The Money and Bond Markets in December

On December 27, the Board of Governors of the Federal Reserve System announced an increase of ½ percentage point in reserve requirements against demand deposits in excess of $5 million at member banks, from 16½ per cent to 17 per cent at the reserve city banks and from 12 per cent to 12½ per cent at other member banks. The increase will take effect in two stages during January 1968, the first at reserve city banks in the reserve computation period beginning on January 11 and the second at other member banks in the computation period beginning on January 18. Required reserves are expected to rise by a total of $550 million—approximately $360 million through the first-stage increase and $190 million through the second. The increase, the first in member bank reserve requirements since September 1966 and the first against demand deposits since November 1960, was undertaken in order to further "the Federal Reserve's objectives of fostering financial conditions conducive to resistance of inflationary pressures and progress toward equilibrium in the United States balance of international payments".

The money market became gradually firmer during December. Despite a contraction in nationwide net reserve availability of member banks after midmonth, the reserve position of the major money market banks remained relatively comfortable throughout the period. Consequently, the money market accommodated without difficulty the heavy seasonal flows of funds associated with corporate tax and dividend payments and year-end portfolio adjustments by commercial banks and corporations, as well as the substantial volume of international financial transactions that developed in the wake of the mid-November devaluation of the British pound. The effective rate for Federal funds was generally at or below the 4½ per cent discount rate during the first three statement weeks, but rose to 4⅝ per cent later. Rates on most other money market instruments also moved higher over the month.

Market yields on longer term Treasury bills moved irregularly lower over most of December, reflecting a strong investment demand from both domestic and foreign sources and relative scarcities of some issues. The market for Treasury notes and bonds showed renewed strength during December, although earlier price gains were pared on the last two trading days after the announcement of the increase in reserve requirements. The better market tone reflected partly an increased willingness of investors to commit funds on a long-term basis at prevailing yields and partly a feeling of relief among market participants that international currency markets had stabilized after the November devaluation of the pound sterling. Intermediate-term issues, moreover, were in demand on a substantial volume of tax switching, while the longer term area benefited from the seasonal slack in new financing operations. At a somewhat higher pattern of yields that emerged at the start of the month, a substantial volume of new and recent offerings of corporate and tax-exempt securities was distributed by underwriters.

BANK RESERVES AND THE MONEY MARKET

Conditions in the money market firmed very gradually during December, although nationwide net reserve availability contracted sharply after midmonth. Average free reserves of all member banks fell to about $80 million in the last two statement weeks (see Table I) from the $200 million level that had prevailed during November and early December. At the same time, however, the reserve positions of major money market banks were unusually comfortable for this period of the year (see Table II), and the banking system accommodated large seasonal demands for funds around midmonth without strain. The effective rate for Federal funds rose above the discount rate in the latter part of the month.

Rates on short-term money market instruments continued to increase during December. The dealer offering rate on ninety-day bankers' acceptances rose by ½ percentage point to 5⅝ per cent, while that on prime four- to six-month commercial paper increased by ⅛ percentage point to 5⅝ per cent. Offering rates on directly placed finance company paper were raised by ¼ percentage point to 5½ per cent for paper maturing in one month or more. Offering rates posted by the major New York City banks on negotiable time certificates of deposit (C/D's) maturing in one to three months were raised during December to a range of 5⅜ to 5½ per cent by the end of the month. At large commercial banks throughout the country, approximately $5.9 billion of negotiable C/D's, or 28 per cent of the total amount outstanding, matured during December. In the statement week ended on December 20, when the bulk of these maturities was concentrated, the C/D runoff amounted to an estimated $731 million.

During the two statement weeks ended on December 20, the period during which seasonal demands for funds from businesses, nonbank financial intermediaries, and securities dealers were at a high point, total loans (adjusted) and investments of all weekly reporting banks expanded by $3.8 billion, almost entirely reflecting a rise in loans. The $3.5 billion loan expansion surpassed increases in loans of $2.8 billion and $3.4 billion, respectively, in the corresponding two weeks of 1966 and 1965.

THE GOVERNMENT SECURITIES MARKET

The market for Treasury notes and bonds strengthened in December, after having been buffeted during November by the combined effects of the uncertainties surrounding the domestic fiscal and credit situation and the devaluation of the British pound in the middle of that month. At the beginning of December, the market suffered fairly sharp price losses in reaction to an announcement by the Chairman of the House Ways and Means Committee that no action would be taken on the Administration's income tax proposal during 1967. The heavy tone also stemmed in part from rumors of an imminent increase in the Federal Reserve discount rate and in the maximum interest rate payable on time deposits under Regulation Q. Subsequently, however, the market turned decidedly more optimistic, and prices rose irregularly until late in the period when news of the increase in reserve requirements exerted some downward price pressures.

A number of influences appeared to contribute to the favorable market tone, including the heavy demand for intermediate issues generated by investor tax-switching transactions, the seasonal contraction of financing activity in the long-term capital markets, and satisfaction among market participants over the performance of international currency markets after the devaluation of sterling. Long-term issues were in demand on outright buying by investors who seemed reluctant to wait for further increases in yields, feeling that perhaps long-term yields had reached a peak. In these circumstances, prices of Treasury coupon securities were not very sensitive to developments which might otherwise have produced a greater effect. Unusually heavy speculative buying of gold in the London market on December 14 and 15, for instance, sparked only a limited price decline in the Government securities market. The reaction in the market to this development was probably tempered by a weekend statement of Treasury and Federal Reserve officials, affirming that the gold value of the dollar would be maintained and that the operation of the London gold market would continue unchanged. Similarly, the market was relatively unaffected by a variety of unfounded rumors about exchange rates and changes in foreign monetary policies and by the publication at midmonth of weekly reserve statistics seeming to suggest that a shift in monetary policy had taken place. For the month as a whole, prices increased by as much as ¾ point in the intermediate maturity area and 1½ points in the long-term sector of the market.

Rates on Treasury bills moved irregularly during December in a pattern generally similar to that of yields on coupon issues. At the start of the month, rates were marked up sharply as a result of aggressive professional

Perspective '67

Each January this Bank publishes *Perspective*, a brief, informative review of the performance of the economy during the preceding year. This booklet is a layman's guide to the economic highlights of the year. A more comprehensive treatment is presented in our *Annual Report*, available in March.

Perspective '67 is available without charge from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N. Y. 10045. (A copy is being mailed with this issue of the *Monthly Review*.) A Spanish version is also available upon request.

Table I

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

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

Factors	Changes in daily averages—week ended on Dec. 6	Dec. 13	Dec. 20	Dec. 27	Net changes
"Market" factors					
Member bank required reserves*	— 285	+ 184	— 576	— 293	— 970
Operating transactions (subtotal)	— 289	— 206	+ 640	+ 81	+ 226
Federal Reserve float	+ 107	— 11	+ 504	+ 240	+ 840
Treasury operations†	+ 267	+ 516	— 54	+ 182	+ 911
Gold and foreign account	— 122	— 319	— 16	+ 8	— 449
Currency outside banks*	— 247	— 338	— 37	— 379	—1,001
Other Federal Reserve accounts (net)‡	— 292	— 54	+ 244	+ 28	— 74
Total "market" factors	— 574	— 22	+ 64	— 212	— 744
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 872	+ 134	— 145	+ 141	+ 502
Bankers' acceptances	+ 7	+ 7	+ 2	+ 5	+ 21
Repurchase agreements:					
Government securities	+ 125	— 172	—	+ 81	+ 34
Bankers' acceptances	+ 14	+ 61	— 75	+ 39	+ 39
Federal agency obligations	+ 9	— 11	—	+ 7	+ 5
Member bank borrowings	— 32	+ 34	+ 64	+ 160	+ 226
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 497	+ 52	— 154	+ 433	+ 828
Excess reserves*	— 77	+ 80	— 90	+ 221	+ 84

	Daily average levels				
Member bank:					
Total reserves, including vault cash*	24,855	24,701	25,187	25.701	25,111§
Required reserves*	24,558	24,374	24,950	25,243	24,781§
Excess reserves*	297	327	237	458	330§
Borrowings	87	121	185	345	185§
Free reserves*	210	206	52	113	145§
Nonborrowed reserves*	24,768	24,580	25,002	25,356	24,926§

	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 308	—	+ 56	+ 465	+ 829
More than one year	—	—	— 169	—	— 169
Total	+ 308	—	— 113	+ 465	+ 660

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 December 27.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS DECEMBER 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on Dec. 6	Dec. 13	Dec. 20	Dec. 27	Averages of four weeks ended on Dec. 27
Eight banks in New York City					
Reserve excess or deficiency(—)°	30	10	25	+ 52	29
Less borrowings from Reserve Banks	—	2	37	27	17
Less net interbank Federal funds purchases or sales(—)	98	— 160	188	250	94
Gross purchases	*1,052*	*905*	*1,147*	*1,172*	*1,069*
Gross sales	*954*	*1,066*	*959*	*922*	*975*
Equals net basic reserve surplus or deficit(—)	— 68	168	— 200	— 225	— 82
Net loans to Government securities dealers	885	887	1,119	1,108	1,000
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)°	14	16	14	34	20
Less borrowings from Reserve Banks	21	54	43	104	56
Less net interbank Federal funds purchases or sales(—)	408	651	512	421	498
Gross purchases	*1,727*	*1,805*	*1,883*	*1,814*	*1,807*
Gross sales	*1,319*	*1,154*	*1,370*	*1,394*	*1,309*
Equals net basic reserve surplus or deficit(—)	— 416	— 688	— 541	— 491	— 534
Net loans to Government securities dealers	648	455	491	379	493

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

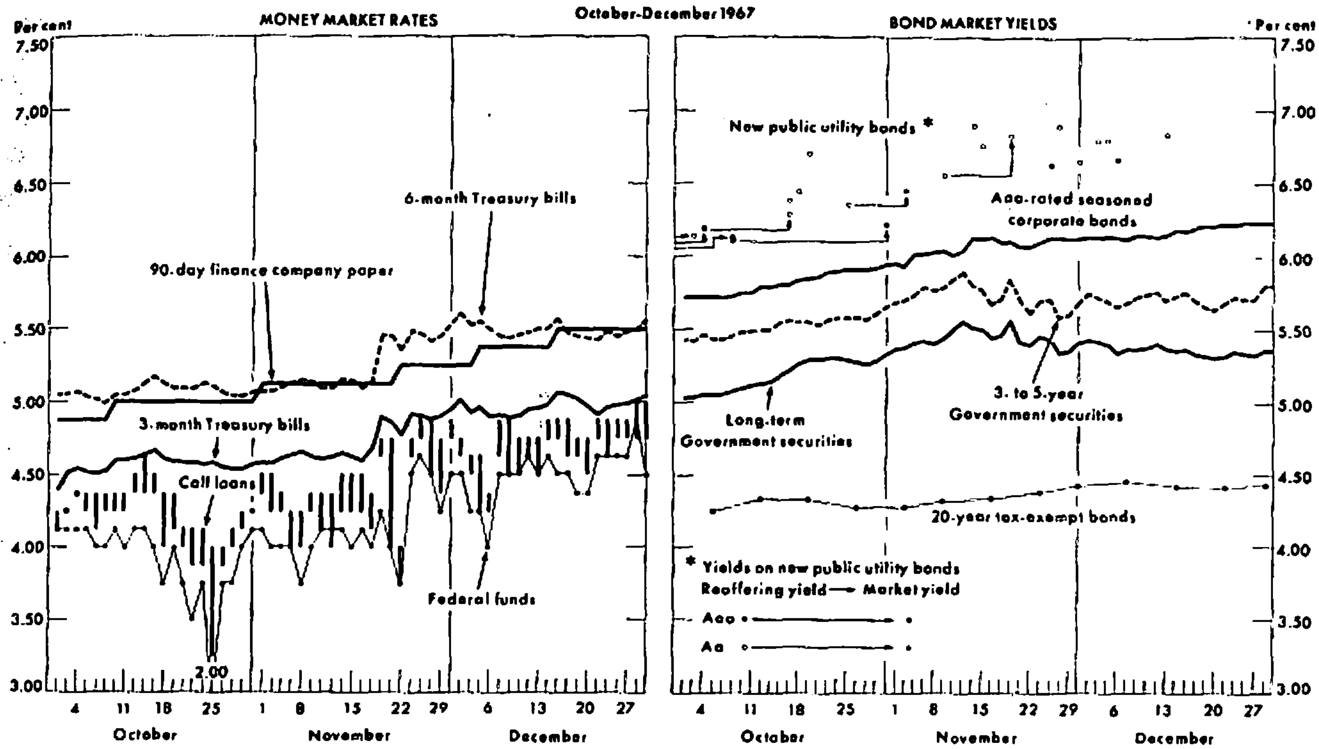
In per cent

Maturities	Weekly auction dates—December 1967: Dec. 4	Dec. 11	Dec. 15	Dec. 22
Three-month	4.989	4.941	5.127	4.989
Six-month	5.580	5.493	5.659	5.515

Maturities	Monthly auction dates—October-December 1967: October 24	November 22	December 26
Nine-month	5.313	5.422	5.555
One-year	5.302	5.430	5.544

° 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.

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.

selling of bills prompted by disappointment over the fate of the tax increase proposal in the Congress and by widespread rumors of a discount rate increase. The rise in rates generated increased investment demand, however, and bidding in the first regular weekly bill auction of the month was very strong, resulting in average issuing rates for the three- and six-month issues, respectively, of 4.989 per cent and 5.580 per cent (see Table III), only slightly higher than in the previous weekly auction. Investment buying of bills, much of it from foreign sources, held at significant levels over the remainder of the month, and scarcities of certain maturities developed frequently. For December as a whole, market yields on the nearest three- and six-month bill maturities rose by 9 and 1 basis points, respectively, to 5.04 per cent and 5.54 per cent.

OTHER SECURITIES MARKETS

A firmer tone emerged in the corporate and municipal bond markets during December, after an initial sharp upward adjustment of yields (see chart). One Aa-rated offering of public utility bonds, priced just before the Congressional announcement that the proposed surtax would not be enacted by the end of the year, was poorly received at a reoffering yield of 6.65 per cent. In contrast, two other similarly rated public utility offerings also carrying five-year call protection, priced shortly after the announcement, were quickly taken by investors at a reoffering yield of 6.80 per cent, a near-record high for this type of offering.

At the higher yield levels, new offerings of tax-exempt bonds were also marketed quite successfully. Among the largest offerings of the month was a $97 million issue of industrial revenue bonds, of which $74 million represented term bonds due in 1990. These bonds, rated Baa by Moody's, were well received at a reoffering yield of 6 per cent. Unsold balances of a number of municipal offerings, which had been overhanging the market since their initial reoffering in November, were released from syndicate price restrictions during December, with resultant upward yield adjustments of as much as 15 basis points. Nevertheless, a certain amount of congestion remained in the tax-exempt market, and at the close of the month the Blue List of dealers' advertised inventories of municipal bonds stood at $506 million, up from $478 million at the end of November.

The average yield on Moody's Aaa-rated seasoned corporate bonds rose to 6.24 per cent at the end of December from 6.13 per cent a month earlier. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying ratings ranging from Aaa to Baa, also rose over the month to 4.44 per cent from 4.42 per cent.