The Money and Bond Markets in March

Developments in domestic financial markets during March were largely dominated by events in the foreign exchange and gold markets. Renewed speculative pressures on the pound sterling and the Canadian dollar, which commenced in the final days of February, spread to the United States dollar. Through midmonth, the demand for gold built up to unprecedented proportions, forcing into sharper focus the fundamental problems of the international monetary system and the domestic economy. The pressure on member bank reserve positions increased steadily over the month, and between March 15 and 22 the discount rates of all twelve Federal Reserve Banks were increased by ½ percentage point to 5 per cent, the highest level in almost forty years. Nine Federal Reserve Banks announced increases in their discount rates on March 14, effective on March 15, and the Federal Reserve Banks of San Francisco and Philadelphia later announced similar increases in their rates effective on March 15 and 18, respectively. The Federal Reserve Bank of New York did not take similar action until March 21, effective the following day.

The structure of interest rates shifted moderately upward in March, reflecting concern in the credit markets over international developments and the degree of monetary stringency that would ultimately be required to defend the dollar. The effective rate for Federal funds was generally quoted at 5½ per cent after the discount rate increase. At midmonth, the large New York City banks increased their offering rates on new negotiable time certificates of deposit (C/D's) in the shortest maturity category to 5½ per cent, the maximum permissible rate under Regulation Q. Rates on bankers' acceptances, finance company paper, and commercial paper rose as much as ½ percentage point. Market yields on Treasury bills closed the month about 15 basis points higher, as a sharp increase through March 14 was partially reversed later under the impact of a strong investment demand due to seasonal and other influences.

The market for Treasury notes and bonds was shaken by the events in international financial markets, and price losses on long-term issues mounted to more than 4 points by mid-March. Subsequently, after international agreement on a two-price system for gold had been reached, the market recovered a substantial part of these losses. Participants were also encouraged when the discount rate increase proved smaller than many had expected and when the Administration expressed willingness to consider the budget cuts that may be necessary in order to secure passage of the needed surtax legislation by the Congress. Yields trended sharply higher in the corporate and municipal bond markets. The volume of new corporate financing fell off from recent levels, while tax-exempt offerings increased sharply as a result of a rush to market industrial revenue bonds before the effective date of an expected Treasury ruling which would subject interest payments on these securities to Federal income taxation.

BANK RESERVES AND THE MONEY MARKET

The availability of reserves at member banks contracted sharply in March, since severe reserve drains through gold and foreign account transactions were not fully offset by System open market operations. On a daily average basis, aggregate net borrowed reserves increased steadily over the month, from $136 million in the final statement week of February to $410 million in the closing March week (see Table I). For the month as a whole, average net borrowed reserves of $306 million contrasted with average free reserves of $16 million in February. The increased pressure on member bank reserve positions produced heavier borrowings from the Reserve Banks; daily average borrowings for the four March statement weeks jumped to $649 million from $368 million in the preceding four weeks.

The pronounced contraction of nationwide net reserve availability had the greatest impact on the banks in major money centers outside New York City. The basic reserve position of the eight New York City money market banks improved, on average, in March but fluctuated widely from week to week within the period (see Table II). After declining to $16 million in the first statement week, the average basic reserve deficit of the city banks rose to $371 million in the week ended on March 13, largely as a result of sizable outflows of demand deposits associated with the quarterly corporate dividend payments

Table I

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

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

Factors	Changes in daily averages—week ended on				Net changes
	March 6	March 13	March 20	March 27	
"Market" factors					
Member bank required reserves*	− 165	+ 408	− 179	+ 99	+ 163
Operating transactions (subtotal)	− 233	− 754	− 405	− 10	− 1,402
Federal Reserve float	+ 173	− 256	+ 195	− 151	− 39
Treasury operations†	+ 48	+ 8	+ 6	+ 309	+ 372
Gold and foreign account	− 5	− 244	− 781	− 427	− 1,457
Currency outside banks*	− 395	− 330	+ 69	+ 229	− 427
Other Federal Reserve accounts (net)‡	− 54	+ 67	+ 108	+ 28	+ 149
Total "market" factors	− 398	− 346	− 584	+ 89	− 1,239
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 295	+ 147	+ 674	− 219	+ 897
Bankers' acceptances	− 1	− 1	—	+ 1	− 1
Repurchase agreements:					
Government securities	+ 49	+ 52	− 101	—	—
Bankers' acceptances	—	—	—	+ 46	+ 46
Federal agency obligations	+ 9	+ 2	− 11	—	—
Member bank borrowings	+ 58	+ 279	− 46	− 151	+ 140
Other loans, discounts, and advances	+ 1	+ 7	+ 7	—	+ 15
Total	+ 411	+ 488	+ 523	− 323	+ 1,098
Excess reserves*	+ 13	+ 142	− 62	− 234	− 141
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	25,814	25,548	25,665	25,333	25,590§
Required reserves*	25,488	25,080	25,259	25,160	25,247§
Excess reserves*	326	468	406	173	343§
Borrowings	500	779	733	582	649§
Free reserves*	− 174	− 311	− 327	− 410	− 306§
Nonborrowed reserves*	25,314	24,769	24,932	24,750	24,941§
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 382	− 170	+ 716	− 419	+ 509
More than one year	+ 84	—	+ 50	+ 67	+ 201
Total	+ 466	− 170	+ 766	− 352	+ 710

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 March 27.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MARCH 1968

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Averages of four weeks ended on March 27*
	March 6	March 13	March 20	March 27*	
Eight banks in New York City					
Reserve excess or deficiency(−)†	24	125	33	− 11	43
Less borrowings from Reserve Banks	—	219	126	15	90
Less net interbank Federal funds purchases or sales(−)	40	277	− 114	42	61
Gross purchases	*797*	*906*	*860*	*966*	*882*
Gross sales	*756*	*629*	*975*	*924*	*821*
Equals net basic reserve surplus or deficit(−)	− 16	− 371	21	− 68	− 109
Net loans to Government securities dealers	1,077	841	866	860	911
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)†	9	47	2	5	16
Less borrowings from Reserve Banks	236	232	179	110	189
Less net interbank Federal funds purchases or sales(−)	753	831	863	552	750
Gross purchases	*1,735*	*1,761*	*1,776*	*1,861*	*1,783*
Gross sales	*982*	*931*	*913*	*1,309*	*1,034*
Equals net basic reserve surplus or deficit(−)	− 980	− 1,015	− 1,039	− 657	− 923
Net loans to Government securities dealers	813	581	435	338	542

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—March 1968			
	March 4	March 11	March 18	March 25
Three-month	5.000	5.107	5.285	5.186
Six-month	5.173	5.321	5.378	5.301

Maturities	Monthly auction dates—January-March 1968		
	January 25	February 21	March 26
Nine-month	5.254	5.239	5.424
One-year	5.267	5.281	5.475

* 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.

concentrated in that week. In the following statement week, containing the March 15 corporate income tax payment date, the city banks moved into a position of basic reserve surplus, as corporate tax borrowing was relatively limited and the banks gained funds through the crediting of corporate income tax payments to Treasury Tax and Loan Accounts. In addition, the city banks benefited from recent sizable increases in Euro-dollar balances due to their own foreign branches, and they were quite successful in replacing the bulk of the C/D's that matured in volume around the corporate tax date. In the final week of March, the city banks reverted to a position of basic reserve deficit, primarily due to a decline in average Euro-dollar holdings.

The money market was firm during March. Transactions in Federal funds generally took place at a premium over the discount rate. This premium rose to 1 per cent on the eve of the discount rate increase but was generally ¼ to ½ per cent at other times during the month. Other short-term interest rates rose during March. Dealers in bankers' acceptances lifted their offering rate on ninety-day unendorsed paper by ½ percentage point to 5¾ per cent. Commercial paper dealers raised their offering rates on prime four- to six-month paper by ¼ percentage point to 5¾ per cent, and major finance companies raised their rates on paper placed directly with investors by ⅜ percentage point. The published rate on finance company paper maturing in 30 to 179 days is now 5½ per cent. Earlier, major finance companies had paid a rate of 5⅛ per cent on paper with maturities of sixty days or more. Market yields on outstanding three- and six-month Treasury bills increased over the month by 15 basis points, as the sharp increases through March 14 were later partially erased (see chart on page 80).

The large New York City banks raised their offering rates on C/D's to the ceiling rate of 5½ per cent "across the board" by midmonth. Until March 13, a rate of 4¾ per cent had generally been posted on one- to three-month maturities. The increases in offering rates aided the city banks in replacing all but $145 million of the heavy volume of C/D's maturing in the week of March 20. At large commercial banks throughout the country, $5.8 billion of C/D's matured in March, about 30 per cent of the total amount they had outstanding. In the four statement weeks ended on March 27, C/D's outstanding at these institutions declined by $540 million.

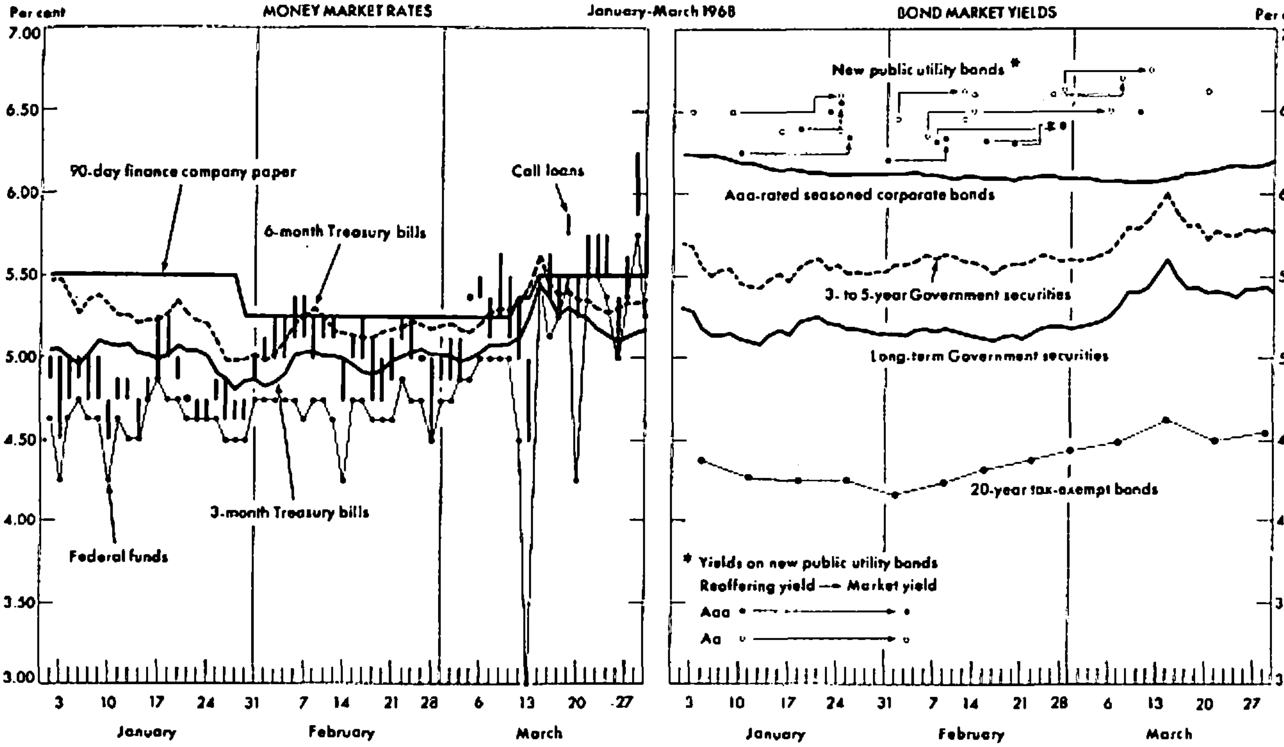
THE GOVERNMENT SECURITIES MARKET

In the Treasury coupon market, the confidence that had prevailed throughout February broke down rapidly in early March. Prices weakened moderately in the first few days in reaction to news reports of a possible need for an extraordinarily large troop buildup in Vietnam, evidence of increased reserve pressure in the banking system, and the reappearance of speculative demand for gold abroad following two months of relative calm in international financial markets. Later, the decline in prices of Treasury coupon issues accelerated as gold buying reached a feverish pitch. The market was also adversely affected by announcements of sizable offerings of securities to be made later in the month by the Federal National Mortgage Association (FNMA) and the International Bank for Reconstruction and Development. By Thursday, March 14, price declines from end-of-February levels were as much as 4¹¹⁄₁₆ points in the long-term area, and increases in market yields available on intermediate- and long-term Treasury issues averaged about 40 basis points.

Subsequently, on Friday and Monday, March 15 and 18, a sharp reversal of the earlier losses occurred, after which prices fluctuated moderately and irregularly through the month end. The sudden improvement in the market tone at midmonth stemmed from a succession of official moves undertaken to restore confidence in the dollar and to end the gold crisis. On March 15, the discount rate increase became effective at ten Federal Reserve Banks, gold trading was suspended in most major markets abroad, and the markets looked forward to the results of a special weekend meeting of the heads of seven central banks and two international financial organizations. The meeting produced agreement on the adoption of a two-price system for gold, whereby the participating monetary authorities will no longer supply gold to the free market but will transfer gold among themselves at official prices, leaving the free market price to fluctuate independently. (The Congress had passed legislation removing the gold cover requirement on Federal Reserve notes on March 14.) Moreover, President Johnson indicated a willingness to accept across-the-board budget cuts in nondefense spending as a means of inducing the Congress to enact the long-sought tax increase, and he apparently also decided on a more moderate buildup of troops in Vietnam than had been requested by the military authorities.

The Treasury bill market opened March on a strong note, reflecting a sizable investment demand for shorter issues originating in part from would-be buyers of equities and long-term debt instruments, who were affected by a general weakening of market confidence. In the first regular weekly auction held on March 4, the three- and six-month bill issues were awarded at average issuing rates of 5.00 per cent and 5.17 per cent (see Table III), down somewhat from rates established in the last regular February auction. However, bidding was not as aggressive as had

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.

been anticipated. Market participants showed some concern over new pressures on the pound sterling and the dollar in international markets and their implication for domestic monetary policy. Subsequently, dealers began to press offerings of bills aggressively on the market, as the money market firmed and financing costs rose and as the atmosphere of tension in the financial markets heightened. Consequently, market yields on Treasury bills maturing within six months rose by about 43 basis points through March 14. In the regular weekly bill auction held on March 18, after market yields had subsided from their monthly peaks, the three- and six-month issues were awarded at average issuing rates of 5.29 per cent and 5.38 per cent, 29 and 21 basis points higher than corresponding rates established in the March 4 auction. Over the remainder of the month, bill rates trended lower under the influence of a broad demand from investors, reflecting both seasonal factors and the search for a safe haven.

Prices of Federal agency obligations also weakened during March under the influence of the new uncertainties stemming from the gold crisis and a large increase in the supply of securities in the market. On March 26, the FNMA sold $1 billion of participation certificates, $730 million to the public and the remaining $270 million directly to Government investment accounts. The public offering, which sold out immediately, consisted of a $200 million issue due in 1971, priced to yield 6.30 per cent, plus a $330 million issue due in 1973 and a $200 million issue due in 1988, both priced to yield 6.45 per cent. The 6.45 yield on the longer term noncallable issues is the highest on any "full faith and credit" obligation of the Government in more than a century. In secondary market trading, the certificates met with an overwhelming demand from individuals and small investors, and yields available on the three securities were driven down to 6.15 per cent, 6.30 per cent, and 6.42 per cent for maturities ranging from the shortest to the longest.

OTHER SECURITIES MARKETS

The calendar of tax-exempt bond offerings was heavy in early March, largely reflecting a new surge in industrial revenue bond financing in advance of an expected Treasury ruling on March 15 which would deny the tax-exemption privilege to bonds issued subsequent to that date. However, the ruling was not issued until later in the month, when it was made effective as late as September 1968 for those offerings for which sufficient preparatory steps had been taken by March 15. Then, on March 28, the Senate voted to end the tax-exemption privilege on such bonds, effective January 1, 1969, and made no transitional provision. Many of the industrial revenue issues that were marketed were accorded excellent receptions, though at yields which were often close to historic highs. One issue was reoffered, after competitive bidding, to yield 6.75 per cent. Other new tax-exempt offerings marketed during the month fared less well, and dealers resorted to widespread price cutting in order to move unsold balances of recent issues. Over the month, the Blue List of dealers' advertised inventories declined slightly from $489 million to $454 million. *The Weekly Bond Buyer's* yield series of twenty seasoned tax-exempt issues (carrying ratings from Aaa to Baa) rose sharply to 4.62 per cent at midmonth but declined to close the period at 4.54 per cent (see chart), 10 basis points above the level at the end of February.

In the corporate bond market, new issue activity tapered off in the first half of March and expanded later in the month. Syndicate pricing restrictions were terminated on a number of recent issues in early March, in adjustment to rising yields in all sectors of the capital market. One Aaa-rated public utility offering of bonds due in 1993 and carrying five-year call protection met an excellent reception on March 11 at a reoffering yield of 6½ per cent, 20 basis points higher than the yield on a comparable offering on February 19. By the end of the month, however, a smaller Aaa-rated public utility offering with similar features was accorded only a fair reception at a reoffering yield of 6.67 per cent, a record high for this type of offering. Over the month, the Moody's index of yields on Aaa-rated seasoned corporate bonds rose to 6.19 per cent from 6.08 per cent.