The Money and Bond Markets in January

The money market was firm throughout January, with the effective rate for Federal funds remaining generally above the discount rate. Member bank borrowings at the Reserve Banks were reasonably steady after the first statement week, in which borrowings reflected the usual bank adjustments prior to the year-end statement date. Net free reserves were allowed to ride up and down to compensate for the shifting amounts of reserves retained by "country" banks. By contrast with the firm rates in the market for overnight funds, rates for most short-term debt instruments declined, reflecting an unusually large seasonal expansion in the volume of funds available for investment. Treasury bill rates declined sharply, despite the sale of an additional $2.5 billion of June tax anticipation bills early in the month. Large commercial banks lowered their posted offering rates on new negotiable time certificates of deposit (C/D's), dealers in bankers' acceptances and in prime commercial paper reduced their offering rates, and major finance companies lowered rates for most maturities of paper which they place directly with investors.

Prices of intermediate- and long-term Government securities scored large gains during January. The market developed a buoyant tone at the beginning of the month, as hopes for peace negotiations on Vietnam blossomed and President Johnson announced a program designed to bring the nation's international payments into balance. Prices rose sharply until midmonth, when market hopes for early progress toward peace faded and the domestic fiscal and credit situation was interpreted as generally unfavorable. The brief downward movement of prices at midmonth was reversed toward the close of the month despite a variety of disquieting developments, including new tensions in Korea. The corporate and tax-exempt bond markets also displayed considerable strength early in January, softened around midmonth, and firmed near the close of the month.

BANK RESERVES AND THE MONEY MARKET

The money market was somewhat firmer, on average, in January than it had been in December, and the effective rate for Federal funds was generally at the 4⅝ per cent level attained late in the preceding month. Wide week-to-week variations in nationwide net reserve availability did not alter the tone of the Federal funds market, which remained consistently firm during the period.

Aggregate free reserves rose to an average level of $405 million in the second statement week (see Table I). However, the increase compensated for extraordinarily large excess reserves held by country banks in that week. At the same time, the large banks in New York City and other major money centers sustained sharp losses of reserves, and the money market remained firm. During the following statement week, the maintenance of a firm tone was consistent with net borrowed reserves of $70 million, as the large accumulated reserve surpluses of the country banks were released to the Federal funds market.

Over the balance of the month the money market remained generally firm in spite of a pronounced improvement in the basic reserve positions of the New York City banks and other major money market banks (see Table II). While reserve positions of country banks were under some pressure, the New York City banks moved into a position of basic reserve surplus near the end of January, as C/D and Euro-dollar liabilities were maintained at declining interest rates and loans and investments decreased.

Short-term debt instruments were in strong demand during January, as savings banks, corporations, and state and local governments sought to invest a plentiful supply of funds. Dealers in bankers' acceptances lowered their offering rates on ninety-day paper on four occasions, by a total of ½ per cent, to 5⅛ per cent. Commercial paper dealers reduced their offering rates on prime four- to six-month paper by ⅛ per cent to 5½ per cent, and major finance companies lowered their rates on directly placed paper by ¼ per cent to 5¼ per cent for paper maturing in two to six months. Moreover, market yields on Treasury bills declined sharply, by as much as 55 basis points on maturities of six months.

The New York City money market banks lowered their posted offering rates on negotiable time C/D's from the flat 5½ per cent on all maturities that had prevailed at the turn of the year. At the end of January, one- to three-month maturities were generally available at 5 per cent, and three- to six-month maturities at 5¼ per cent, while longer maturities continued to be quoted at the ceiling rate. At a lower pattern of offering rates, large commercial banks throughout the country succeeded in rolling over unusually heavy C/D maturities of $5.9 billion, more than one third of the total outstanding. Moreover, C/D liabilities of these banks rose by $565 million, net, over the four statement weeks ended on January 24. Much of the improvement in C/D sales during January reflected purchases of certificates maturing in more than three months.

THE GOVERNMENT SECURITIES MARKET

The market for Treasury notes and bonds was buoyant until mid-January, and prices rose by as much as 4 points. While the earlier optimism of market participants faded around midmonth, it revived later so that, for the month as a whole, prices of some coupon issues recorded gains of 3 points or more. In the initial surge of prices, yields on intermediate- and long-term issues were driven down roughly 35 basis points from end-of-December levels and 50 basis points from yields at mid-November, prior to the devaluation of the pound sterling. At the month end, long-term Treasury yields were still about 20 basis points below year-end levels.

Investors and professionals alike reacted very favorably to President Johnson's announcement on January 1 of a broad program to bring the nation's international payments into balance. This event, following on the heels of the December 27 increase in member bank reserve requirements, had a beneficial effect on market psychology. Subsequently, the market was given additional encouragement by a series of reports that North Vietnam was taking a more conciliatory position with regard to peace negotiations. Moreover, the declining yield trend in the corporate bond market and the rapid sellout of some key corporate issues favorably affected the Treasury coupon market. In the market atmosphere that prevailed early in the month, announcements of sizable cash financings by the Treasury and the Federal National Mortgage Association (FNMA) had no adverse effect on the coupon sector.

From January 12 through 22, Treasury coupon prices dropped sharply and a considerable part of the earlier gains was lost. Market participants registered some disappointment over the failure of the hoped-for peace negotiations to materialize and over the President's State of the Union Message on January 17, which they had hoped would contain specific proposals for the achievement of peace and a lower level of Federal spending. The market was further sobered by the realization that the President's proposed 10 per cent income tax surcharge seemed no closer to enactment into law now that the Congress was reconvened than it had before the Congressional adjournment in December. After a brief interval, the market resumed its uptrend, though on a more cautious note than earlier. Peace hopes were stirred by further press reports, while new tensions in Korea had little adverse impact.

The market also displayed little apprehension about the approaching Treasury refunding operation and, in fact, began to build up a favorable sense of anticipation as the announcement date approached. After the close of the

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1968

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

Factors	Changes in daily averages—week ended on					Net changes
	Jan. 3	Jan. 10	Jan. 17	Jan. 24	Jan. 31	
"Market" factors						
Member bank required reserves*	— 550	+ 456	— 79	— 147	+ 186	— 134
Operating transactions (subtotal)	+ 207	— 11	+ 39	— 51	— 102	+ 72
Federal Reserve float	— 58	— 1	— 347	— 261	— 284	— 946
Treasury operations†	— 229	— 98	+ 28	+ 90	— 161	— 375
Gold and foreign account	— 449	— 13	+ 6	+ 5	— 11	— 462
Currency outside banks*	+ 659	+ 34	+ 381	+ 278	+ 384	+1,736
Other Federal Reserve accounts (net)‡	+ 279	+ 68	— 34	— 164	— 29	+ 120
Total "market" factors	— 343	+ 445	— 50	— 198	+ 84	— 62
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 195	+ 65	— 409	+ 405	— 169	+ 87
Bankers' acceptances	— 1	— 1	— 5	— 1	— 2	— 10
Repurchase agreements:						
Government securities	+ 133	— 140	— 17	— 57	+ 34	— 47
Bankers' acceptances	+ 44	— 83	+ 6	+ 49	— 30	— 14
Federal agency obligations	+ 33	— 40	+ 1	— 1	—	— 7
Member bank borrowings	+ 150	— 315	+ 44	+ 9	+ 8	— 104
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+ 554	— 518	— 381	+ 403	— 158	— 95
*Excess reserves**	+ 211	— 68	— 431	+ 205	— 74	— 157
	Daily average levels					
Member bank:						
Total reserves, including vault cash*	26,448	25,924	25,572	25,924	25,664	25,906§
Required reserves*	25,795	25,339	25,418	25,565	25,379	25,409§
Excess reserves*	653	585	154	359	285	407§
Borrowings	495	180	224	233	241	275§
Free reserves*	158	405	— 70	126	44	133§
Nonborrowed reserves*	25,953	25,744	25,348	25,691	25,423	25,632§
	Changes in Wednesday levels					
System Account holdings of Government securities maturing in:						
Less than one year	+ 342	—1,032	+ 508	— 56	+ 47	— 191
More than one year	—	—	—	+ 78	—	+ 78
Total	+ 342	—1,032	+ 508	+ 22	+ 47	— 113

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 five weeks ended on January 31.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JANUARY 1968

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Average of five weeks ended on Jan. 31*
	Jan. 3	Jan. 10	Jan. 17	Jan. 24	Jan. 31*	
Eight banks in New York City						
Reserve excess or deficiency(—)†	85	7	15	15	14	27
Less borrowings from Reserve Banks	156	55	51	—	27	58
Less net interbank Federal funds purchases or sales(—)	407	831	518	— 126	— 190	288
Gross purchases	*1,127*	*1,381*	*1,246*	*883*	*840*	*1,095*
Gross sales	*720*	*550*	*728*	*1,009*	*1,030*	*807*
Equals net basic reserve surplus or deficit(—)	— 478	— 880	— 554	140	177	— 319
Net loans to Government securities dealers	1,284	1,299	1,152	974	1,301	1,202
Thirty-eight banks outside New York City						
Reserve excess or deficiency(—)†	99	14	15	22	—	30
Less borrowings from Reserve Banks	181	20	63	77	43	77
Less net interbank Federal funds purchases or sales(—)	659	840	926	532	308	653
Gross purchases	*1,631*	*1,958*	*1,981*	*1,798*	*1,664*	*1,806*
Gross sales	*972*	*1,118*	*1,055*	*1,267*	*1,356*	*1,153*
Equals net basic reserve surplus or deficit(—)	— 741	— 846	— 975	— 587	— 351	— 700
Net loans to Government securities dealers	404	693	737	719	703	651

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

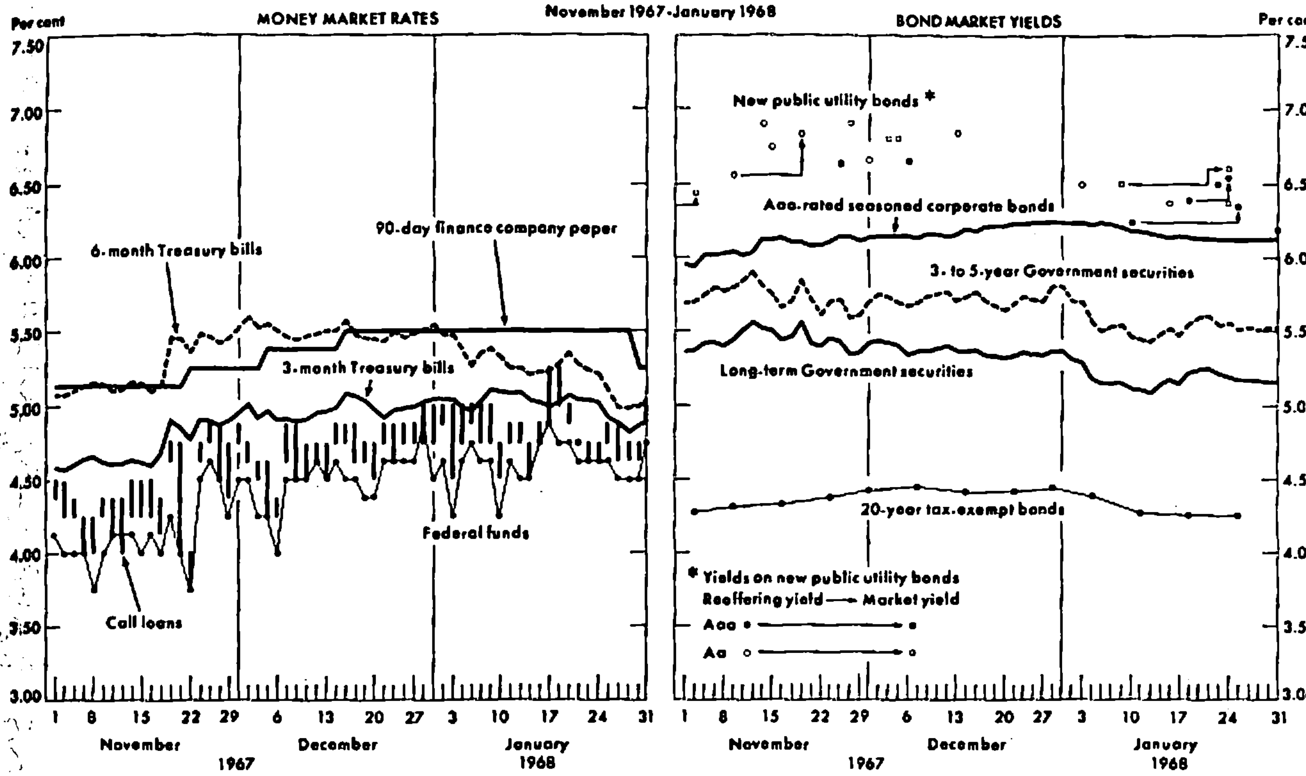
Maturities	Weekly auction dates—Jan. 1968			
	Jan. 8	Jan. 15	Jan. 22	Jan. 29
Three-month	5.080	5.072	5.068	4.846
Six-month	5.376	5.238	5.335	4.957

Maturities	Monthly auction dates—Nov. 1967-Jan. 1968		
	Nov. 22	Dec. 26	Jan. 25
Nine-month	5.422	5.555	5.254
One-year	5.430	5.544	5.267

* 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

November 1967-January 1968



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.

market on January 31, the Treasury announced a refunding and prerefunding of five issues of notes and bonds maturing on February 15, August 15, and November 15, 1968. Holders of 5⅝ per cent notes due February 15, 4¼ per cent notes and 3¾ per cent bonds due August 15, and 5¼ per cent notes and 3⅞ per cent bonds due November 15 may exchange their holdings for new 5¾ per cent seven-year notes to be dated February 15, 1968 and to mature on February 15, 1975. Of the $24.3 billion of the maturing securities outstanding, approximately $12.1 billion is held by the public. Subscription books for the exchange will be open February 5 through 7. The Treasury also announced that it will offer about $4 billion of fifteen-month notes for cash on February 13. Terms of the offering will be announced on February 8.

Market yields on Treasury bills declined during January, as a generally strong investment demand—which persisted through the close of the month—frequently encountered a thin supply of offerings. The strength elsewhere in the securities markets also contributed to the downward rate adjustments. Demand centered largely in issues with maturities of more than three months, and rates on these bills fell 19 to 55 basis points. Shorter issues, on the other hand, were subjected to some selling pressure by commercial banks, reversing purchases of these bills which had been made for statement purposes prior to the year-end.

The market took in stride the sale by the Treasury on January 9 of an additional $2.5 billion of tax anticipation bills maturing on June 24, 1968 and acceptable at face value in the payment of Federal income taxes on June 15.

(June tax anticipation bills in the amount of $3 billion were already outstanding.) Commercial banks were permitted to make payment for the bills on January 15 by crediting the full amount of purchases to Treasury Tax and Loan Accounts. This feature of the offering was estimated by the market to have been the equivalent of roughly 40 basis points in yield to commercial banks. The bills were awarded in strong bidding at an average issuing rate of 5.058 per cent. Average issuing rates on the regular issues of three- and six-month bills trended lower over the month. In the final weekly auction held on January 29, average issuing rates on the three- and six-month issues were set at 4.846 per cent and 4.957 per cent (see Table III), respectively, 26 and 64 basis points lower than in the last December auction.

Prices of Federal agency securities followed movements in other sectors of the capital market during January. On January 16, the FNMA sold $1,250 million of participation certificates, $800 million to the public and $450 million to Government investment accounts. The public offering consisted of $500 million of three-year certificates, priced to yield 6 per cent, and $300 million of twenty-year certificates, priced to yield 6.084 per cent, about 32 basis points lower than the yield offered on a FNMA long-term financing in November 1967.

OTHER SECURITIES MARKETS

The corporate and tax-exempt bond markets reacted vigorously to the President's balance-of-payments program and to the seemingly more concrete hopes for peace that pervaded the capital markets early in January. Corporate bond prices extended their December gains, and pressures lifted from the tax-exempt market. The Blue List of dealers' advertised inventories of tax-exempt bonds plummeted to $311 million near midmonth from $506 million at the end of December. By the close of January, however, the Blue List figure had risen to $444 million, as a result of the mild deterioration in market sentiment around midmonth and a sharp increase in the volume of tax-exempt offerings in the final week of the month.

New corporate bonds were offered at sharply lower interest rates in early January (see chart), and a few offerings that had been postponed previously were brought to market during this period. However, issues for which underwriters had bid very aggressively encountered some resistance from investors. At midmonth, a large offering of Aaa-rated long-term telephone debentures carrying five-year call protection received only a fair reception at a reoffering yield of 6.25 per cent, 40 basis points less than the yield on a similar offering early last December. At the month end, a comparable utility issue, priced to yield 6.20 per cent, received only a lukewarm response from investors.

The average yield on Moody's Aaa-rated seasoned corporate bonds declined by 12 basis points to 6.12 per cent during January, while *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying ratings ranging from Aaa to Baa, fell by 19 basis points to 4.25 per cent.