The Money and Bond Markets in January

Prices rose considerably further in the bond markets in January, and most short-term interest rates declined appreciably. The State of the Union message on January 10, in which the President requested a tax increase and expressed the Administration's intention to strive toward the attainment of lower interest rates, bolstered confidence throughout the financial markets and was followed by a sharp rise in the prices of stocks and bonds. Some caution appeared in the bond market around the time of the budget message on January 24, when the market also awaited the terms of the Treasury's February refinancing which some thought might be broadened to include a pre-refunding of issues maturing later this year. When the Treasury announced on January 25 a routine cash refunding of the February maturities through the sale of two new notes, bond prices rose. The advance accelerated after the cut in the British bank rate and in the prime lending rate of United States commercial banks. A more restrained tone developed toward the end of the month, but yields on Treasury notes and bonds were down over the month as a whole by approximately 20 basis points in the three- to five-year maturity area and by 15 basis points in the long-term area. As a result, yields for most coupon issues reached their lowest levels since late in 1965. A good demand was evident in the markets for corporate and tax-exempt bonds in January. The relatively heavy volume of new flotations was readily absorbed, and prices of new and seasoned bonds continued to advance during most of the period.

In the money market, the month was highlighted by the steady downward movement of short-term interest rates, climaxed by reductions in the prime lending rate of commercial banks announced late in the period. Treasury bill rates declined further during the month, while rates on various other short-term money market instruments—including time certificates of deposit (C/D's), bankers' acceptances, and commercial paper—and dealer loans were all reduced over the period. On January 30, new three-month Treasury bills were sold at an average issuing rate of 4.486 per cent, the first time since last June that this rate was below the discount rate. While nationwide reserve availability expanded somewhat in January, the reserve positions of banks in the leading money centers moved into substantial deficits in the first half of the month, partly as a result of a sharp rise in their loans to United States Government securities dealers. Subsequently, reserves again shifted back toward the money centers, contributing to an easier tone in the money market.

THE MONEY MARKET AND BANK RESERVES

The money market remained comfortable in January. Most Federal funds trading took place in a 4 to 5½ per cent range, compared with the 5 to 5½ per cent range which had predominated in December. Treasury bill rates continued to edge downward while, by the close of the month, dealers in bankers' acceptances were quoting a 4⅞ per cent (bid) rate on ninety-day unendorsed acceptances, ¾ of a per cent lower than a month earlier. Offering rates on prime four- to six-month dealer-placed commercial paper declined by ⅝ of a per cent over the month to 5⅜ per cent, while rates on various maturities of directly placed finance company paper fell by ⅝ to ¾ of a per cent. In addition, New York City banks lowered their offering rates on large new C/D's from the 5½ per cent ceiling at which such rates had held since last August. By January 25, the most frequently quoted offering rate on various maturities of new certificates had declined to 5⅜ per cent, and some banks were posting rates as low as 5¼ per cent. In addition, the volume of C/D's outstanding at commercial banks expanded dramatically during the month. The reporting banks throughout the nation experienced a $2.2 billion rise in their outstanding certificates over the four weeks ended January 25, and thus had recouped by late January approximately three fourths of the dollar amount of the certificates lost from midsummer through late 1966.

Nationwide reserve availability increased moderately in January from the average level in December, while average member bank borrowings from the Federal Reserve Banks contracted (see Table I). Despite the apparent easing of reserve pressures in the nation as a whole, the

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1967

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

Factors	Changes in daily averages—week ended Jan. 4	Jan. 11	Jan. 18	Jan. 25	Net changes
"Market" factors					
Member bank required reserves*	− 539	+ 412	+ 320	+ 46	+ 239
Operating transactions (subtotal)	+ 190	− 497	+ 314	+ 53	− 40
Federal Reserve float	− 284	− 270	− 106	− 88	− 751
Treasury operations†	− 27	− 107	− 58	− 135	− 327
Gold and foreign account	− 13	+ 24	− 7	− 25	− 21
Currency outside banks*	+ 475	+ 10	+ 483	+ 301	+ 1,298
Other Federal Reserve accounts (net)‡	+ 40	− 148	− 69	− 63	− 240
Total "market" factors	− 349	− 85	+ 634	+ 99	+ 199
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 434	+ 303	− 203	+ 109	+ 643
Bankers' acceptances	+ 2	+ 9	− 2	− 1	+ 8
Repurchase agreements:					
Government securities	− 152	+ 42	− 408	− 106	− 624
Bankers' acceptances	+ 17	− 6	− 87	− 40	− 115
Federal agency obligations	+ 1	− 22	− 5	—	− 26
Member bank borrowings	+ 17	+ 20	− 308	+ 331	− 10
Other loans, discounts, and advances	− 10	—	—	− 1	− 11
Total	+ 307	+ 348	−1,073	+ 232	− 136
Excess reserves*	− 42	+ 263	− 539	+ 381	+ 63

	Daily average levels				
Member bank:					
Total reserves, including vault cash*	24,662	24,512	23,654	23,989	24,203§
Required reserves*	24,267	23,856	23,535	23,489	23,787§
Excess reserves*	395	656	119	500	418§
Borrowings	565	586	217	538	476§
Free reserves*	− 170	70	− 98	− 38	− 58§
Nonborrowed reserves*	24,097	23,926	23,437	23,451	23,728§

	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	− 66	+ 93	− 120	+ 207	+ 204
More than one year	—	—	—	—	—
Total	− 66	+ 93	− 120	+ 207	+ 204

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 January 25.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JANUARY 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended Jan. 4	Jan. 11	Jan. 18	Jan. 25	Average of four weeks ended Jan. 25
Eight banks in New York City					
Reserve excess or deficiency(−)*	19	30	16	22	22
Less borrowings from Reserve Banks	201	255	3	—	115
Less net interbank Federal funds purchases or sales(−)	945	1,222	940	440	887
Gross purchases	*1,266*	*1,648*	*1,753*	*1,256*	*1,481*
Gross sales	*321*	*426*	*812*	*815*	*594*
Equals net basic reserve surplus or deficit(−)	−1,128	−1,446	− 927	− 419	− 980
Net loans to Government securities dealers	1,210	1,114	918	1,111	1,088
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)*	28	15	9	27	20
Less borrowings from Reserve Banks	232	187	82	396	224
Less net interbank Federal funds purchases or sales(−)	643	1,467	1,853	1,398	1,340
Gross purchases	*1,473*	*2,024*	*2,353*	*1,932*	*1,946*
Gross sales	*831*	*558*	*501*	*533*	*606*
Equals net basic reserve surplus or deficit(−)	− 846	−1,639	−1,925	−1,767	−1,544
Net loans to Government securities dealers	396	849	1,040	818	776

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—January 1967: Jan. 9	Jan. 16	Jan. 23	Jan. 30
Three-month	4.818	4.716	4.680	4.486
Six-month	4.890	4.686	4.662	4.460

Maturities	Monthly auction dates—November 1966-January 1967: November 23	December 27	January 24
Nine-month	5.552	4.920	4.656
One-year	5.519	4.820	4.576

* 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.

major money market banks experienced steadily deepening basic reserve deficits during the first half of the month, partly reflecting a very sharp rise in their loans to Government securities dealers. In the two weeks ended January 18, the forty-six major reserve city banks had aggregate deficits averaging approximately $3 billion, the highest on record (see Table II). These banks were able, however, to fill the bulk of their reserve needs in the Federal funds market, where excess reserves were readily available at rates generally lower than in December. Consequently, borrowings by these banks from their Federal Reserve Banks remained moderate during this period. In the latter part of January, the basic reserve positions of banks in the central money market—and to a much lesser extent in reserve centers outside New York—improved when the nationwide distribution of reserves shifted more in favor of the money market banks.

THE GOVERNMENT SECURITIES MARKET

The rising trend in prices, which had prevailed in the market for Treasury notes and bonds in December, generally persisted in January. As the new year opened, most market participants continued to feel that, with some relaxation of monetary policy, the financial tides were shifting and the outlook for lower interest rates was improving. Over the first third of January, prices of coupon issues fluctuated irregularly and activity contracted as traders awaited the details of the President's State of the Union address. During this period, the coupon sector reacted cautiously to reports (subsequently confirmed) that the Export-Import Bank was planning to offer between $400 million and $500 million of participation certificates in February. At the same time, however, bond traders were encouraged by the excellent investor receptions being accorded both to an offering of participation certificates by the Federal National Mortgage Association and to a large telephone company bond flotation.

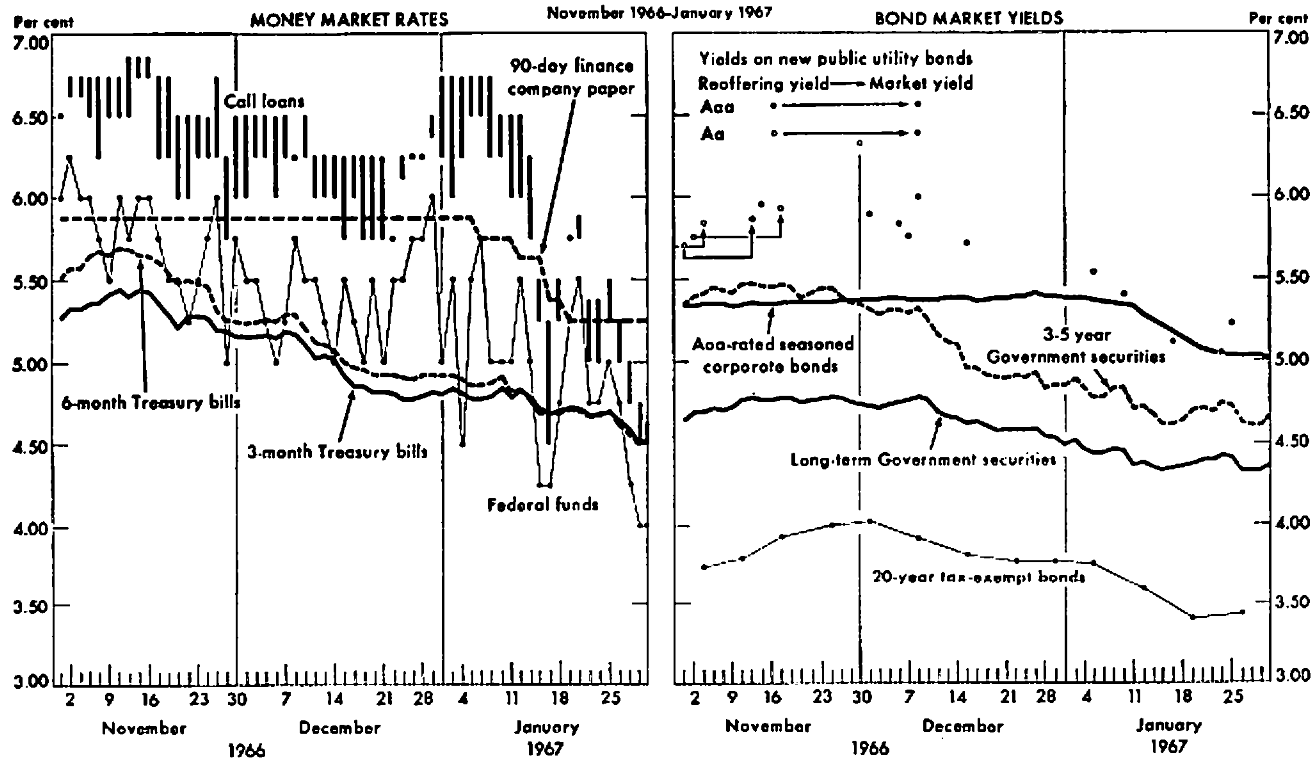
Prices of Treasury notes and bonds rose sharply, following the President's January 10 State of the Union message. Although some observers foresaw strong Congressional opposition to the President's request for higher individual and corporate income taxes, most market participants viewed the proposal as constructive and interpreted the President's general remarks on interest rates as improving the price outlook for various debt instruments. As a result, price quotations for Treasury notes and bonds rose ¼ of a point to almost 2 full points in initial trading on January 11.

Subsequently, a basically confident atmosphere persisted in the coupon sector, but prices of notes and bonds reacted unevenly to several developments. Market sentiment was buoyed by the bullish attitudes expressed in several market advisory letters, by the continuation of comfortable conditions in the money market, by talk of further peace moves in Vietnam, and by news that the United States and four major European nations had agreed to make cooperative efforts toward achieving lower interest rates. Activity gradually contracted, however, as participants awaited the terms of the Treasury's forthcoming February refunding operation. In this environment, some caution reemerged following reports that considerable resistance was developing in Congress to the President's surtax proposal, and in reaction to indications in the President's budget message that substantial public offerings of participation certificates were in prospect for fiscal 1968. From January 12 through January 25, prices of Treasury notes and bonds maturing in five years moved irregularly while prices of longer term issues declined. Although some profit taking on the part of dealers and investors appeared during this period, the underlying tone of the market remained fairly confident.

On January 25, the Treasury announced the terms of its February refunding. Its offering consisted of approximately $5.5 billion of new 4¾ per cent fifteen-month notes maturing in May 1968, priced to yield about 4.85 per cent, and $2 billion of new 4¾ per cent five-year notes maturing in February 1972 and priced to yield about 4.84 per cent. Subscription books were open only on January 30 for the new notes which will replace $2.4 billion of 3⅝ per cent notes and $5.2 billion of 4 per cent notes coming due on February 15. The market responded quite enthusiastically to the refunding announcement and to the fact that a pre-refunding was not included. In addition, the subsequent news that the British bank rate had been reduced from 7 per cent to 6½ per cent and that the prime lending rate of most United States commercial banks had been lowered from 6 per cent to 5¾ per cent (one major bank cut its prime rate to 5½ per cent) considerably strengthened market sentiment. In reaction, prices of intermediate- and long-term coupon issues moved sharply higher until late in January. In the closing days of the month, offerings expanded somewhat—partly reflecting sales of notes and bonds by investors switching into the new refunding issues—and prices edged lower. Over the month as a whole, prices of outstanding issues maturing within five years ranged from 2/32 to 1 4/32 points higher, those of five- to ten-year obligations ranged from 20/32 to 1 9/32 points higher, while quotations on longer term issues rose by 29/32 to 2 19/32 points. (The right-hand panel of the chart illustrates the movements in yields which accompanied these price changes.)

SELECTED INTEREST RATES *

November 1966–January 1967



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.

On February 1, the Treasury released the results of the refunding operation. Subscriptions up to $100,000 for the new notes of May 1968 will be allotted in full, while larger subscriptions will be subject to a 10 per cent allotment (but assured of an allotment of at least $100,000 per subscription). Subscriptions up to $50,000 for the new notes of February 1972 will be allotted in full, with larger subscriptions subject to a 7 per cent allotment (but assured of a minimum allotment of at least $50,000 per subscription). All subscriptions from official and other governmental accounts were allotted in full.

A confident tone was also evident in the market for Government agency obligations in January, and prices of most issues rose on balance during the period. For the month as a whole, new public offerings by agencies totaled approximately $2 billion and were accorded good investor receptions. Early in the period, market attention focused on a $600 million public offering by the Federal National Mortgage Association of five-, ten-, and fifteen-year participation certificates. (An additional $500 million of certificates was sold directly to Treasury trust accounts.) The new participation certificates—the first to be issued since June of last year—were priced at par to yield 5.20 per cent and attracted considerable investor interest. Later in the period, the Export-Import Bank confirmed reports that it would offer $500 million of participation certificates on February 7.

In the market for Treasury bills, where yields had fallen sharply in December, rates receded further in January. During the first third of the month, bill rate declines were held in a narrow range. Although investment demand for Treasury bills remained fairly extensive during this period, the relatively high dealer loan rates being posted by New York City banks had some restraining effect on professional participants and commercial banks expanded their sales of shorter term bills. The President's State of the Union remarks about interest rates and tax policy buoyed the bill sector, and rates fell sharply on January 11. The demand for bills subsequently expanded, dealer financing costs eased, and bill rates edged irregularly lower from January 12 through the end of the month (see the left-hand panel of the chart). At the regular monthly auction of new nine- and twelve-month bills on January 24, average issuing rates were set at 4.656 per cent and 4.576 per cent, respectively, 26 and 24 basis points below average rates set a month earlier (see Table III). At the final regular weekly auction of the month on January 30, average issuing rates were set at 4.486 per cent for the new three-month bills and 4.460 per cent for the new six-month issue, 34 and 45 basis points, respectively, below average rates at the comparable auction a month earlier.

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, prices continued to advance on balance in January. (Note the comparable sharp drop in yields illustrated in the right-hand panel of the chart.) Underwriters generally bid aggressively for the substantial volume of new corporate and tax-exempt bond flotations during the month. Investor interest in the new issues proved strong, with commercial bank demand for tax-exempt bonds especially significant during the period.

In the corporate sector, the largest new bond offering in January consisted of $250 million of Aaa-rated 5½ per cent American Telephone and Telegraph Company debentures that reached the market on January 10. The obligations, which are due to mature in 1997, carry five-year call protection. The issue, reoffered to yield 5.40 per cent, was accorded an excellent reception by investors and quickly advanced in price. The pricing of this issue was in sharp contrast to that of a comparable telephone company bond flotation last August, which was reoffered to yield 5.58 per cent and traded later that month at yields as high as 5.82 per cent. On January 17, a $40 million Aaa-rated power company utility issue, maturing in 1997 and carrying five-year call protection, was reoffered to yield 5.12 per cent, 28 basis points below the original reoffering yield on the January A.T.&T. issue. Later in the month, a relatively small Aa-rated utility issue, maturing in 1997 and carrying five-year call protection, was reoffered to yield 5.05 per cent and encountered some investor resistance.

In the tax-exempt sector, the largest January bond flotation consisted of $114 million of New York City various-purpose bonds which were reoffered to yield from 3.10 per cent in 1968 to 3.90 per cent in 1997. The bonds, which were Baa-rated by Moody's, attracted a fairly good investor interest. In October 1966, reoffering yields on a New York City bond issue ranged from 4.50 per cent to 4.60 per cent for bonds maturing in the 1968 to 1971 interval and from 4.55 per cent to 4.50 per cent for bonds maturing from 1972 to 1997.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds fell by 37 basis points to 5.02 per cent. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying ratings ranging from Aaa to Baa, dropped sharply by 34 basis points to 3.43 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.