The Money and Bond Markets in July

A steadier tone developed in the Government securities market in July in the wake of the sharp upward adjustments in yields that had occurred in June. This improvement primarily reflected the favorable market reaction to more intensive discussion of an early tax rise which would moderate future Treasury debt financing needs. A cautious atmosphere briefly reappeared in the coupon market after midmonth, as participants awaited the terms of the Treasury's August refunding, news of the Administration's revised budget figures for fiscal 1968, and clarification of pending tax action. Late in the month, demand for coupon issues expanded again, and the Treasury's announcement of the details of its August refunding was well received by the market (see page 143).

In the Treasury bill market, the considerably higher levels to which rates had risen in late June and early July eventually stimulated renewed investor and professional demand, and a steadier tone emerged during the first two thirds of the month. Rates then moved higher for a few days when demand contracted, but a stronger tone reappeared in the market in late July and rates again declined.

Higher available yield levels revived investor demand for corporate and tax-exempt bonds during the first half of July, dealer inventories were steadily reduced, and the technical position of both sectors improved considerably. In this atmosphere, traders became more confident of the ability of these markets to absorb the heavy demands for capital which were expected to persist. From about midmonth onward, the tone of the corporate sector deteriorated somewhat, reflecting renewed market uncertainty over the future course of fiscal policy and the buildup in the calendar of scheduled corporate flotations. The tax-exempt sector continued to improve, however.

A comfortable tone predominated in the money market in July. Weekly average free reserves ranged from a low of $109 million to a high of $592 million in July (see Table I), but the effective rate on Federal funds generally fluctuated in a narrow 3¾ to 4 per cent range. During the month, money market banks selectively raised their offering rates on new time certificates of deposit (C/D's) in an effort to replace their portion of the more than $4.4 billion maturing in July.

THE GOVERNMENT SECURITIES MARKET

In the market for Treasury bills, rates continued to rise sharply at the beginning of July (see the left-hand panel of the chart on page 145). During this period, the bill market cautiously assessed the Treasury's plans (outlined in late June) for raising $6.2 billion of new cash through the sale of bills beginning in July.[1] In this atmosphere, dealers pressed bill offerings on the market in their eagerness to lighten their inventories, and showed little interest in absorbing customer offerings. By midday on July 5, three-month bills were being bid at 4.36 per cent, more than 1 percentage point above the 3.33 per cent low rate for the year recorded on June 23. At the rising rate levels, however, demand for bills expanded somewhat. In the July 5 auction of $4 billion of March and April tax anticipation bills, commercial banks were the principal bidders, attracted not only by the prevailing rate levels but also by the fact that they were permitted to make full payment for the tax bills in the form of credits to Treasury Tax and Loan Accounts. (Market sources estimated this privilege to be worth between 25 and 30 basis points to the banks.) Average issuing rates for the March 22 and April 22 tax bills were set at 4.861 per cent and 4.899 per cent, respectively.

From July 6 through July 19, investor interest in outstanding bill issues revived markedly. As customer demand began to weigh upon the thin market supply of most issues, dealers sought to replenish their inventories. At the regular weekly auction on July 10—the first auction to include an extra $100 million of three-month bills in line with the Treasury's new bill financing program—bidding was fairly strong and average issuing rates of 4.285 per cent for the new three-month bill and 4.688 per cent for the six-month issue (see Table III) were about unchanged and 3 basis points lower, respectively, than the auction rates established a week earlier. Sub-

[1] For details, see this *Review*, July 1967, pages 130-31.

sequently, the broadly based demand persisted, while investor selling was limited, a situation which partly reflected the more comfortable tone that had gradually developed in the money market. In view of the continued uncertainty over the future course of interest rates, however, demand generally favored 1967 bill maturities. Against this background, rates on most outstanding bills in this maturity area fell, although declines offset only part of the pronounced upward rate movement that had occurred in late June and early July, and rates on longer bills fluctuated irregularly.

The atmosphere of the Treasury bill market briefly deteriorated from July 20 through July 24, when investor demand contracted and dealers again pressed their offerings. As higher bill rate levels emerged, demand broadened once more. In the regular monthly auction of nine-month and one-year bills on July 25, bidding was quite aggressive and average issuing rates were set at 5.164 per cent for the new nine-month bill and 5.150 per cent for the new one-year bill—in each case considerably below earlier market forecasts. The market tone strengthened in the wake of the aggressive bidding at this auction, and over the remainder of the month rates on outstanding bills declined in response to good professional and investor demand.

At the final weekly auction of the month on July 31, average issuing rates were set at 4.182 per cent for the new three-month bill and 4.638 per cent for the new six-month bill, about 72 and 69 basis points higher, respectively, than average rates at the weekly auction on June 26. At the close of business on July 31, the latest outstanding three-month bill was quoted at 4.12 per cent (bid), 12 basis points higher than the rate quoted at the end of June, while the newest outstanding six-month bill was bid on July 31 at 4.60 per cent, 19 basis points above its June 30 level.

As the month opened, sentiment in the coupon sector of the Government securities market remained generally apprehensive in reaction to the sharply rising trend in yields that had beset the capital markets and the Treasury bill market in June. After the July 4 Independence Day holiday, however, demand for coupon issues began to expand at the more attractive current yield levels, as the market derived encouragement from several factors. Widespread discussion of the likelihood that the Administration would seek an early tax increase, and speculation that any further buildup of troops in Vietnam might be smaller than had been expected, led many in the coupon sector to feel that market pressures might ease. In addition, improvements in the tone of the corporate and tax-exempt bond markets during the first half of the month also bolstered the Treasury securities market. Nevertheless, despite the appearance of a somewhat more optimistic atmosphere in the coupon sector, market observers remained basically cautious in their appraisal of the interest rate outlook. Against this background, prices of Treasury notes and bonds fluctuated widely through midmonth, moving generally higher on balance. (See the right-hand panel of the chart showing the associated decline in yields.) With some issues in rather scarce supply, a small volume of trading or the appearance of additional factors affecting market psychology tended to have an exaggerated effect on prices. During this period, the largest price gains were recorded in the long-term maturity area.

After midmonth, traders began to shift their attention to the Treasury's approaching August refunding announcement. In addition, President Johnson's reference at his July 18 press conference to a possible 6 per cent surcharge on income taxes was cautiously appraised in the market for Treasury coupon issues where many traders hoped for a larger tax rise. Investor offerings of notes and bonds expanded and, in the absence of significant demand, prices of intermediate- and long-term issues moved sharply lower from July 18 through July 24. As prices reached lower levels, a better demand developed, including dealer short covering. Prices of intermediate-term issues rebounded strongly, but prices continued to move downward in the longer term sector where some investor switching out of Governments into new, high-yielding corporate issues took place.

After the close of business on July 26, the Treasury announced the details of its August refunding. It offered $9.6 billion of new fifteen-month 5¼ per cent notes (priced to yield 5.30 per cent), the proceeds of which will be used to redeem in cash three outstanding Treasury issues maturing on August 15. Subscription books were open on July 31, with payments—in the form of cash or in any of the maturing securities—due on August 15. The Treasury also announced that it will raise $2 billion to $2½ billion of new cash through an offering late in August, possibly in the form of somewhat longer term notes than those used in the refunding. Market reaction to the refunding announcement was quite favorable. In the closing days of the month, prices of outstanding intermediate- and long-term coupon issues generally moved higher in response to good demand.

In the market for Government agency obligations, prices of outstanding issues drifted lower in light trading at the beginning of July. Subsequently, investment demand expanded, and prices of many issues rebounded and then fluctuated irregularly. Over the month as a whole, public offerings by agencies totaled approximately $1.6 billion. Most of these offerings were accorded favorable investor receptions.

Table I

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

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

Factors	Changes in daily averages—week ended on				Net changes
	July 5	July 12	July 19	July 26	
"Market" factors					
Member bank required reserves*	− 306	+ 21	− 237	+ 125	− 397
Operating transactions (subtotal)	− 741	+ 97	+ 606	− 153	− 191
Federal Reserve float	− 177	+ 473	+ 143	− 239	+ 200
Treasury operations†	− 208	+ 2	+ 47	− 162	− 321
Gold and foreign account	− 20	+ 14	+ 5	+ 12	+ 11
Currency outside banks*	− 488	− 307	+ 321	+ 207	− 267
Other Federal Reserve accounts (net)‡	+ 153	− 86	+ 90	+ 28	+ 184
Total "market" factors	−1,047	+ 118	+ 369	− 28	− 588
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 331	+ 846	− 630	+ 244	+ 791
Bankers' acceptances	+ 12	+ 2	− 9	− 6	− 1
Repurchase agreements:					
Government securities	+ 35	+ 1	− 52	—	− 16
Bankers' acceptances	− 3	+ 21	− 66	—	− 48
Federal agency obligations	+ 3	+ 2	− 5	—	—
Member bank borrowings	+ 212	− 284	− 18	+ 3	− 87
Other loans, discounts, and advances	− 11	− 8	− 3	− 2	− 24
Total	+1,078	+ 81	− 785	+ 240	+ 614
Excess reserves*	+ 31	+ 199	− 416	+ 212	+ 26
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	23,854	24,062	23,882	23,970	23,950§
Required reserves*	23,422	23,401	23,638	23,513	23,494§
Excess reserves*	462	661	245	457	456§
Borrowings	353	69	51	54	132§
Free reserves*	109	592	194	403	324§
Nonborrowed reserves*	23,501	23,993	23,832	23,916	23,818§
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 854	− 334	− 451	+ 545	+ 614
More than one year	+ 62	—	—	—	+ 62
Total	+ 916	− 334	− 451	+ 545	+ 676

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 of four weeks ended on July 26.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JULY 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Averages of four weeks ended on July 26*
	July 5	July 12	July 19	July 26	
Eight banks in New York City					
Reserve excess or deficiency(−)†	117	63	19	8	52
Less borrowings from Reserve Banks	173	—	—	—	43
Less net interbank Federal funds purchases or sales(−)	452	986	857	480	694
Gross purchases	*1,268*	*1,719*	*1,534*	*1,395*	*1,479*
Gross sales	*816*	*733*	*677*	*915*	*785*
Equals net basic reserve surplus or deficit(−)	− 508	− 923	− 838	− 472	− 685
Net loans to Government securities dealers	732	523	694	700	662
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)†	46	38	39	9	33
Less borrowings from Reserve Banks	81	2	—	8	23
Less net interbank Federal funds purchases or sales(−)	817	1,283	1,199	697	999
Gross purchases	*1,730*	*2,128*	*2,093*	*1,736*	*1,922*
Gross sales	*913*	*845*	*894*	*1,039*	*923*
Equals net basic reserve surplus or deficit(−)	− 852	−1,247	−1,161	− 696	− 989
Net loans to Government securities dealers	224	292	391	404	328

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—July 1967				
	July 3	July 10	July 17	July 24	July 31
Three-month	4.280	4.285	4.245	4.423	4.182
Six-month	4.716	4.688	4.745	5.044	4.638

Maturities	Monthly auction dates—May-July 1967		
	May 24	June 27	July 25
Nine-month	3.944	4.723	5.164
One-year	3.933	4.732	5.150

* 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.

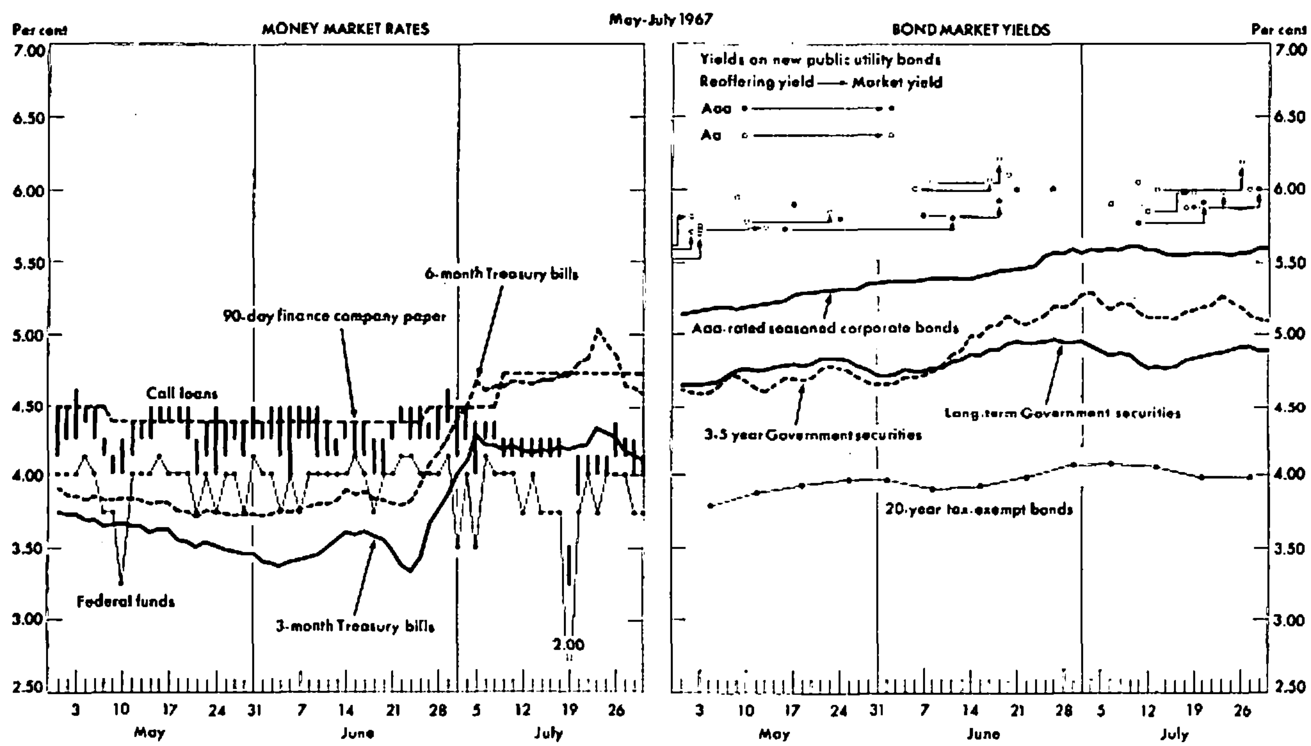
OTHER SECURITIES MARKETS

A better atmosphere developed in the markets for corporate and tax-exempt bonds in the first half of July, as investor demand responded to the relatively high yield levels which had been reached in late June. The corporate sector was favorably affected by some short covering in selected issues and by indications of renewed investment interest on the part of savings banks. Although an undertone of caution generated by the continuing heavy current calendar of flotations could be detected throughout this period, dealers' inventories of corporate bonds were kept to manageable proportions and observers expressed some confidence in the market's ability to accommodate large upcoming credit demands. Against this background, underwriters bid fairly aggressively for new corporate flotations and reoffering yields receded somewhat from their June highpoints (see the right-hand panel of the chart). A heavier atmosphere emerged in the corporate sector in the second half of July when participants cautiously awaited more information concerning future fiscal policy and also reflected upon the large calendar of scheduled corporate bond offerings. In reaction, prices of corporate issues began to decline once more. As yields on new corporate bonds moved higher, demand expanded and some switching out of long-term Government securities into new corporate issues took place.

In the tax-exempt sector during the first half of July, widespread price cutting persisted and somewhat higher yields seemed necessary on new offerings in order to at-

SELECTED INTEREST RATES*

May-July 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.

tract good investor interest. However, at rising yield levels considerable demand was forthcoming from institutional investors (notably insurance companies), and dealers steadily reduced their unsold balances of recent offerings. In part, the better demand reflected the growing conviction that some tax increase is inevitable and that tax-exempt securities will thus become more attractive investments. In the second half of July, the market was also buoyed by the moderate near-term calendar of scheduled tax-exempt financings and prices generally steadied.

Over the month as a whole, the average yield on Moody's Aaa-rated seasoned corporate bonds rose by 4 basis points to 5.60 per cent. *The Weekly Bond Buyer's* average yield series for twenty seasoned tax-exempt issues, carrying ratings ranging from Aaa to Baa, fell by 8 basis points to 3.98 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.

BANK RESERVES AND THE MONEY MARKET

The money market remained basically comfortable in July. Early in the month, the market was significantly affected by reserve adjustments related to the June 30 bank-statement publishing date and the July 4 holiday. Banks managed their reserve positions very cautiously prior to both these dates. They bid aggressively for Federal funds at rates as high as 4⅛ per cent and 4¼ per cent, and then borrowed heavily at the Federal Reserve "discount window" to cover their residual reserve needs. As a result of these Federal funds purchases and heavy borrowings from the Federal Reserve, the major money market banks managed to accumulate substantial excess reserves. After the July 4 holiday, these heavy accumulations of excess reserves spilled into the money market, Federal funds were bid at rates as low as ½ per cent on July 5, and member bank borrowings contracted sharply. Despite the substantial volume of reserves supplied by System Account operations over the July 5 statement period, nationwide free reserves dipped to an unexpectedly low average of $109 million while member bank borrowings from the Reserve Banks averaged $353 million (see Table I), the highest weekly level since February.

In the statement weeks ended on July 12 and July 19, a fairly comfortable tone prevailed in the money market, although the underlying conditions were quite different in each week. Reserve distribution sharply favored "country" banks during the July 12 period. Thus, while nationwide average free reserves expanded to almost $600 million, primarily reflecting increases in float and in System Account holdings of Government securities, the basic reserve deficit of banks in the leading money centers increased (see Table II). However, their reserve needs were readily filled in the Federal funds market to which some of the abundant reserves lodged in country banks gravitated. Against this background, most Federal funds trading took place in a 3¾ to 4 per cent range and member bank borrowings from the Federal Reserve Banks contracted sharply.

During the July 19 statement period, nationwide average free reserves contracted, but available reserves were more evenly distributed within the banking system and an easier tone emerged in the money market. As a result, the basic reserve deficits of banks in the leading money centers declined somewhat, member bank borrowings from the Federal Reserve Banks contracted further, and the effective rate on Federal funds steadily declined from 4 per cent at the beginning of the period to 2 per cent at the close. The money market remained comfortable during the remainder of the month. The reserve positions of the major money market banks improved further, while nationwide reserve availability increased and Federal funds continued to trade largely in a 3¾ to 4 per cent range.

The money market banks generally continued to boost their offering rates on negotiable C/D's during July in order to attract additional deposits and replace the substantial amount maturing during the month. Individual banks frequently posted higher rates for selective maturities, placed new certificates, and then lowered their rates. Toward the end of the month, the most frequently quoted rates on new C/D's ranged from 4.50 per cent for the shortest available maturities to 5.25 per cent for longer certificates, approximately 25 to 37 basis points above the comparable rates a month earlier. The C/D's outstanding at weekly reporting banks rose by approximately $545 million between June 28 and July 26. During the month, some of the major money market banks also borrowed substantial amounts of Euro-dollars from their foreign branches.

Adjustments were made in the rates on several other short-term money market instruments during July. By the end of the month, offering rates on prime commercial paper and on directly placed finance company paper were generally ¼ per cent higher than a month earlier, while rates quoted by dealers in bankers' acceptances on ninety-day unendorsed paper were ⅛ per cent lower.