The Money and Bond Markets in June

Yields in the capital markets rose sharply again in June. The prospect of very substantial Treasury financing in the second half of the calendar year, as well as continuing heavy current and prospective demands for funds by corporations and state and local governments, led to increasing pressures on the markets. Against this background, the atmosphere in the Treasury market on several occasions became quite demoralized and prices fell at times with very little resistance. By the end of the month, some new corporate issues were being offered at record yields and yields on Treasury coupon issues were up by as much as 84 basis points from their end-of-May levels. In this environment, there was increasing discussion of the need for a tax increase to help ease the pressures in the markets during the months ahead. While most market participants seemed to feel that some tax increase would be enacted, there was widespread concern that it might not be large enough to relieve significantly the pressures in the capital markets.

In the Treasury bill market, rates moved down for a time in June—particularly on short maturities which were in heavy demand—but then rose very sharply in the final week of the month. Expectations that the Treasury was soon to begin its financing for the second half of the year were confirmed on June 28, when the Treasury announced that it would sell in early July $4 billion of new tax anticipation bills and would also begin raising the size of the weekly and month-end auctions by $100 million each. By the end of the month, the bid rate on the latest outstanding three-month bill had climbed to 4 per cent, 54 basis points higher than a month earlier, and bid rates on longer bills were as high as 4.90 per cent. Rates on other short-term market instruments also rose somewhat during June, particularly during the last week of the month when bill rates were under such heavy upward pressure.

Money market conditions remained relatively comfortable in June. Nationwide net reserve availability was ample throughout the month, as free reserves fluctuated around the range for May. Although these reserves tended to shift away from banks in the money centers at times during the month, there was a substantial return flow through the Federal funds market, where funds traded predominantly in a 3¾ to 4⅛ per cent range.

THE GOVERNMENT SECURITIES MARKET

Activity in the Government securities market came close to a standstill during the first week of June, while participants awaited developments in the Middle East. Prices of Government securities were marked temporarily lower upon the outbreak of hostilities on June 5, but no significant selling pressures developed, and a steady tone quickly emerged with the limited trading that did take place conducted in an orderly fashion. In fact, quotations of notes and bonds improved somewhat in subsequent sessions, when reports that the United States and the Soviet Union were cooperating toward bringing about a cease-fire relieved concern that the Middle East situation would escalate further.

By June 8, however, the atmosphere in the Treasury securities market began to deteriorate again, as market participants directed their attention to the heavy Government demand for funds anticipated for the months ahead on top of the already crowded calendar of other securities offerings. Moreover, the spread between yields on Treasury issues on the one hand and high-grade corporate and Government agency securities on the other continued to widen, inducing some investor switching into corporate and agency issues. As midmonth approached, market attention focused upon the pricing of new participation certificates to be offered by the Federal National Mortgage Association (FNMA). When the initial offering yields on these certificates proved to be well above those anticipated earlier by market observers, expectations of higher interest rates were reinforced. In this atmosphere, trading activity was very light, and dealers' attempts to trim inventories of Treasury issues contributed to the sharp price declines.

Bond prices weakened further during the week ended June 21. A modest rally took place on June 22, largely reflecting some investment interest, professional short covering, and demand from other sources. However, during the remainder of the month, bond prices resumed their decline when participants again focused upon the heavy current and anticipated demands for funds in the capital markets. By the end of June, prices of most Government coupon issues were at their lows of the year and in some cases were below even the lows reached in August 1966. Yields in the one- to five-year and five- to ten-year maturity areas were as high as 5.34 per cent and 5.27 per cent, respectively, and were generally 28 to 84 basis points above their end-of-May levels. In the long-term end of the market, yields averaged around 4.95 per cent, compared with 4.93 per cent at the August 1966 peaks.

In the market for Treasury bills, rates moved irregularly during the first three weeks of June and then soared in the closing days of the month. At the beginning of June, the bill market displayed a fairly strong tone. Investment demand favored bills maturing within five months, and rate declines generally clustered at the shorter end of the maturity scale. Rates on longer bills edged higher. (See left-hand panel of the chart on page 133.) From June 6 through June 16, demand abated and some selling of bills by various types of investors developed. Augmented by aggressive attempts of dealers to lighten inventories, these pressures pushed bill rates up quite sharply.

With the passage of the midmonth quarterly corporate dividend and tax payment period, however, a steadier tone developed in the bill market. Substantial demand stemmed from the reinvestment of the proceeds of maturing tax anticipation bills, approximately $3.5 billion of which was redeemed for cash on June 22. Part of the proceeds of a Federal agency issue maturing on June 26 also found its way into the bill market. In addition, there was some demand for bills from commercial banks preparing for publication of their midyear statements and from the Federal Reserve to meet the pre-July 4 reserve needs. Once again, private demand centered in the short maturity area and, as these issues became increasingly scarce in the market, short bill rates moved down sharply. By June 23, the bid rate on the three-month bill was down to 3.33 per cent, its low for the year. Supplies of longer term bills were more adequate, and rates on some of these securities edged higher during this period. Thus, the yield spread between the latest outstanding three- and six-month bills widened to as much as 50 basis points, reflecting the general expectation in the market of a sharp turnaround in short rates once the special demands of the midyear period were satisfied.

If anything, the turnaround came sooner and was considerably sharper than had been expected. As investment demand contracted, and participants became cautious in view of the belief that an announcement of Treasury financing plans was imminent, the bill market became rather weak on Monday, June 26, and this atmosphere continued through the rest of the month. Bidding in the weekly bill auction on June 26 was quite restrained, as dealers tended to be more cautious about increasing their inventory positions. Average issuing rates were set at 3.462 per cent for the new three-month bill and 3.950 per cent for the new six-month bill (see Table III), about 2 basis points lower and 22 basis points higher, respectively, than average rates at the final weekly auction in May. Even greater restraint was evident in the auction of month-end bills on June 27, with the average issuing rate on the new one-year bills set at 4.732 per cent, up 80 basis points from the average set a month earlier. Some tenders were accepted in that auction at rates as high as 4.84 per cent.

On June 28, the Treasury announced the first steps in its program of borrowing to meet cash needs during the fiscal year beginning July 1. The Treasury scheduled a July 5 auction of $4 billion of tax anticipation bills, including $2 billion maturing on March 22, 1968 and $2 billion maturing on April 22, 1968. Payments for the bills will be due on July 11, with commercial banks permitted to make payment in the form of credits to Treasury Tax and Loan Accounts. The Treasury also announced that its weekly offerings of three-month bills will be enlarged by $100 million beginning with the July 10 auction, and that $900 million in new cash will be raised through additions to the regular monthly auctions of nine-month and one-year bills during the new fiscal year. The heavy tone continued in the bill market following the announcement, and the upward trend in bill rates accelerated over the final days of the month. From June 27 through June 30, rates on bills maturing within three months rose 45 to 65 basis points, rates on issues maturing in three to six months increased by 38 to 63 basis points, and longer bill maturities rose by 40 to 58 basis points. By the close of the month, the latest outstanding three-month bill was quoted at 4 per

Table I

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

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

Factors	Changes in daily averages— week ended on				Net changes
	June 7	June 14	June 21	June 28	
"Market" factors					
Member bank required reserves*	— 153	— 8	— 654	+ 385	— 430
Operating transactions (subtotal)	— 101	+ 451	+ 442	— 591	+ 201
Federal Reserve float	+ 171	+ 59	+ 328	— 300	+ 258
Treasury operations†	+ 137	+ 271	— 52	— 431	— 75
Gold and foreign account	+ 27	— 1	+ 10	— 5	+ 31
Currency outside banks*	— 436	— 113	+ 72	+191	— 286
Other Federal Reserve accounts (net)‡	— 1	+ 236	+ 84	— 45	+ 273
Total "market" factors	— 254	+ 443	— 212	— 206	— 229
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 312	— 273	— 21	+ 240	+ 257
Bankers' acceptances	—	+ 3	— 1	+ 7	+ 9
Special certificates	—	—	+ 12	— 12	—
Repurchase agreements:					
Government securities	+ 15	— 84	+ 67	— 51	— 53
Bankers' acceptances	+ 24	— 30	—	+ 48	+ 42
Federal agency obligations	+ 2	— 2	—	—	—
Member bank borrowings	— 25	— 34	+ 48	+ 50	+ 39
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 226	— 410	+ 106	+ 390	+ 303
Excess reserves*	— 28	+ 24	— 106	+ 184	+ 74

	Daily average levels				
Member bank:					
Total reserves, including vault cash*	23,183	23,216	23,763	23,562	23,431§
Required reserves*	22,840	22,848	23,502	23,117	23,077§
Excess reserves*	343	367	261	445	354§
Borrowings	77	43	91	141	88§
Free reserves*	+ 266	+ 324	+ 170	+ 304	+ 266§
Nonborrowed reserves*	23,106	23,172	23,672	23,421	23,343§

	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	— 280	— 566	+ 832	— 164	— 158
More than one year	+ 113	—	+ 102	+ 55	+ 270
Total	— 147	— 566	+ 934	— 109	+ 112

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 on June 28.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JUNE 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Average of four weeks ended on June 28*
	June 7	June 14	June 21	June 28*	
Eight banks in New York City					
Reserve excess or deficiency(—)†	27	10	8	15	15
Less borrowings from Reserve Banks	7	—	25	—	8
Less net interbank Federal funds purchases or sales(—)	567	559	922	451	625
Gross purchases	*1,212*	*1,284*	*1,669*	*1,333*	*1,375*
Gross sales	*645*	*725*	*747*	*882*	*750*
Equals net basic reserve surplus or deficit(—)	— 547	— 550	— 939	— 436	— 618
Net loans to Government securities dealers	729	1,077	1,086	584	869
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)†	27	21	11	— 9	13
Less borrowings from Reserve Banks	17	2	40	28	22
Less net interbank Federal funds purchases or sales(—)	1,465	1,703	1,622	1,051	1,460
Gross purchases	*2,222*	*2,342*	*2,437*	*2,028*	*2,257*
Gross sales	*757*	*638*	*815*	*977*	*797*
Equals net basic reserve surplus or deficit(—)	—1,454	—1,684	—1,651	—1,088	—1,469
Net loans to Government securities dealers	424	484	516	274	425

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—June 1967			
	June 5	June 12	June 19	June 26
Three-month	3.386	3.505	3.572	3.462
Six-month	3.758	3.796	3.841	3.950

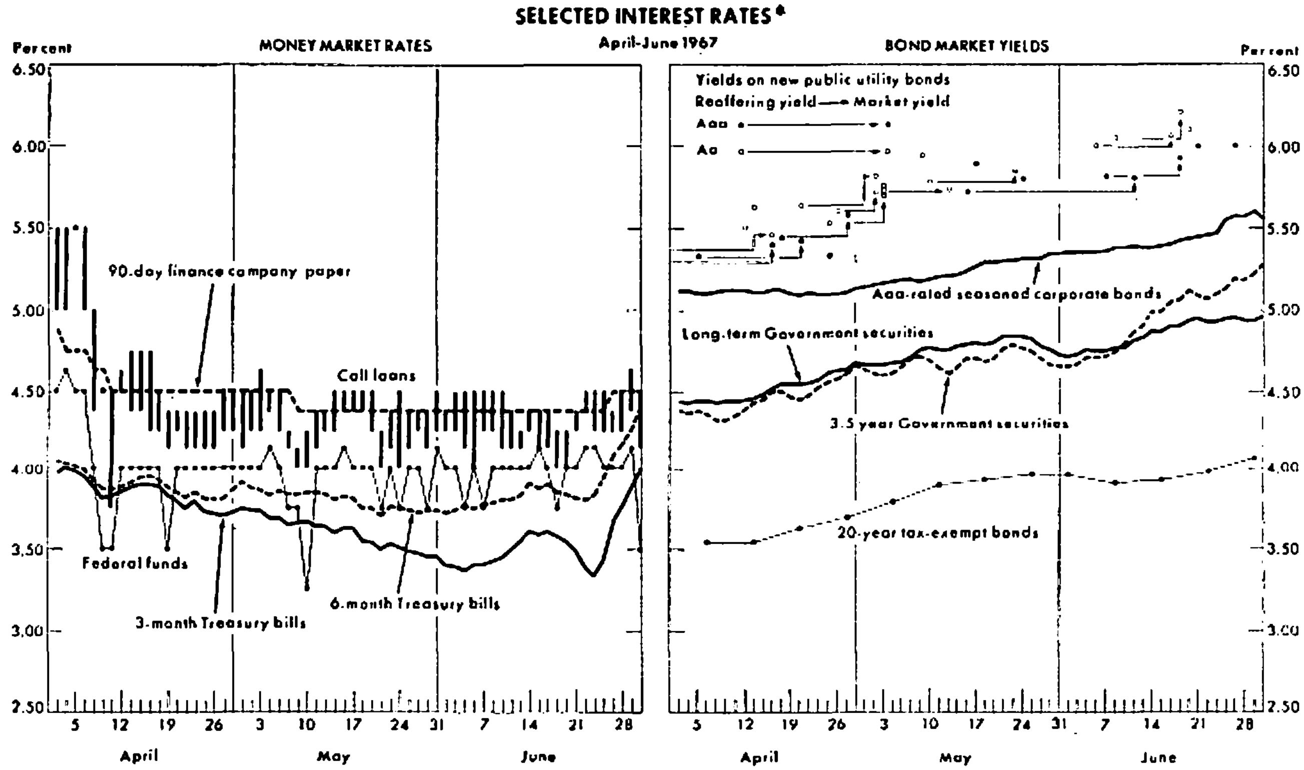
	Monthly auction dates—April-June 1967		
	April 25	May 24	June 27
Nine-month	3.842	3.944	4.723
One-year	3.832	3.933	4.732

* 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.

cent (bid), 54 basis points above the rate quoted at the end of May, while the newest six-month bill was bid at 4.41 per cent on June 30, 67 basis points above its May 31 rate level.

The market for Government agency securities concentrated during the early part of the month on preparations for the June 15 public offering of $650 million of FNMA participation certificates. (An additional $250 million of the certificates was placed with Treasury trust accounts.) The public part of the offering consisted of $350 million of 27-month notes priced at par to yield 5.25 per cent and $300 million of five-year notes priced at par to yield 5.50 per cent. These yields—in each case ½ percentage point higher than had been offered on similar maturities of participation certificates last March—seemed quite attractive relative to yields available on comparable maturities of Treasury issues. However, investors apparently were focusing on recent increases in rates on negotiable certificates of deposit (C/D's), to around 5 per cent on longer maturities, as a base for comparison. Thus, even though market reports indicated that the shorter issue was fully sold on the offering day and that the longer term issue was accorded a good, albeit somewhat less enthusiastic investor reception, both issues turned out to be less than completely placed when released for free trading in the secondary market on June 20, and their prices dropped sharply below par. Other agency issues floated during June encountered mixed investor receptions.

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.

OTHER SECURITIES MARKETS

The corporate bond market was still dominated by the heavy volume of current and prospective financing. Approximately $1.6 billion of new corporate issues was floated publicly in June, roughly matching the record set in March. Thus it appears that the volume of public corporate flotations in the first half of 1967 exceeded $7 billion, roughly double the $3.5 billion issued in the first half of 1966. The new corporate issues in June met with mixed investor response, despite rising yields which approached, and in some cases exceeded, the peak levels reached last August. Some scheduled offerings were postponed because of adverse market conditions. On June 20, underwriters reoffered a $75 million issue of Aa utility bonds carrying five-year call protection at a yield of 6.10 per cent; this was a record for such an issue at the original underwriting terms. The next day, a $40 million Aaa-rated utility issue was reoffered to yield 6.00 per cent—a record yield for a Aaa-rated utility offering. Both issues were very well received and quickly moved to premiums in secondary market trading. Subsequent issues came out at roughly comparable rates, and by the end of the month some market participants expressed the hope that 6 per cent might prove a viable yield level for high-grade corporate bond offerings at least for a time.

Prices in the municipal market remained fairly firm through midmonth, with substantial demand from banks and insurance companies. Particularly good support appeared for longer maturities for the first time in some weeks. After midmonth, however, prices of tax-exempt bonds began to decline under the mounting pressure of a congested market and the relatively heavy schedule of new offerings. Receptions of new issues were only fair, and sales from dealers' inventories proceeded slowly. By the end of the month, the volume of tax-exempt issues advertised on the Blue List stood at $638 million, compared with $576 million at the end of May. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying ratings ranging from Aaa to Baa, rose by 10 basis points to 4.06 per cent (see chart). This index is, however, based on only a limited number of seasoned issues and does not necessarily reflect market movements fully, particularly in the case of new and recent issues.

BANK RESERVES AND THE MONEY MARKET

Conditions in the money market continued generally comfortable in June. Pressures stemming from the heavy midmonth corporate dividend and tax payments were generally accommodated with ease. On a nationwide basis, free reserves averaged $266 million during the month (see Table I), roughly in line with the average level in May. Free reserves did drop temporarily to an average of $170 million in the week ended June 21, partially under the pressure of sharply rising bank loans and accompanying increases in required reserves, but a good flow of money was in evidence as "country" banks turned loose previously accumulated excess reserves. Most trading in the Federal funds market during this week as well as during the month as a whole was in a 3¾ to 4⅛ per cent range. This ready flow in the funds market enabled most banks to cover their reserve deficiencies with little recourse to the Federal Reserve "discount window". Thus, member bank borrowings from the Reserve Banks averaged only $88 million during June, compared with an average of $94 million in May.

The basic reserve positions of the forty-six major money market banks, which had improved late in May, deteriorated sharply in the first several weeks of June. The combined basic reserve deficit deepened to an average of about $2.6 billion by the third week (see Table II). At the major banks in New York City, reserves employed in dealer financing operations increased substantially over the period, since other sources of dealer borrowing tended to recede around the quarterly dividend and tax payment dates. In addition, business loans rose sharply in the weeks before and after the midmonth tax date, following earlier weakness in such lending.

The money market banks stepped up their efforts to attract and hold C/D's during June. (During the month, over $3½ billion of C/D's matured at large commercial banks.) Such certificates outstanding at thirteen large New York City banks rose by $296 million during the first two weeks of the month, declined by $203 million in the week ended June 21, and then edged upward by $15 million in the final June statement period. Banks gradually raised their offering rates; by the end of the month, the most frequently quoted rates on new C/D's ranged from 4.25 per cent for the shortest maturities to 5 per cent for longer C/D's, with the actual rates offered prime customers tending to be well up toward the top of this range.

Interest rates on several other short-term money market instruments also were raised during the month. By the end of June, offering rates on 30- to 239-day directly placed finance company paper had advanced by ⅛ percentage point to 4½ per cent and dealers in bankers' acceptances had raised their rates by ½ percentage point.