The Money and Bond Markets in August

Money market conditions remained comfortable during August. Federal funds generally traded in a narrow band around the 4 per cent discount rate, while nationwide net reserve availability continued to fluctuate within the range of recent variation. As the month progressed, there was a significant improvement in the basic reserve positions of major banks in the money centers, reflecting in part a substantial contraction in business loans and increased acquisitions of Euro-dollars. Major banks also acquired a large volume of funds through sales of negotiable certificates of deposit (C/D's) during the month.

As was the case in July, even with the comfortable tone in the money market, yields on short-term and capital market instruments rose further in August. The President's request on August 3 for a 10 per cent surcharge on individual and corporate income taxes was welcomed by market participants, but the optimistic reaction was soon dampened by consideration of the accompanying projections of a large budget deficit and Treasury financing needs in fiscal 1968. Two Treasury cash offerings during the month—one to refund the August maturities and the other to raise new money—attracted only routine interest on the part of investors and trading activity in the Treasury market was generally light. Meanwhile, large current and anticipated corporate borrowing and the fair to poor receptions accorded several new corporate issues—in spite of mounting yields—contributed to a hesitant atmosphere throughout the capital markets. By the end of the month, yields on intermediate-term Treasury issues had risen by about 24 basis points, while long-term yields were up about 6 basis points. The yield on a new Aa-rated utility bond issue with five years' special call protection reached 6.20 per cent at the end of the month, 15 basis points more than the highest yielding comparable offering in July. The tax-exempt market was under somewhat less pressure than the corporate market, against a background of a comparatively light calendar and talk of an added relative yield advantage for tax-exempt securities in the event of a tax increase.

The cautious mood of the capital markets during August also pervaded the market for Treasury bills. Although there was a significant investment demand for bills at times during the month, rates on outstanding issues rose almost steadily until late in the month, when they receded slightly. The market yields on three- and six-month maturities rose by 26 and 23 basis points, respectively, to 4.38 per cent and 4.83 per cent at the close of the month.

BANK RESERVES AND THE MONEY MARKET

The money market remained comfortable throughout August. The effective rate for Federal funds generally was close to the 4 per cent discount rate, with some trading at 4⅛ per cent in the first half of the month and generally in a 3 to 4 per cent range later on. Free reserves averaged

Table I

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

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

Factors	Changes in daily averages—week ended on Aug. 2	Aug. 9	Aug. 16	Aug. 23	Aug. 30	Net changes
"Market" factors						
Member bank required reserves*	− 82	+ 82	+ 214	+ 63	+ 94	+ 371
Operating transactions (subtotal)	− 235	− 107	− 8	+ 330	− 49	− 68
Federal Reserve float	− 193	− 54	− 18	+ 247	− 324	− 342
Treasury operations†	− 178	+ 477	− 79	− 7	− 84	+ 179
Gold and foreign account	− 14	− 60	+ 2	− 6	− 2	− 70
Currency outside banks*	+ 29	− 510	+ 71	+ 125	+ 242	− 43
Other Federal Reserve accounts (net)‡	+ 122	+ 81	+ 14	− 30	+ 73	+ 210
Total "market" factors	− 317	− 25	+ 206	+ 393	+ 46	+ 303
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 118	− 29	− 200	− 100	− 255	− 466
Bankers' acceptances	+ 1	—	—	− 6	− 7	− 12
Repurchase agreements:						
Government securities	—	+ 127	− 17	− 110	—	—
Bankers' acceptances	—	+ 49	− 40	—	—	—
Federal agency obligations	—	—	+ 2	− 2	—	—
Member bank borrowings	+ 62	− 25	+ 38	− 82	− 1	− 8
Other loans, discounts, and advances	+ 8	− 8	—	—	—	—
Total	+ 184	+ 120	− 226	− 301	− 263	− 486
Excess reserves*	− 133	+ 95	− 20	+ 92	− 217	− 183
	Daily average levels					
Member bank:						
Total reserves, including vault cash*	23,907	23,980	23,746	23,775	23,464	23,786§
Required reserves*	23,676	23,594	23,380	23,317	23,223	23,438§
Excess reserves*	231	386	366	458	241	348§
Borrowings	116	91	129	47	46	86§
Free reserves*	115	295	237	411	195	262§
Nonborrowed reserves*	23,791	23,889	23,617	23,728	23,418	23,700§
	Changes in Wednesday levels					
System Account holdings of Government securities maturing in:						
Less than one year	− 50	—	−1,424	− 100	−335	−1,909
More than one year	—	—	+1,224	—	—	+1,224
Total	− 50	—	− 200	− 100	−335	− 685

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 five weeks ended on August 30.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS AUGUST 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on Aug. 2	Aug. 9	Aug. 16	Aug. 23	Aug. 30*	Averages of five weeks ended on August 30*
Eight banks in New York City						
Reserve excess or deficiency(−)†	19	12	10	14	25	16
Less borrowings from Reserve Banks	26	—	6	—	—	6
Less net interbank Federal funds purchases or sales(−)	392	486	508	169	− 19	307
Gross purchases	*1,255*	*1,186*	*1,198*	*1,120*	*991*	*1,150*
Gross sales	*862*	*700*	*690*	*951*	*1,010*	*843*
Equals net basic reserve surplus or deficit(−)	− 399	− 474	− 505	− 155	44	− 298
Net loans to Government securities dealers	963	1,048	943	928	907	958
Thirty-eight banks outside New York City						
Reserve excess or deficiency(−)†	18	28	30	24	6	21
Less borrowings from Reserve Banks	28	17	13	—	—	12
Less net interbank Federal funds purchases or sales(−)	813	1,038	835	633	370	738
Gross purchases	*1,845*	*1,936*	*1,901*	*1,698*	*1,666*	*1,809*
Gross sales	*1,032*	*898*	*1,066*	*1,065*	*1,296*	*1,071*
Equals net basic reserve surplus or deficit(−)	− 823	−1,029	− 818	− 609	− 364	− 729
Net loans to Government securities dealers	537	669	571	560	505	568

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—August 1967: August 7	August 14	August 21	August 28
Three-month	4.174	4.193	4.336	4.490
Six-month	4.757	4.791	4.922	4.995

Maturities	Monthly auction dates—June-August 1967: June 27	July 25	August 24
Nine-month	4.723	5.164	5.098
One-year	4.732	5.150	5.100

* 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.

about the same as in July, with continued fairly wide fluctuations from week to week in line with varying demands for excess reserves (see Table I). Nationwide borrowings from the Federal Reserve Banks also averaged about the same as in July but declined sharply in the last two statement weeks of August. In the week ended on August 23, the banking system benefited substantially from large declines in required reserves and currency outside banks. In that week, the major reserve city banks were entirely free of Reserve Bank indebtedness, and borrowings of other reserve city and "country" banks fell to negligible levels (see Table II). In the final week, only country banks borrowed at the Reserve Banks. Throughout the month, banks in New York City having branches abroad continued to borrow substantial amounts of Euro-dollars, as they had in July. The sharply increased use of Euro-dollars since June has resulted from a considerable narrowing of the differential between Euro-dollar rates and domestic C/D rates. The attractiveness of Euro-dollars as a source of funds for banks is enhanced by the fact that such borrowings are not subject to reserve requirements or deposit insurance assessments.

The financing needs of Government securities dealers increased during August but were satisfied without difficulty by borrowing from either the New York City banks or out-of-town institutions or through repurchase agreements with corporations. Borrowing was particularly heavy at the start of the period when the dealers made payment for their awards of the new nine- and twelve-month Treasury bills sold in the regular monthly auction. Rates posted by the large New York City banks on new call loans to Government securities dealers were generally quoted within a 4⅛ to 4⅜ per cent range during most of August, but declined rather sharply toward the month end. Most other short-term money rates were little changed on balance during August.

The New York City money market banks continued to attract time deposits in volume during August through the issuance of negotiable C/D's; over the five statement weeks ended on August 30, the net increase in C/D liabilities amounted to $298 million. Large commercial banks outside New York City also benefited from a rapid inflow of funds from this source, and their aggregate C/D liabilities expanded by $643 million over the same five weeks. The most often posted offering rate on new C/D's of the large New York City banks at the end of August was 4.125 per cent for the shortest maturities, down from 4.50 per cent earlier in the month. On the other hand, the city banks seemed to be having difficulty in selling longer term C/D's, though the generally posted rate remained at 5¼ per cent.

THE GOVERNMENT SECURITIES MARKET

An atmosphere of renewed caution appeared in the Treasury coupon market in August, following a temporary improvement in the market tone during July. Prices moved irregularly lower to register declines for the month as a whole of as much as 1 point in the intermediate area and almost 1½ points in longer maturities. Exceptionally large Treasury financing needs in the second half of this calendar year, together with the prospect of a sustained heavy corporate demand for funds, were again the major market influence during August. The President's request for a 10 per cent surcharge on corporate and individual income taxes buoyed the market briefly at the beginning of the month, but participants quickly came to the realization that the deficit would be very large even after allowance for the additional revenues this tax measure would produce. Moreover, it was felt in the market that the timing and magnitude of the tax surcharge or, indeed, its very adoption by the Congress were far from certain.

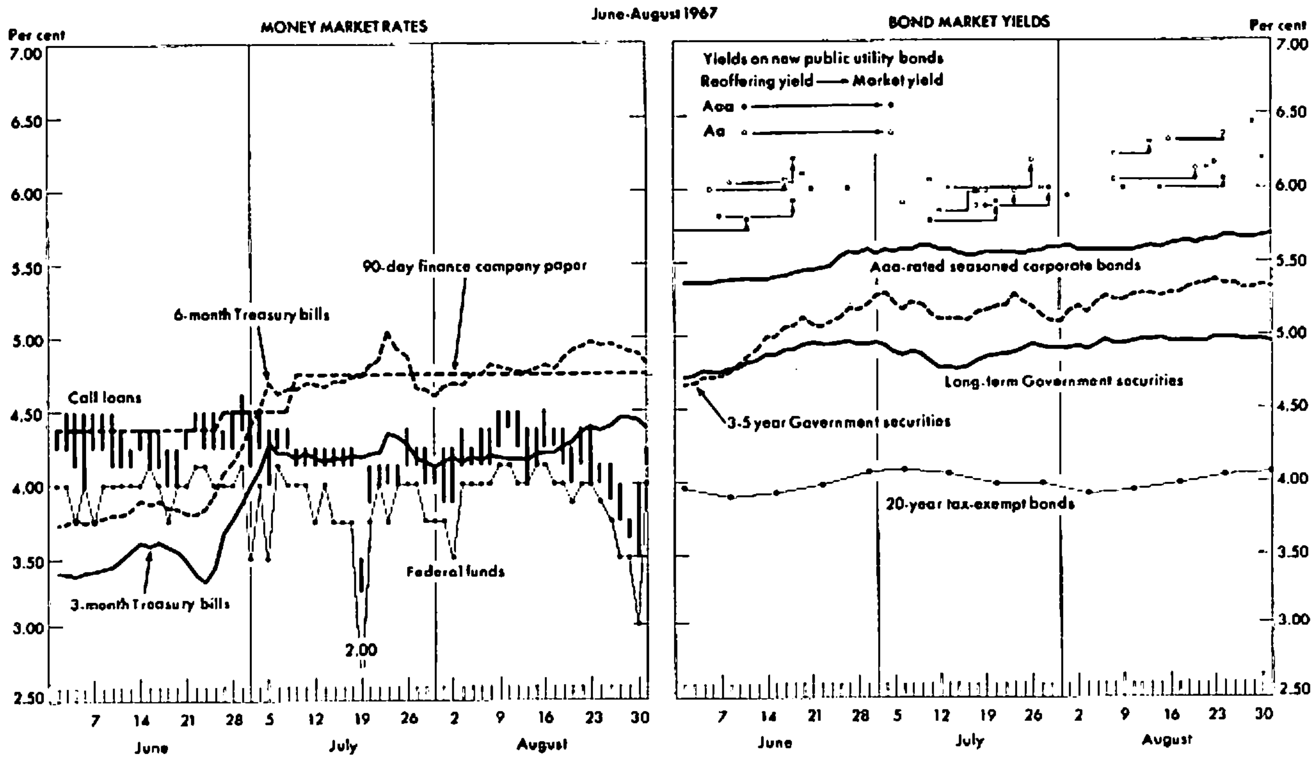
Two Treasury financing operations executed in August dominated trading during the month. After the close of the market on August 2, the Treasury announced the results of its refunding of three issues maturing on August 15, for which subscription books had been open on July 31.[1] Awards of the new fifteen-month 5¼ per cent notes offered for cash or in exchange for the maturing securities amounted to $9.9 billion against total subscriptions of $15.6 billion. Larger public subscriptions were subject to a 35 per cent allotment. This allotment percentage was somewhat higher than initially estimated by most market participants.

After the close of the market on August 17, the Treasury announced the terms of a $2.5 billion of new cash borrowing. Investors were offered a new 5⅜ per cent note due February 15, 1971, priced at 99.92 to yield 5.40 per cent. Subscription books were open on August 22, and payment was made on August 30. Commercial banks were permitted to make payment for the issue by credits to Treasury Tax and Loan Accounts. Many market participants had hoped that the Treasury would offer a somewhat longer note, perhaps in the five- to seven-year area, as a means of extending the average maturity of its outstanding debt. The Treasury's choice of a 3½-year maturity was widely interpreted as an attempt to avoid a higher coupon rate which might have had adverse effects on the thrift institutions and on other securities markets. Sub-

[1] For details, see this *Review*, August 1967, page 143.

SELECTED INTEREST RATES*

June-August 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.

scriptions totaled $6 billion and late on August 24, the Treasury announced that larger ones would be subject to a 38 per cent allotment. This allotment percentage was above initial estimates by most market participants, but generally in line with the consensus that emerged after the books had closed.

Price fluctuations on Treasury coupon issues were fairly wide early in August, but considerably narrower over the remainder of the month. In the first three days of the period, prices of intermediate issues declined in reaction to speculation that the response of investors to the offering of the new 5¼ per cent note in the August refunding would prove less favorable than had originally been thought. Prices rebounded immediately thereafter in a highly favorable market reaction to the President's request for a tax surcharge, since the suggested 10 per cent was higher than most market participants had expected. Once the new Federal budget statistics were fully digested, however, prices began an irregular downward drift which continued through the month end. The pessimism prevalent in the market was reinforced by the rising yield trend in the corporate and tax-exempt bond markets. The reports of a light volume of subscriptions for the new 5⅜ per cent notes had little effect on the market. Market activity during the month was mainly confined to professional liquidation of holdings of intermediate issues, investment switching into the new 5¼ per cent notes, and outright sales of long-term issues by investors moving into corporate securities.

The Treasury bill market was moderately firm over the first part of August, and rates for short-term bills continued to decline from the high levels attained in July after the Treasury announced that it would increase the size of each of the regular weekly and monthly bill auctions by $100 million. The early strength of the market resulted partly from the favorable yield on longer term bills relative to that offered on the closely competitive new 5¼ per cent Treasury notes of November 1968. Moreover, a fairly good investment demand from public funds and commercial banks was in evidence. After midmonth, the declining rate trend was reversed as the bill market was affected by the caution apparent in the coupon sector. With investor demand contracting and the possibility of some selling of bills around the mid-September dividend and tax dates, dealers were cautious in bidding for bills in the final auctions held during the month, and bill rates rose somewhat. In the monthly auction of nine- and twelve-month bills held on August 24, average issuing rates were set at 5.098 per cent and 5.100 per cent, respectively, slightly lower than in the July monthly auction. Average issuing rates established on the regular three- and six-month Treasury bills moved progressively higher over the month, and in the last weekly auction these rates reached 4.490 per cent and 4.995 per cent, respectively (see Table III), compared with 4.182 per cent and 4.638 per cent in the last July auction. In the wake of the auction, an active demand for bills by investors and dealers developed, and rates declined over the final three days of the month.

OTHER SECURITIES MARKETS

Developments in the markets for corporate and tax-exempt securities closely paralleled those in the Government securities market during August. The President's proposal of an income tax surcharge injected some temporary optimism into the market at the beginning of the month and, in fact, aided underwriters in completing a lagging distribution of the month's largest single corporate bond offering. Subsequently, however, market sentiment deteriorated with the growing concern over the huge demands likely to be made on the capital markets by the Treasury and corporate borrowers in coming months. The tax-exempt sector was slower than the corporate area to succumb to the general weakening tendencies, however, because of the somewhat lighter calendar of new offerings than in other recent weeks and perhaps also because of the yield advantage tax-exempt securities will gain by any income tax increase. Nevertheless, *The Weekly Bond Buyer's* average yield series for twenty seasoned tax-exempt bonds, carrying ratings ranging from Aaa to Baa, rose to 4.06 per cent at the month end from 3.98 per cent at the close of July (see chart). The average yield on Moody's Aaa-rated seasoned corporate bonds rose to 5.69 per cent from 5.60 per cent a month earlier.

In the corporate sector, a total of $1.8 billion of securities was publicly offered during August, the same amount as in July. The largest single offering was a $250 million Aaa-rated issue of 6 per cent 33-year debentures of the American Telephone and Telegraph Company, reoffered to yield 5.95 per cent and nonredeemable for five years. The issue was awarded to underwriters at a net interest cost of 6.006 per cent, a record for this borrower and considerably higher than the net interest cost of 5.46 per cent on a similar flotation by the same company in January of this year. The offering drew only a modest investor response prior to the President's tax message, but subsequently sold out quickly. In the heavier market atmosphere that developed later in the month, only negotiated industrial issues sold well, while public utility offerings awarded in competitive bidding were received unenthusiastically by investors. One $200 million offering by an oil company of Aaa-rated 5¾ per cent sinking fund debentures, carrying ten-year call protection, sold well at a reoffering yield of 5.85 per cent, 10 basis points higher than the yield on a comparable offering only three weeks earlier. During the month there were a number of syndicate terminations resulting in upward yield adjustments of about 10 basis points.

Total new publicly-offered tax-exempt securities amounted to $0.7 billion in August, down from $0.8 billion in July. In contrast to the corporate market, the municipal market retained a firm tone through midmonth, enabling dealers to reduce their inventories to the lowest level in seven months. Encouraged by the improved technical position of the market and rather light volume of offerings, dealers bid aggressively for new issues around midmonth. Investors showed considerable resistance to the lower yield levels, however, and reoffering yields tended to rise subsequently. Even at the higher yields available over the latter part of the month, there was a marked lack of enthusiasm for new issues being marketed, and most offerings moved very slowly.