The Money and Bond Markets in October

The money and bond markets settled down in October. There was growing confidence among market participants that the factors underlying the tense financial atmosphere of late summer had been largely overcome and that a period of greater interest rate stability lay ahead. In the view of many observers, the severe pressures which had beset the credit markets in earlier months primarily reflected the inflationary pace of domestic economic expansion and the nation's military involvement in Vietnam. In October, the conviction became quite widespread that some of these pressures would soon be alleviated, either as a result of a Federal tax increase, improvement of the situation in Vietnam, or some moderation in the rate of growth in the civilian sector of the economy. In addition, the money and bond markets were bolstered when the belief grew that the monetary authorities were concerned with avoiding any recurrence of the strong upward pressures on interest rates which had developed in midsummer. The money market was notably free of stress in October, amid signs that the demand for bank credit had slackened somewhat, at least temporarily.

A surge of demand for Treasury bills from a wide range of investors both reflected and contributed to the more confident climate which spread through the money and bond markets in October. As a result of the sharp rise in demand, pronounced scarcities developed in the bill market, particularly at the short end of the maturity scale, and rates moved progressively lower.

Prices of Treasury notes and bonds edged irregularly higher over the month as a whole, reflecting increased demand from dealers and investors. The Treasury was able in its November refunding to achieve some debt extension and the market reaction to its late October offering was quite favorable. The corporate and tax-exempt bond markets were in a very strong technical position in October, and both new and seasoned issues were generally well absorbed at rising prices.

THE MONEY MARKET AND BANK RESERVES

The money market displayed a generally firm undertone in October. However, no real pressure was evident in the market and conditions became relatively easy on a number of occasions. Except for a short period at the beginning of the month, Federal funds traded predominantly at rates below 6 per cent in October, whereas they had traded at 6 per cent or even above in early September. This absence of stress was more noteworthy than the week-to-week variations in reserve statistics during the month (see Table I).

In this money market climate, the major reserve city banks experienced no particular difficulty in adjusting to the sizable swings that occurred in their basic reserve positions from week to week (see Table II). There was for a time a tendency for heavier borrowing by the major reserve city banks from their Reserve Banks than in earlier months, but this proclivity appeared to diminish as the month progressed. Member bank borrowings from the Reserve Banks ranged between $928 million and $518 million on a weekly average basis. Treasury bill rates declined during the month, and dealers in bankers' acceptances generally lowered their offering rates by ⅛ of a per cent. Government securities dealers, who were primarily faced with posted call loan rates of 6 per cent to 6½ per cent at the New York City banks, often were able to finance their positions through other sources at lower rates.

Bank credit extended by the large weekly reporting banks contracted by $1.8 billion on a seasonally unadjusted basis from the last Wednesday in September through the final Wednesday in October. The decline compared with a $1.5 billion expansion a year earlier. The contraction in seasonally unadjusted bank credit at the weekly reporting banks in October followed an apparent slackening in the growth of bank loans and investments which developed in the third quarter of the year.[1]

A slower rate of growth in bank loans to business has also been apparent recently. Loans extended by the weekly reporting banks to commercial and industrial borrowers,

[1] For a more detailed discussion of bank credit developments in the third quarter of 1966, see this *Review* (November 1966), pages 245-46.

Table I

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

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

Factors	Changes in daily averages—week ended Oct. 5	Oct. 12	Oct. 19	Oct. 26	Net changes
"Market" factors					
Member bank required reserves*	— 224	+ 355	+ 117	— 289	— 51
Operating transactions (subtotal)	— 214	— 370	+ 583	— 63	— 64
Federal Reserve float	— 372	+ 55	+ 275	— 112	— 154
Treasury operations†	+ 344	+ 30	— 22	— 227	+ 120
Gold and foreign account	— 7	— 11	+ 7	+ 21	+ 10
Currency outside banks*	— 270	— 443	+ 171	+ 258	— 284
Other Federal Reserve accounts (net)‡	+ 89	— 7	+ 154	— 4	+ 232
Total "market" factors	— 448	— 15	+ 700	— 353	— 115
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 496	— 20	— 448	+ 194	+ 222
Bankers' acceptances	+ 1	+ 8	—	+ 1	+ 5
Repurchase agreements:					
Government securities	+ 10	— 10	—	+ 79	+ 79
Bankers' acceptances	+ 7	+ 87	— 44	+ 18	+ 18
Member bank borrowings	+ 178	+ 100	— 138	— 272	— 132
Other loans, discounts, and advances	+ 3	+ 4	— 4	—	+ 3
Total	+ 695	+ 114	— 634	+ 20	+ 195
Excess reserves*	+ 247	+ 99	+ 66	— 332	+ 80
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	23,614	23,358	23,307	23,264	23,386§
Required reserves*	23,300	22,946	22,828	23,117	23,048§
Excess reserves*	314	412	479	147	338§
Borrowings	828	928	790	518	766§
Free reserves*	— 514	— 515	— 311	— 371	— 428§
Nonborrowed reserves*	22,786	22,430	22,517	22,746	22,620§
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+1,293	— 497	— 537	+ 468	+ 727
More than one year	—	—	—	—	—
Total	+1,293	— 497	— 537	+ 468	+ 727

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 October 26.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS OCTOBER 1966

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended Oct. 5	Oct. 12	Oct. 19	Oct. 26	Average of four weeks ended Oct. 26
Eight banks in New York City					
Reserve excess or deficiency(—)*	19	32	7	13	18
Less borrowings from Reserve Banks	265	234	96	7	151
Less net interbank Federal funds purchases or sales(—)	5	656	437	— 22	269
Gross purchases	*915*	*1,443*	*1,330*	*999*	*1,172*
Gross sales	*909*	*786*	*893*	*1,021*	*902*
Equals net basic reserve surplus or deficit(—)	— 251	— 858	— 525	28	— 402
Net loans to Government securities dealers	472	299	370	395	384
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	25	30	14	31	25
Less borrowings from Reserve Banks	96	345	335	126	226
Less net interbank Federal funds purchases or sales(—)	819	856	896	824	849
Gross purchases	*1,811*	*1,855*	*1,881*	*1,844*	*1,848*
Gross sales	*992*	*999*	*985*	*1,020*	*999*
Equals net basic reserve surplus or deficit(—)	— 890	—1,171	—1,217	— 919	—1,049
Net loans to Government securities dealers	148	119	151	312	183

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—October 1966: October 3	October 10	October 17	October 24	October 31
Three-month	5.408	5.471	5.424	5.246	5.234
Six-month	5.673	5.750	5.651	5.536	5.513

Maturities	Monthly auction dates—August-October 1966: August 25	September 27	October 25
Nine-month	—	5.807	5.567
One-year	5.844	5.806	5.544

* 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.

which had increased at a lower rate in the third quarter of 1966 than both earlier in the year and in 1965, apparently continued to grow at a slower pace in October. This slowdown occurred despite large corporate payments to the Treasury in October arising from the accelerated remittance of withheld income taxes and social security contributions. Over the four weeks ended October 26, business loans at weekly reporting banks expanded by only $84 million, compared with a $112 million rise a year earlier.

Approximately $5.2 billion of negotiable time certificates of deposit (C/D's) outstanding at large commercial banks matured in October. Certificates outstanding at the weekly reporting banks declined by about $1.1 billion, on balance, over the four weeks ended October 26, partly reflecting the October 19 maturity of a large block of certificates that had originated in mid-September in connection with the financing of an industrial merger. Toward the end of the month, however, the banks apparently were able to renew a larger portion of their maturing certificates, as their C/D rates became more competitive following the decline in a number of other money market rates. Throughout the month, banks generally continued to pay the 5½ per cent ceiling rate on all maturities of new negotiable time certificates of deposit of $100,000 or more.

THE GOVERNMENT SECURITIES MARKET

The improved tone which had emerged in the Treasury bill market during the last third of September intensified in October. A broadly based demand from public funds, corporations, and other sources encountered mounting scarcities in the available market supply of bills, and rates moved considerably lower during the month (see the left-hand panel of the chart on page 252). Demand from dealers also expanded, as they sought to replenish their inventories, in part because of improved financing opportunities.

On October 5, the Treasury announced that it would auction $3.5 billion of tax anticipation bills on October 11, for payment on October 18. The sale consisted of an addition of $1.5 billion to the outstanding issue of bills maturing in April 1967 and $2 billion of new bills maturing in June 1967. The announcement was favorably received by the market—particularly since some participants had expected a larger offering—and demand for outstanding issues remained quite spirited. To some extent, this demand reflected increased interest on the part of small investors, who were apparently attracted by the high levels to which bill rates had climbed in late summer.

Commercial banks were permitted to make full payment for the new tax bills through credits to Treasury Tax and Loan Accounts, a privilege which some participants estimated might be worth about 30 basis points for the April issue and just over 20 basis points for the June issue. Consequently, at the auction, interest in the new bills was generally confined to commercial banks. Average issuing rates were set at 5.484 per cent for the April issue, for which demand was quite aggressive, and 5.587 per cent for the June maturity, for which bidding was more restrained. After the tax bill auction, a broad investment demand for outstanding bills reappeared and bill rates once more moved downward. The decline was most pronounced in the short maturity area where market supplies were quite limited. At the same time, however, a fairly good investor interest also spilled over into the longer maturity area and, despite the $3½ billion addition of tax bills to the market supply, rates on bills maturing beyond ninety days also receded.

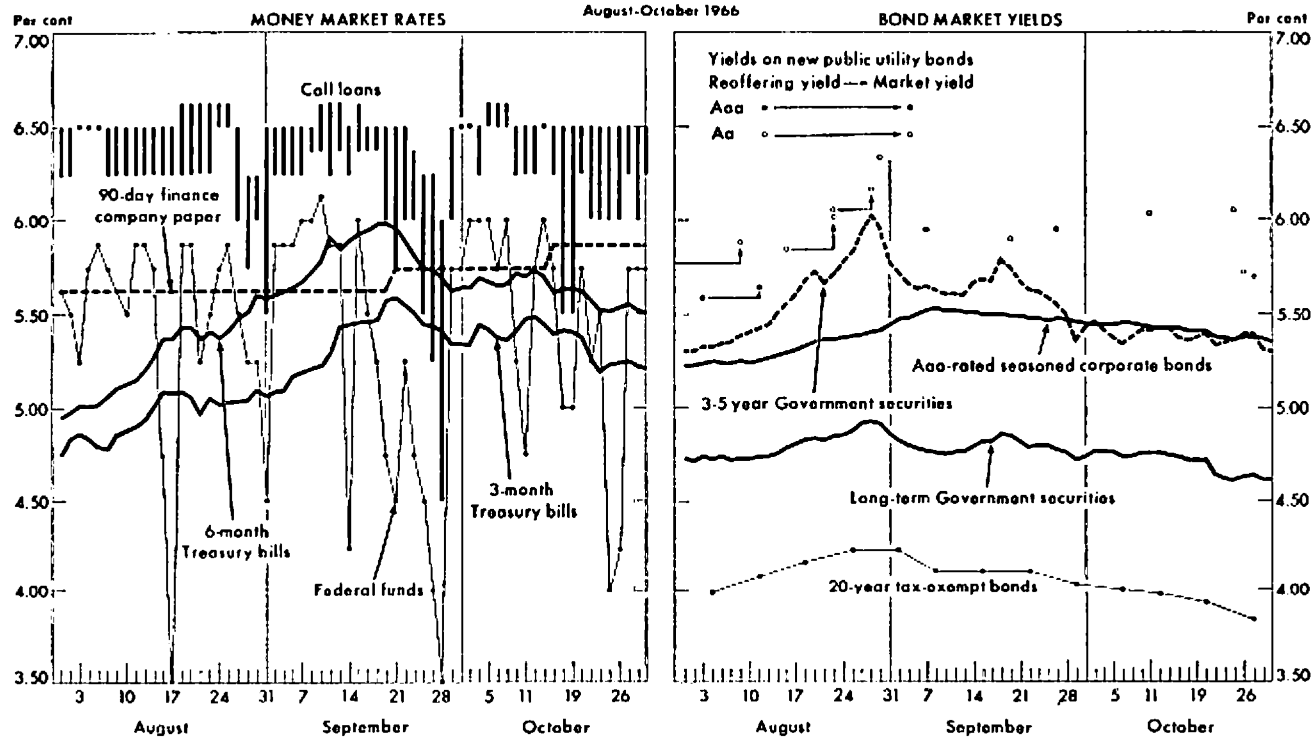
At the regular monthly auction of new nine- and twelve-month bills on October 25, average issuing rates were 5.567 per cent and 5.544 per cent, respectively, 24 and 26 basis points below average rates set a month earlier. At the final regular weekly auction of the month on October 31, average issuing rates were set at 5.234 per cent for the new three-month issue and 5.513 per cent for the new six-month issue, 27 and 29 basis points, respectively, below the average rates at the final weekly auction in September (see Table III).

Prices of Treasury notes and bonds moved in a fairly wide range during the first half of October, reflecting a cautious market appraisal of a number of reports concerning the domestic economic outlook, the future course of interest rates, and the chances for improvement in the Vietnam situation. At times during this period, prices rose sharply in largely professional trading when the market responded favorably to peace rumors, to talk that the pace of economic expansion might slow in 1967, and to the strong tone of the Treasury bill sector. However, these price gains were periodically pared, as the feeling emerged that each of the rallies might have been overdone. Throughout the period, however, a generally confident undertone was evident in the coupon sector.

As the month progressed, participants became progressively more confident of the viability of prevailing yields. Market optimism over the outlook for a moderation of the Vietnam conflict continued to exert a strengthening effect, as did increasing discussion that, if the conflict persisted and defense expenditures remained heavy, the Administration might move to raise taxes. Demand for coupon issues from dealers and investors expanded, and prices of Treasury notes and bonds moved higher. (The right-hand panel of the chart illustrates the decline in yields which accom-

SELECTED INTEREST RATES*

August-October 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.

panied this rise in prices.) From about October 20 onward, market attention began to focus on the Treasury's approaching November refunding. The feeling of confidence prevailing among market participants was sufficient to suggest to many observers that the market would be receptive to a Treasury refunding offering beyond the short-term maturity area.

On Thursday, October 27, the Treasury stated that it would borrow approximately \$4.1 billion through the issuance of new fifteen-month and five-year notes (priced at par), and would use the proceeds to redeem in cash a like amount of obligations maturing on November 15. The Treasury's offerings (both dated November 15, 1966) consisted of \$2.5 billion of 5⅝ per cent notes, maturing on February 15, 1968, and \$1.6 billion of 5⅝ per cent notes, maturing on November 15, 1971. The maturing outstanding securities which are being replaced include \$1.3 billion of 3⅝ per cent bonds, \$1.7 billion of 4 per cent notes, and \$1.1 billion of 4¾ per cent certificates. The subscription books were open on Tuesday, November 1, with the settlement date scheduled for November 15. Payment for the new securities may be made either in cash or in the maturing securities. The Treasury's announcement brought a quick improvement in the prices of outstanding coupon issues which had moved lower for a time before the announcement. Good investor and professional short covering was in evidence and the month closed on a firm note.

After the close of business, on November 4 the Treasury announced the results of the refinancing. Both offerings were heavily oversubscribed; the Treasury accepted about \$2.6 billion of the subscriptions for the 5⅝ per cent notes of 1968 and \$1.7 billion of subscriptions for the 5⅜ per cent notes of 1971. Subscriptions from governmental institutions and official accounts were allotted in full, as were subscriptions from other sources up to \$100,000. Subscriptions in excess of \$100,000 were subject to a 30 per cent allotment in the case of the new 5⅝ per cent notes, and 10 per cent in the case of the new 5⅜ per cent notes, but subscribers were assured of a minimum award of at least \$100,000.

In the market for United States Government agency issues, good investor demand was evident throughout the month and prices edged higher, especially in the longer maturity area. In line with the Administration's fiscal and budgetary programs announced in September, no additional new money was raised through the sale of Government agency obligations in the open market during the period. However, several agencies offered refunding issues to the public and raised some new cash through additional direct sales of their obligations to Treasury trust accounts. On October 14, the Federal Home Loan Banks offered \$700 million of one-year notes, replacing a maturing \$506 million issue and raising additional funds. Treasury trust accounts purchased \$250 million of the issue, and \$450 million was publicly offered. The notes, which were priced to yield about 6.05 per cent—significantly below the record 6.20 per cent yield on a comparable issue floated in mid-September—were accorded a fairly good reception. On October 18, the Banks for Cooperatives offered \$256 million of 5.95 per cent six-month debentures, priced at par. Treasury trust accounts purchased \$111 million of the issue, providing new cash to the agency. The remainder of the issue, which was used for refunding purposes, was well received when publicly sold. The other agency offerings that reached the market in October also were accorded good receptions.

OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt bonds edged steadily higher during the month. The volume of flotations reaching the market was relatively light. In the corporate sector, new offerings with call protection were well received, while offerings carrying no special protection moved slowly at first but were subsequently sold out. As a result, dealers' unsold balances of recent corporate issues were very light during most of the month. Investor resistance to the decline in yields began to build up, however, as the month closed. In the tax-exempt sector, underwriter bidding for the month's flotations became fairly aggressive. Even at the higher reoffering prices that resulted, the new issues were subsequently accorded fair to good investor receptions. As a result, the Blue List of advertised dealer inventories generally remained in a relatively low \$300 million to \$375 million range during the month.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds declined by 10 basis points to 5.35 per cent. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) fell by 20 basis points to 3.83 per cent (see the right-hand panel of the chart), the lowest point since June. 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.