The Money and Bond Markets in February

Conditions in the money market were quite varied during February, with the underlying tone at times appearing somewhat firmer than might have been expected purely on the basis of current nationwide net reserve availability. Money market conditions were relatively easy at the end of January and in early February, when a severe snowstorm hampered check-clearing operations and caused a sharp bulge in float. A firmer tone prevailed over much of the next three weeks before a more comfortable atmosphere was restored toward the end of the month. As the month progressed, System open market operations provided substantial amounts of reserves on a day-to-day basis—mostly through repurchase agreements—to offset larger than expected absorptions of reserves stemming from movements in other factors. But the excess reserves left in the banking system tended for a time to remain widely dispersed outside the money centers. Money center banks, on the other hand, had sizable reserve deficits. As a consequence, they raised their dealer lending rates from the lower levels prevailing in the second half of January and also for a time bid for Federal funds at somewhat higher rates than had been the case earlier. Conditions became easier again toward the end of the month, when reserve distribution shifted back toward banks in the money centers.

Late on the final day of the month, the Federal Reserve Board announced a reduction in reserve requirements against all savings deposits and Christmas and vacation club accounts and against the first $5 million of other time deposits at each member bank. The reduction was from 4 per cent to 3 per cent, with half of the cut effective in the statement period beginning March 2 and the remainder becoming effective two weeks later. The Board noted that the action was "intended to assist in meeting developing credit needs throughout the country in a manner consistent with the Federal Reserve's policy objectives of assuring that the availability of credit is adequate to provide for orderly economic growth".

Short-term interest rates generally rose through most of February, though in the Treasury bill market sharp declines in rates late in the month erased a good portion of the earlier increases. The rise in bill rates during much of the month in part reflected the profit taking of dealers and other professionals against the background of the firmer conditions prevailing temporarily in the money market. Dealers became more confident again toward the end of the month, when easier conditions returned to the money market. They were also encouraged by large sales to the Federal Home Loan Banks which bought bills in an operation designed to help the Treasury avoid exceeding the legal debt limit. The reduction in reserve requirements noted above buoyed the bill market further on the final day of the month.

In the longer term markets, the buoyancy that had prevailed during January gave way to a very cautious atmosphere during most of February—though in these markets, too, a sharp rally in prices began late on the final day of the month. The major source of concern during the month was the steady stream of announcements pointing to a very substantial current and prospective demand for capital. These announcements built up the calendar of corporate and tax-exempt bond offerings scheduled for March to more than $2 billion. The International Bank for Reconstruction and Development scheduled a $250 million offering—its largest ever—and there were rumors that the Federal National Mortgage Association (FNMA) would be selling another large issue of participation certificates. There was also some uncertainty over the prospective course of monetary policy amid further discussion of possibly greater strength in the economy later in the year.

In this environment, investors responded unenthusiastically to the fairly heavy supply of capital market offerings, despite progressively higher yields. As many of the new issues moved slowly, intensive price cutting occurred and prices of outstanding issues fell. The pressures in the corporate and tax-exempt area carried over into the market for Treasury coupon issues, and prices fell by as much as $3\frac{12}{32}$ points through February 23. Prices of Treasury issues firmed somewhat on the following day, when Treasury trust accounts bought a large amount of coupon issues because of the debt ceiling problem. These purchases of coupon issues, along with some eventual improvement in the distribution of the new issues that were offered in other sectors

Table I

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

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

Factors	Changes in daily averages—week ended				Net changes
	Feb. 1	Feb. 8	Feb. 15	Feb. 22	
"Market" factors					
Member bank required reserves*	− 91	+ 19	+ 256	+ 64	+ 248
Operating transactions (subtotal)	+ 522	− 692	− 370	− 58	− 598
Federal Reserve float	+ 241	− 250	− 97	− 65	− 171
Treasury operations†	+ 111	+ 154	− 254	+ 44	+ 55
Gold and foreign account	+ 37	− 7	+ 4	− 2	+ 32
Currency outside banks*	+ 191	− 488	− 38	+ 128	− 207
Other Federal Reserve accounts (net)‡	− 58	− 100	+ 16	− 163	− 305
Total "market" factors	+ 431	− 673	− 114	+ 8	− 348
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	− 208	+ 230	+ 59	− 143	− 62
Bankers' acceptances	− 2	+ 1	+ 1	+ 1	+ 1
Repurchase agreements:					
Government securities	− 34	+ 204	+ 46	+ 212	+ 428
Bankers' acceptances	—	+ 50	—	+ 14	+ 64
Federal agency obligations	—	+ 1	+ 6	+ 24	+ 31
Member bank borrowings	− 362	+ 177	+ 103	+ 21	− 61
Other loans, discounts, and advances	—	+ 1	− 1	—	—
Total	− 606	+ 664	+ 214	+ 129	+ 401
Excess reserves*	− 175	− 9	+ 100	+ 137	+ 53
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	23,905	23,877	23,721	23,794	23,824§
Required reserves*	23,580	23,561	23,305	23,241	23,422§
Excess reserves*	325	316	416	553	403§
Borrowings	176	353	456	477	366§
Free reserves*	+ 149	− 37	− 40	+ 76	+ 37§
Nonborrowed reserves*	23,729	23,524	23,265	23,317	23,459§
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	− 501	+ 852	−2,220	− 126	−1,995
More than one year	—	—	+2,457	—	+2,457
Total	− 501	+ 852	+ 237	− 126	+ 462

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 February 22.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS FEBRUARY 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended				Averages of four weeks ended Feb. 22
	Feb. 1	Feb. 8	Feb. 15	Feb. 22	
Eight banks in New York City					
Reserve excess or deficiency(−)*	47	8	25	62	36
Less borrowings from Reserve Banks	—	64	136	210	103
Less net interbank Federal funds purchases or sales(−)	353	641	869	529	598
Gross purchases	*1,278*	*1,230*	*1,326*	*1,192*	*1,257*
Gross sales	*925*	*589*	*457*	*664*	*659*
Equals net basic reserve surplus or deficit(−)	− 306	− 697	− 979	− 676	− 665
Net loans to Government securities dealers	1,093	1,017	774	668	888
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)*	97	19	42	37	49
Less borrowings from Reserve Banks	91	206	150	127	144
Less net interbank Federal funds purchases or sales(−)	1,429	1,400	1,291	1,321	1,360
Gross purchases	*2,223*	*1,837*	*1,930*	*1,877*	*1,967*
Gross sales	*794*	*437*	*639*	*556*	*607*
Equals net basic reserve surplus or deficit(−)	−1,423	−1,587	−1,398	−1,412	−1,455
Net loans to Government securities dealers	1,020	852	694	706	818

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—February 1967			
	Feb. 6	Feb. 10	Feb. 20	Feb. 27
Three-month	4.530	4.577	4.621	4.538
Six-month	4.524	4.581	4.694	4.534

Maturities	Monthly auction dates—December 1966-February 1967		
	December 27	January 24	February 21
Nine-month	4.920	4.656	4.718
One-year	4.820	4.576	4.696

* 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.

of the capital market during the month, left the market in a reasonably good technical position at the month end.

BANK RESERVES AND THE MONEY MARKET

Conditions in the money market varied over a fairly wide range during February, a period complicated by the holidays on Lincoln's Birthday and Washington's Birthday, by severe weather conditions which affected reserve availability, and by the tendency of reserves frequently to fall short of expectations. Federal funds, after having traded below 5 per cent in late January and the first few days of February, traded in a 5 to 5¼ per cent range during most of the following three weeks despite continued relatively ample levels of nationwide net reserve availability. Most trading was at a 4¾ per cent rate on the final three days of February, however. Rates posted by the large New York City banks on call loans to Government securities dealers were quoted in a 5½ to 6 per cent range over much of February, before falling back to as low as 5 per cent at the end of the month. Dealers in bankers' acceptances boosted their rates on unendorsed acceptances in two steps by a total of ¼ of a per cent during the month.

Continuing the January trend, offering rates on large new time certificates of deposit (C/D's) issued by the major New York City banks declined in early February to a most frequently quoted rate of 5 per cent. The lower rates slowed the expansion in the dollar volume of C/D's outstanding at weekly reporting banks from the rapid pace that occurred in January. The banks continued this somewhat less aggressive policy of attracting C/D money over the remainder of the month, though in the light of the rises in other short-term interest rates they did raise their offering rates somewhat as the month progressed. At the close of the month, some banks were reportedly paying as much as 5¼ per cent to certain customers for some maturities. Over the four weeks ended February 22, reporting banks throughout the nation recorded a $0.7 billion rise in their outstanding C/D's as against a $2.2 billion rise during the four weeks ended January 25.

When the month began, nationwide net reserve availability had risen to a relatively high level in the wake of a severe Midwestern snowstorm which gave rise to a sharp bulge in float in the statement week ended February 1 (see Table I). As a result, free reserves averaged $149 million that week, and member bank borrowings from the Federal Reserve Banks contracted sharply. Nationwide net reserve availability fell back during the next two statement weeks into the range which had prevailed in late January, with member bank borrowings concurrently expanding somewhat.

During much of the month, Federal Reserve float persistently averaged lower than anticipated, thus providing less reserves than expected. In part, this reflected a change in the schedule of crediting cash items in the process of collection from banks that are open on Saturdays. Meanwhile, bank credit continued to grow at a rapid pace, with the result that member banks' required reserves persistently averaged higher than expected for the season.

To offset these implicit reserve drains and promote bank credit growth, System open market operations injected reserves rather steadily during most of the period, arranging new repurchase agreements to meet the emerging reserve needs. Much of the reserves remained lodged outside the money centers, however, while heavy lending to dealers and others pushed money center banks into deep basic reserve deficit. To accommodate the very large demand for excess reserves from "country" banks in the week ended February 22, net free reserves were allowed to expand to an average of $76 million; however, the money market remained firm. As the previously accumulated excess reserves flowed into the money centers in the following week, and as dealers' financing needs weighed less heavily on money market banks, the atmosphere in the money market again became easier.

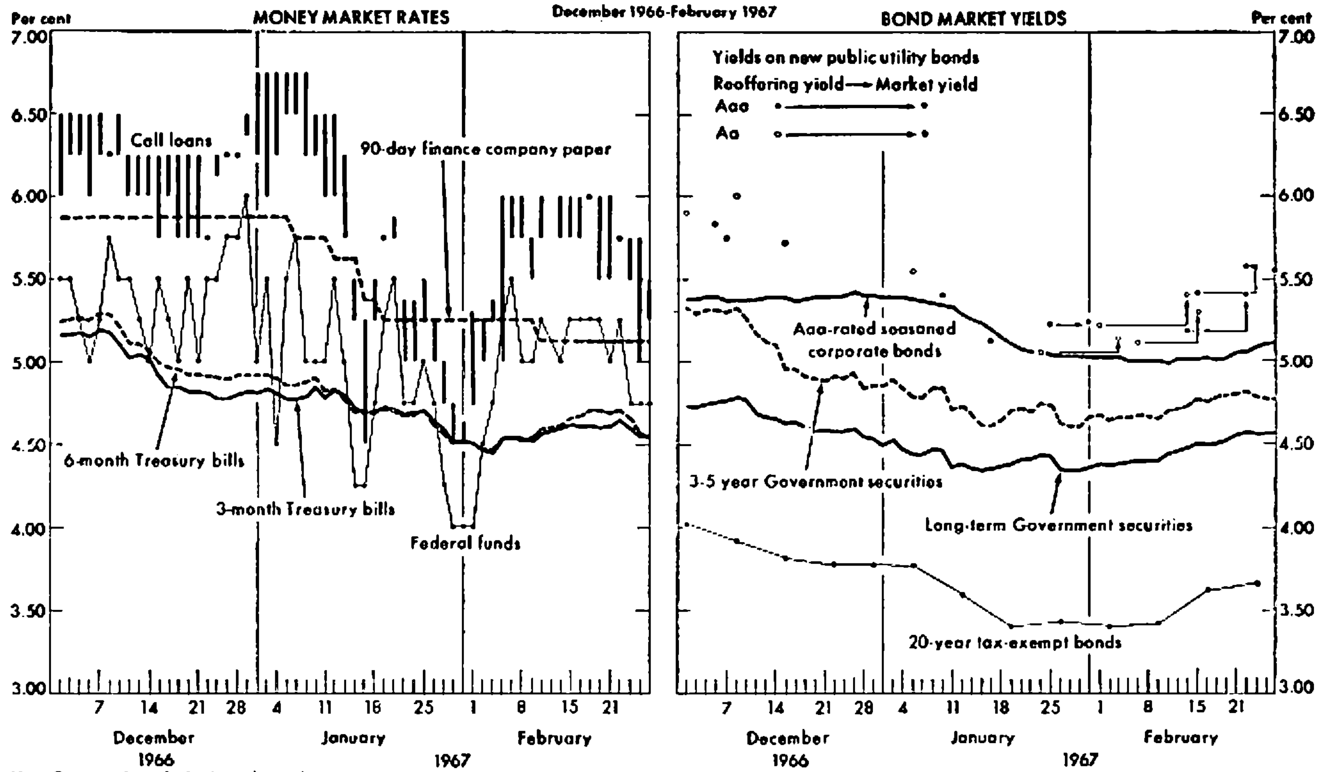
THE GOVERNMENT SECURITIES MARKET

In the market for Treasury notes and bonds, the optimistic tone which had predominated in December and January continued in evidence at the beginning of February. The disclosure on February 1 of the very successful results of the Treasury's February refinancing operation[1] confirmed earlier market expectations and contributed to the buoyant market sentiment. The exuberance of the coupon sector, however, began to wane shortly thereafter. Observers viewed with increasing caution the mounting additions to the future calendar of corporate and tax-exempt bond offerings and later rumors that the FNMA would soon offer another large volume of participation certificates. With indications that heavy demands for funds would persist in the capital markets for some time to come, and in view of market uncertainty over the future posture of monetary policy, bond market observers began to reassess the sustainability of the higher bond price levels that had emerged during the preceding two months.

[1] For details of the refinancing, see this *Review* (February 1967), pages 37-38.

SELECTED INTEREST RATES*

December 1966-February 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.

Against this background, an atmosphere of deepening caution emerged in the market for Treasury notes and bonds during most of February. Although little investment selling developed, investment demand was quite limited and professional offerings depressed prices of coupon securities sharply through February 23. Many issues suffered their largest losses since last summer. Coupon issues maturing within five years recorded price declines ranging as high as $\frac{22}{32}$ of a point during this period, while prices of longer term issues—which were particularly affected by the weakness developing elsewhere in the capital market—declined as much as $3\frac{12}{32}$ points. (The right-hand panel of the chart illustrates the rise in yields which accompanied these price declines.) In the final days of February, a steadier tone developed when Government agencies and trust funds purchased a sizable volume of marketable outstanding Treasury obligations and redeemed special issues in order to help the Treasury avoid exceeding the legal debt limit. The month closed on a fairly strong note when the market responded quite favorably to news of the reduction in reserve requirements against certain deposits, as noted above. By the end of the month, prices of many coupon issues had recouped a portion of their earlier losses.

A more cautious tone also developed in the market for Treasury bills for a time in February. Although demand remained fairly good, it was less intense than in earlier months. At the same time, increasing dealer financing costs led to an expansion in professional offerings, as dealers attempted to lighten their fairly sizable positions, while commercial bank offerings also increased. As a result, prices fell and demand did expand somewhat. Meanwhile, rates on bills maturing beyond one month generally rose through February 23. At the regular monthly auction of new nine- and twelve-month bills on February 21, average issuing rates were set at 4.718 per cent and 4.696 per cent, respectively, 6 and 12 basis points above average rates set a month earlier (see Table III).

Subsequently, the tone of the bill market strengthened when the money market became more comfortable, and considerable demand developed on the part of Government agencies. At the final regular weekly auction of the month on February 27, bidding was very aggressive and average issuing rates were set at 4.538 per cent for the new three-month bills and 4.534 per cent for the new six-month bills—8 and 16 basis points, respectively, below average rates at the comparable auction a week earlier but 5 and 7 basis points, respectively, above rates at the last weekly auction in January. At the end of February, the bill sector was encouraged by news of the reserve requirement action earlier discussed.

In the market for Government agency obligations, prices fluctuated irregularly during the month. Prices of short- and intermediate-term maturities were narrowly mixed, while prices of longer term obligations moved sharply lower. Over the month as a whole, new public offerings by agencies totaled approximately $1.3 billion. Early in the month, the Export-Import Bank offered $500 million of participation certificates (priced at par), including $250 million of 5 per cent certificates maturing in 1971 and an equal amount of 5.10 per cent certificates coming due in February 1982. Investor response to these offerings was restrained, and the prices of both issues quickly declined from their initial offering levels. Other new agency issues offered subsequently at lower prices were accorded better investor receptions. However, prices of many agency issues continued to decline, as the market reacted cautiously to talk that additional FNMA participation certificates might soon be sold.

OTHER SECURITIES MARKETS

A heavier tone developed in the markets for corporate and tax-exempt bonds in February. During the early part of the month, underwriters bid fairly aggressively for the large supply of new offerings, and reoffering yields continued to decline. However, as the calendar of scheduled corporate and tax-exempt flotations steadily expanded during the month, investors became more resistant to the lower yield levels and it became increasingly difficult for dealers to distribute the backlog of recent issues and the heavy supply of new offerings. In the tax-exempt sector, commercial bank demand contracted and the Blue List of dealers' advertised inventories of tax-exempt issues swelled to as much as $677 million, its highest level in over a year. When syndicate price restrictions were removed on several slow-moving issues, yields were adjusted higher by 30 basis points or more from original reoffering rates, but investment demand remained restrained. In the corporate sector, several underwriting syndicate pricing agreements were terminated during the month and the price declines that followed boosted yields by 20 basis points or more (see the right-hand panel of the chart). At the lower price levels, demand for corporate bonds did expand somewhat. Both sectors were encouraged at the end of the period by the announcement of a reduction in reserve requirements against savings and certain time deposits.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 9 basis points to 5.11 per cent. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying rates ranging from Aaa to Baa, increased by 23 basis points to 3.66 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.