issue auctioned in June.

OTHER SECURITIES MARKETS

In the corporate and municipal bond markets, prices declined during the first half of the month in the face of increases in money market rates and uncertainties over future movements in interest rates. New-issue activity in both the corporate and municipal sectors was significantly reduced from the June level. With the slackening of the pace of new offerings, dealers in municipal bonds succeeded in reducing their inventories substantially, though often at the cost of price concessions. A heavier calendar of new offerings is scheduled for August.

In addition to the pressures on the capital markets in general, the municipal market suffered from liquidation of holdings of tax-exempt bonds by commercial banks and an abatement of bank demand for new issues, as pressures on bank reserve positions intensified. A $112.9 million offering of New York City bonds was awarded on July 26 at a net interest cost of about 4.65 per cent, 41 basis points more than the City paid in April. The corporate market was influenced in the early part of the interval by the overhang of two syndicate-bound issues with large unsold balances. When price restrictions were lifted on July 6 and 7, respectively, the bonds moved out with upward adjustments of 10 to 15 basis points in yield. Two Aaa-rated corporate issues were reoffered on July 12 and 13 at somewhat higher yields. One, a telephone issue with five-year call protection, sold out immediately at 5.55 per cent, while the other, a power company issue callable only at a penalty price, eventually sold out at a 5.75 per cent yield.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 13 basis points to 5.23 per cent, while *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) rose by 13 basis points to 3.96 per cent (see the right-hand panel of the chart). These indexes are, however, based on only a limited number of seasoned issues and do not necessarily reflect market movements fully, particularly in the case of new and recent issues.