The Money and Bond Markets in September

The improved atmosphere which had emerged in the bond markets at the end of August generally persisted in September. Although an undertone of considerable nervousness reappeared several times during the month, it ended on a strong note. In the early part of September, market participants were hopeful that bond yields had reached their peaks in August, and that a period of greater interest rate stability lay ahead for the capital markets. The resulting rally in bond prices fed on reports that a move to raise Federal taxes and curtail the sale of Government assets was in the wind. The bond markets responded favorably when President Johnson, on September 8, announced a fiscal program to combat inflation and alleviate some of the pressures which had recently beset the credit markets.[1] In the wake of the President's statement, the Treasury announced that certain types of Government agency financing would be curtailed over the remainder of the year.

Subsequently, renewed uncertainties appeared in the bond markets when participants began to feel that credit demands would nevertheless remain heavy. A sharp rise in Treasury bill rates during the first two thirds of the month also had a restraining effect upon the bond markets. In the last third of the month, however, these markets strengthened considerably. Among the factors contributing to the improvement were the spreading view that further tax action would be requested after the November elections and that prospects for peace in Vietnam had improved. In addition, the much more relaxed tone which emerged in the money market during this period strengthened dealers' confidence in their ability to carry positions in Government securities and other obligations.

The steep rise in Treasury bill rates during the early part of September occurred in a highly nervous atmosphere. Participants were quite concerned about the prospects for a sharp expansion in direct Treasury borrowing in the bill sector as a result of the curtailment of Government agency financing. In addition, the tight money market conditions then prevailing stimulated both expanded commercial bank bill sales and more aggressive professional offerings, while dealers expected that substantial pressures would beset the bill sector over the midmonth corporate tax date. These pressures did not materialize, however, and the tone of the bill market improved markedly in the last third of the month when bills came under heavy demand from a wide range of sources.

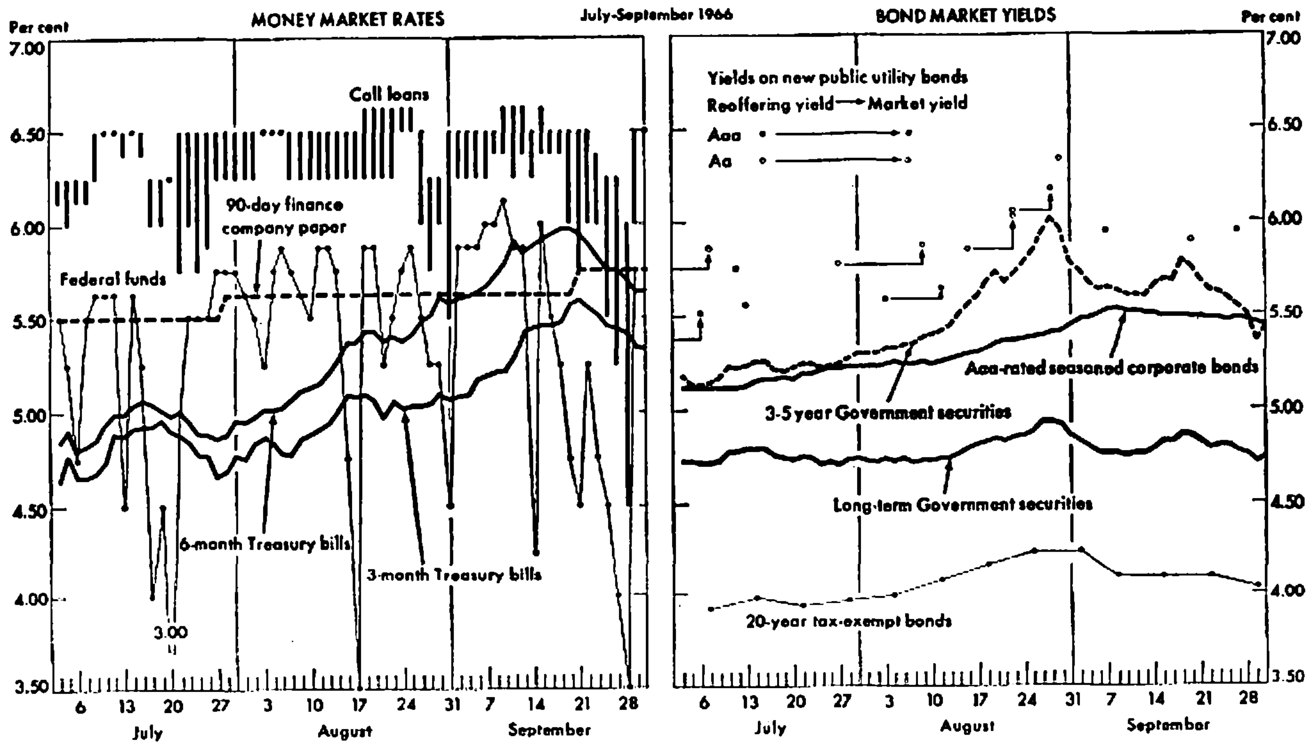
The money market was taut during the first half of September. Most Federal funds trading occurred at rates ranging from 5⅞ per cent to 6 per cent, and the basic reserve positions of banks in the leading money centers moved into relatively deep deficits. A more comfortable tone emerged after the September 15 corporate tax payment date had passed without giving rise to any severe pressures in the money market. During the rest of the month, Federal funds traded mainly in a 4½ to 5¾ per cent range, and average member bank borrowings from the Federal Reserve Banks declined. The reserve positions of banks in the central money market improved in the final statement period of September, while over the month as a whole these banks were quite successful in replacing most of their maturing time certificates of deposit.

THE GOVERNMENT SECURITIES MARKET

As the month opened, participants in the market for Treasury notes and bonds were optimistic about the possibility that the Administration might take fiscal action to cope with inflation and moderate the upward spiral of interest rates. Market attention was drawn particularly to a Treasury official's assertion that further economic restraint, if needed, would have to be applied by fiscal rather than monetary means. The market also responded favorably to the President's Labor Day remarks which suggested that nonessential Government spending and the sale of Government agency obligations might soon be curtailed. Thus, although an undertone of caution persisted, prices of intermediate- and long-term issues generally climbed from ¾ to 1½ points during the first week

[1] The program is outlined in this *Review* (October 1966), page 215.

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 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.

in September, and prices of shorter term obligations rose from $^{2}/_{32}$ to $^{22}/_{32}$. (The right-hand panel of the chart illustrates the decline in yields which accompanied this rise in prices.)

The coupon sector responded favorably when, on September 8, President Johnson outlined his program to deal with the problems of inflation and credit stringency. The subsequent announcement that offerings of participation certificates and Government agency obligations for the purpose of raising new cash would be curtailed for the remainder of the calendar year also initially buoyed sentiment in the market for Treasury notes and bonds. The market buoyancy quickly subsided, however, when the view spread that the Administration's program, though a move in the right direction, might not be sufficient to stem the upward tide in interest rates. The coupon market was also adversely affected by the weak tone in the Treasury bill sector where participants were becoming increasingly concerned that the available market supply of bills would increase over the corporate tax date, and when the Treasury filled its fall cash needs. In general, bond market participants seemed to feel that bill yields could not continue to rise without exerting upward pressures on longer term interest rates as well. Investor selling of coupon issues expanded reflecting some switching out of long-term Government securities into higher yielding corporate bonds, and offerings of intermediate-term maturities by commercial banks and savings institutions. Investment demand was quite limited, and trading was dominated by professionals. Against this background, prices of Treasury notes and bonds moved irregularly lower from September 12 through September 19.

Subsequently, the coupon sector responded favorably to renewed discussion of a possible income tax increase, to preliminary proposals by the President calling for the sale of new Treasury savings notes, to the imposition of new interest rate ceilings on consumer-type time deposits,[2] and to reports of peace moves in Vietnam. The market for Treasury notes and bonds was also encouraged by the better tone emerging in the Treasury bill market. Against this background, prices of coupon issues rebounded during the last third of the month, in response to good investor and dealer demand.

In the Treasury bill market, the cautious tone which had been evident through most of August deepened during the first half of September. The bill sector generally welcomed the Administration's program to combat inflation. However, the subsequent announcement that agency new cash financing in the open market would be curtailed for the remainder of the calendar year gave rise to considerable apprehension that this action would necessitate an increase in the Treasury's direct financing in the bill market. Largely in reflection of this apprehension and of the very firm tone of the money market, a very heavy atmosphere developed in the bill sector. Investor demand remained quite light, and bill offerings from commercial banks and other sources expanded sharply. Dealers became more aggressive in their offerings, especially in preparation for the pressures which they expected would emerge in the bill market over the September corporate dividend and tax payment period, and rates on most outstanding bills rose sharply to record highs. At the regular weekly auction on September 12, average issuing rates on the new three- and six-month bills soared by 29 and 27 basis points, to 5.447 per cent and 5.926 per cent, respectively (see Table III on page 222). At the next weekly auction, rates rose by an additional 14 and 11 basis points, respectively, to 5.586 per cent for the new three-month bill and 6.039 per cent for the six-month issue.

The bill market weathered the midmonth tax date rather easily when the anticipated severe pressures failed to develop, and a somewhat steadier tone emerged over the September 21 statement week. At the end of that period, the Treasury announced that it would auction, on September 27, for payment on September 30, $900 million of new Treasury bills maturing in September 1967, and an additional $500 million of bills maturing in June 1967. The proceeds of the joint sale were to be used to redeem the $1.0 billion of one-year bills scheduled to mature on September 30 and to raise $400 million in new cash. The Treasury indicated that the sale marked the start of a program to auction both nine- and twelve-month bills each month. The bill market strengthened over the remainder of the month. The demand for bills from commercial banks and other sources expanded sharply, and this increase in investment demand generated a good deal of short covering. The more comfortable atmosphere in the money market during this period also had an affirmative influence on the bill market. Against this background, bill rates generally declined from September 20 through the end of the month. At the final regular weekly auction of the month on September 26, bill rates receded from their peaks. The new three-month bill was sold at an average rate of 5.503 per cent, and the six-month issue was sold at an average rate of 5.804 per cent. At the Treasury's September 27 auction of new nine- and twelve-month bills, average issuing rates were set at 5.807 per cent and 5.806 per cent, respectively.

In the market for United States Government agency obligations, attention focused early in the month on reports that a large expected September offering of participation certificates by the Federal National Mortgage Association might not, in fact, materialize. Prices of outstanding agency issues moved higher in anticipation of the conjectured cancellation. On September 8, the Federal

[2] On September 21, President Johnson signed into law a bill which provided regulatory agencies with increased power and flexibility to establish ceiling rates on time deposits and savings accounts. Acting under the new authority, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board announced a series of new interest rate ceilings on time deposits and savings accounts, which generally went into effect on September 26. The maximum rate of interest which both Federal Reserve member banks and nonmember banks insured by the Federal Deposit Insurance Corporation may pay on any individual time deposit of under $100,000 was reduced from 5½ per cent to 5 per cent. (All other interest rate ceilings on savings and time deposits at insured commercial banks—including multiple maturity time deposits—remained unchanged.) The Federal Home Loan Bank Board imposed rate ceilings on the deposits of all member institutions of the Federal Home Loan Bank System, except those savings banks having deposits insured by, and therefore subject to, the new 5 per cent rate ceiling imposed by the Federal Deposit Insurance Corporation. Member institutions subject to the Federal Home Loan Bank Board regulations generally may pay up to 4¾ per cent on passbook savings accounts with the following exceptions: Those institutions now paying more than 4¾ per cent on such accounts may pay a return as high as, but not exceeding, 5 per cent. In addition, institutions in Alaska, California, and Nevada may pay rates as high as 5¼ per cent on passbook savings accounts. For member institutions paying no more than 4¾ per cent on passbook accounts, the Board imposed a limit of 5¼ per cent on certificate accounts carried for at least six months. However, institutions paying more than 4¾ per cent on passbook accounts will not be permitted to pay more than 5 per cent on savings certificates, with one exception: Institutions in Alaska, California, and Nevada will be allowed to renew existing certificate accounts at rates up to 5¾ per cent if these funds were received before September 22, 1966.

Table I

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

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

Factors	Changes in daily averages— week ended				Net changes
	Sept. 7	Sept. 14	Sept. 21	Sept. 28	
"Market" factors					
Member bank required reserves*	− 41	− 385	− 457	+ 88	− 795
Operating transactions (subtotal)	− 379	+ 416	+1,054	− 462	+ 629
Federal Reserve float	− 21	+ 160	+ 571	− 288	+ 422
Treasury operations†	+ 124	+ 164	+ 205	− 406	+ 87
Gold and foreign account	+ 11	+ 2	− 4	− 10	− 1
Currency outside banks*	− 559	+ 88	+ 212	+ 291	− 23
Other Federal Reserve accounts (net)‡	+ 68	+ 53	+ 72	− 48	+ 145
Total "market" factors	− 420	+ 31	+ 597	− 374	− 166
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 380	− 82	− 370	− 32	− 104
Bankers' acceptances	—	− 2	+ 2	− 2	− 2
Repurchase agreements:					
Government securities	—	+ 41	− 41	—	—
Bankers' acceptances	—	—	—	—	—
Member bank borrowings	+ 58	+ 139	− 117	− 121	− 41
Other loans, discounts, and advances	—	+ 3	+ 6	+ 1	+ 10
Total	+ 438	+ 100	− 521	− 154	− 137
Excess reserves*	+ 18	+ 131	+ 76	− 528	− 303
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	22,700	23,216	23,749	23,133	23,200§
Required reserves*	22,323	22,708	23,165	23,077	22,818§
Excess reserves*	377	508	584	56	381§
Borrowings	749	888	771	650	765§
Free reserves*	− 372	− 380	− 187	− 594	− 383§
Nonborrowed reserves*	21,951	22,328	22,978	22,483	22,435§
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 473	− 368	− 220	− 366	− 481
More than one year	—	—	—	—	—
Total	+ 473	− 368	− 220	− 366	− 481

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 September 28.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS SEPTEMBER 1966

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended				Average of four weeks ended Sept. 28*
	Sept. 7	Sept. 14	Sept. 21	Sept. 28*	
Eight banks in New York City					
Reserve excess or deficiency(−)†	20	90	26	29	41
Less borrowings from Reserve Banks	21	111	159	161	113
Less net interbank Federal funds purchases or sales(−)	29	502	431	− 66	224
Gross purchases	*1,028*	*1,239*	*1,392*	*1,121*	*1,195*
Gross sales	*999*	*737*	*961*	*1,187*	*971*
Equals net basic reserve surplus or deficit(−)	− 31	− 523	− 565	− 66	− 296
Net loans to Government securities dealers	380	448	481	359	417
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)†	36	86	12	7	35
Less borrowings from Reserve Banks	198	284	156	133	193
Less net interbank Federal funds purchases or sales(−)	789	979	1,031	1,034	958
Gross purchases	*1,817*	*1,695*	*1,928*	*1,976*	*1,854*
Gross sales	*1,028*	*716*	*897*	*942*	*896*
Equals net basic reserve surplus or deficit(−)	− 950	−1,177	−1,174	−1,160	−1,115
Net loans to Government securities dealers	250	207	298	182	234

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 1966			
	Sept. 2	Sept. 12	Sept. 19	Sept. 26
Three-month	5.155	5.447	5.586	5.503
Six-month	5.657	5.926	6.039	5.804

Maturities	Monthly auction dates—July-September 1966		
	July 26	August 25	September 27
Nine-month	4.964	5.844	5.807
One-year			5.806

* 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.

Land Banks floated a $302 million offering of ten-month bonds, refunding $219 million of maturing obligations and raising $83 million in new money through direct sales to Treasury trust accounts. The bonds, which were re-offered at par and carried a 6.05 per cent coupon, were accorded an excellent investor reception.

The September 10 announcement that the anticipated September offering of participation certificates would not be forthcoming, and that no additional new money would be raised through the sale of Government agency obligations in the open market during the remainder of 1966, further bolstered the intermediate- and long-term maturity areas of the agency sector. However, the short-term maturity area remained quite sensitive to movements in Treasury bill rates, reflecting the very narrow yield spreads between bills and agency issues. On September 15, the Federal Home Loan Banks offered $650 million of 6.25 per cent one-year bonds replacing a $500 million maturity with $400 million offered to the public and $250 million placed directly with Treasury trust accounts. The bonds were priced to yield 6.20 per cent and were accorded a fairly good reception. In the later part of September, prices of outstanding agency issues generally rose throughout the maturity spectrum, and refinancing issues were well received.

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, the atmosphere continued to improve during the early part of September. Investor demand expanded considerably and prices of many issues moved higher in moderately active trading. In the corporate sector, gains following the disclosure of the Administration's plan for combating inflation boosted prices of many recent offerings from four to six points above either their recent low points or their original reoffering levels. At the same time, new corporate offerings—a considerable portion of which were convertible bond issues—generally drew good investor receptions. The Federal Reserve System's September 1 policy statement[3] also had an affirmative effect on bond market sentiment, especially in the tax-exempt sector. Net price gains of as much as four points were recorded by tax-exempt bonds during the three weeks ended September 14. The surge in demand for state and local issues during this period reduced the Blue List of advertised dealer inventories to $242 million on September 9, the lowest level in over six years. Beginning around midmonth and for some time afterward, prices of corporate and tax-exempt bonds generally receded somewhat in response to many of the same factors restraining the Government bond market. Subsequently, however, a better tone also reappeared in the corporate and tax-exempt sectors and prices rebounded again over the remainder of the month.

During the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 1 basis point to 5.45 per cent, while *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) fell by 21 basis points to 4.03 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.

THE MONEY MARKET AND BANK RESERVES

The money market was quite taut in the first half of September, but a more comfortable atmosphere developed later in the month. Market conditions varied considerably from day to day in response to changes in aggregate nationwide reserve availability (see Table I), shifting patterns of reserve distribution within the banking system, and the willingness of individual banks to bid aggressively for Federal funds.

The reserve positions of commercial banks in the leading money centers deteriorated substantially over the first half of the month (see Table II). The worsening basic reserve positions of city banks partly reflected the rather large Treasury Tax and Loan Account withdrawals early in the month, the heavy volume of negotiable certificates of deposit reaching maturity, and the increase in reserve requirements against certain time deposits which began to go into effect on September 8. As banks sought funds to fill their substantial reserve needs, they bid strongly for Federal funds which traded predominately in a 5⅞ to 6 per cent rate range during the first half of the month. For the first time some trading also took place at a 6¼ per cent rate, 1¾ percentage points above the Federal Reserve discount rate. In addition, the banks turned to the "discount window" to fill their residual reserve needs. Rates posted by the major New York City banks on call loans to Government securities dealers generally remained in a high 6¼ per cent to 6⅝ per cent range, thus contributing to the stresses evident in the Treasury bill market where yields were rising sharply.

A somewhat more comfortable tone emerged after the

[3] For details of the statement, see this *Review* (September 1966), page 209.

midmonth corporate tax date passed without giving rise to any real stress in the money market. Federal funds traded mainly in a 4½ to 5¾ per cent range in the second half of the month, rates on bank call loans to Government securities dealers eased somewhat and were generally quoted in a 5½ to 6½ per cent range, while member bank borrowings at the Federal Reserve discount window contracted. The loan expansion over the tax date was of relatively moderate proportions, while banks in the central New York City money market replaced a larger portion of their maturing certificates of deposit than had generally been anticipated, although mainly with very short maturities.

Approximately $5.3 billion of certificates of deposit outstanding at all reporting banks—or about one third of the total of such certificates outstanding—matured in September. Roughly, $1.2 billion of the total amount maturing fell due on September 15, the corporate tax date. About one half of the nationwide maturities over the month as a whole, and over the tax date as well, was outstanding at the New York City reporting banks. The New York banks managed to roll over approximately three fourths of their maturing certificates in the four weeks ended September 28, partly reflecting the temporary investment in time certificates of funds involved in a merger financing. However, an increasing proportion of the newly issued certificates was placed at the short end of the maturity scale. During the month, banks continued to pay the 5½ per cent ceiling rate on all maturities of new negotiable time certificates of deposit of $100,000 or more.