The Money and Bond Markets in November

The tone of the capital markets remained heavy in November. Interest rates generally continued to move higher in the face of persistently large credit demands and considerable investor restraint. In the early days of the month, the suspension of the bombing of North Vietnam generated some optimism in the capital markets, but the favorable market reaction was tempered by caution on the eve of the national elections. Subsequently, the uncertain status of the Vietnam peace negotiations, together with evidence of continuing economic strength and rather firm money market conditions, generated widespread caution. Large-scale speculation in the foreign exchange markets, which reflected the view that the German mark might be revalued upward and that the French franc might be devalued, was also unsettling to the domestic capital markets but only temporarily.

Against this background, yields on corporate and tax-exempt bonds and on all but the shortest maturities of Government securities rose progressively. Very firm conditions generally prevailed in the money market during the first half of the month, when the reserve positions of banks in the leading money centers came under mounting pressure. Subsequently, the tone of the market eased considerably as reserve distribution shifted in favor of banks in the major money centers. In the closing days of the month, a firm tone again predominated but no pronounced pressures were evident in the money market.

BANK RESERVES AND THE MONEY MARKET

The basic reserve positions of banks in the leading money centers were generally under substantial pressure during the first half of November. As a result, these banks borrowed heavily in the Federal funds market—where most trading occurred in a 6 to 6⅛ per cent range—and filled a portion of their residual needs at the Federal Reserve "discount window". Over the last two statement weeks of the month, the average basic reserve deficit of the forty-six major money market banks declined, while the effective rate on Federal funds eased to a predominant 5½ to 6 per cent range.

On a nationwide basis, excess reserves of all member banks averaged $242 million during the four statement weeks ended on November 27 (see Table I), little changed from October.[1] Member bank borrowings from the Federal Reserve Banks rose by $82 million on average in November.

In the first statement period of November, the basic reserve positions of the forty-six major money market banks deteriorated sharply. Reserves were absorbed in part as a result of an expansion in loans to Government securities dealers and nonbank financial institutions, while borrowings from foreign branches also contracted. As a result, the average basic reserve deficit of the forty-six leading reserve city banks soared by $1.2 billion in the November 6 statement week to a $3.3 billion average level (see Table II), and a substantial demand for Federal funds produced trading in volume at 6¼ per cent. At the same time, the major money market banks also increased their borrowings from the Federal Reserve Banks.

The money market remained quite firm through most of the following week. The major city banks managed their reserve positions cautiously in preparation for the Veterans Day holiday weekend. The New York City banks, which were experiencing considerable reserve pressure primarily as a result of a contraction in demand deposits and a lagged increase in required reserves, borrowed heavily at the Federal Reserve discount window over the long weekend and increased their purchases of Federal funds (then trading predominantly at 6⅛ per cent) to near-record levels. A similar pattern of behavior was evident at large banks in other money centers, which had to cover net reserve deficiencies carried over into the November 13 statement week. Toward the end of the period, however, the reserve positions of the money market banks improved somewhat, the large amount of reserves which these banks had accumulated earlier flowed into the Federal funds market, and the tone of the money

[1] Data cited for excess reserves do not include the carry-over of excess reserves or deficiencies.

Table I

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

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

Factors	Changes in daily averages—week ended on Nov. 6	Nov. 13	Nov. 20	Nov. 27	Net changes
"Market" factors					
Member bank required reserves	+ 204	− 403	− 174	+ 330	− 37
Operating transactions (subtotal)	− 231	+ 39	+ 301	+ 88	+ 197
Federal Reserve float	− 28	+ 348	+ 636	− 410	+ 546
Treasury operations*	+ 30	+ 63	+ 426	− 32	+ 487
Gold and foreign account	+ 12	− 17	− 23	− 64	− 93
Currency outside banks	− 198	− 357	− 584	− 79	−1,218
Other Federal Reserve accounts (net)†	− 47	+ 2	− 158	+ 673	+ 475
Total "market" factors	− 27	− 364	+ 127	+ 424	+ 160
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	− 51	+ 201	− 53	− 557	− 400
Bankers' acceptances	—	+ 3	+ 3	− 1	+ 5
Repurchase agreements:					
Government securities	+ 81	+ 84	− 172	—	− 57
Bankers' acceptances	—	+ 27	− 27	—	—
Federal agency obligations	+ 7	+ 6	− 13	—	—
Member bank borrowings	− 105	+ 283	− 164	+ 71	+ 85
Other loans, discounts, and advances	—	—	—	—	—
Total	− 117	+ 664	− 428	− 487	− 368
Excess reserves	− 144	+ 300	− 301	− 63	− 208
	Daily average levels				
Member bank:					
Total reserves, including vault cash	26,348	27,051	26,924	26,525	26,712‡
Required reserves	26,165	26,568	26,742	26,406	26,470‡
Excess reserves	183	483	182	119	242‡
Borrowings	392	675	511	582	540‡
Free (+) or net borrowed (−) reserves	− 209	− 192	− 329	− 463	− 298‡
Nonborrowed reserves	25,956	26,376	26,413	25,943	26,172‡
Net carry-over, excess or deficit (−)§	143	60	226	131	138‡
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 88	+ 79	−7,631	+ 823	−6,641
More than one year	—	—	+6,294	—	+6,294
Total	+ 88	+ 79	−1,337	+ 823	− 347

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ Average of four weeks ended on November 27, 1968.
§ Not included in average levels of excess or free reserves.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS NOVEMBER 1968

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on Nov. 6	Nov. 13	Nov. 20	Nov. 27	Averages of four weeks ended on Nov. 27
Eight banks in New York City					
Reserve excess or deficiency(−)*	24	78	78	− 63	29
Less borrowings from Reserve Banks	36	129	43	51	65
Less net interbank Federal funds purchases or sales(−)	1,171	1,809	1,114	312	1,102
Gross purchases	*1,950*	*2,276*	*1,942*	*1,493*	*1,915*
Gross sales	*779*	*466*	*828*	*1,181*	*814*
Equals net basic reserve surplus or deficit(−)	−1,182	−1,860	−1,079	− 426	−1,137
Net loans to Government securities dealers	886	765	579	489	680
Net carry-over, excess or deficit(−)†	9	18	44	57	32
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)*	− 68	127	− 79	19	—
Less borrowings from Reserve Banks	119	242	168	154	171
Less net interbank Federal funds purchases or sales(−)	1,944	2,029	1,877	1,595	1,861
Gross purchases	*3,112*	*3,309*	*3,122*	*2,867*	*3,102*
Gross sales	*1,167*	*1,280*	*1,246*	*1,272*	*1,241*
Equals net basic reserve surplus or deficit(−)	−2,132	−2,144	−2,124	−1,730	−2,032
Net loans to Government securities dealers	857	412	575	318	541
Net carry-over, excess or deficit(−)†	57	− 10	83	− 1	32

Note: Because of rounding, figures do not necessarily add to totals.
* Reserves held after certain adjustments applicable to the reporting period less required reserves.
† Not reflected in data above.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In per cent

Maturities	Weekly auction dates—November 1968: Nov. 4	Nov. 8	Nov. 18	Nov. 25
Three-month	5.554	5.483	5.483	5.448
Six-month	5.616	5.602	5.679	5.573

Maturities	Monthly auction dates—September-November 1968: Sept. 24	Oct. 24	Nov. 22
Nine-month	5.202	5.446	5.693
One-year	5.108	5.401	5.568

* 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.

market eased sharply. Thus, the effective rate on Federal funds declined to 5¼ per cent on November 13, and funds traded at rates as low as ¼ per cent late that day.

The tone of the money market was comfortable during the November 20 statement period, in part because member banks had carried a substantial volume of excess reserves into the period (see Table I). The average basic reserve position of the eight major New York City banks improved markedly (see Table II) as a result of an increase in demand deposits and a contraction in loans to Government securities dealers, while their liabilities to foreign branches also expanded. Against this background, these banks sharply reduced their borrowings in the Federal funds market and from the Federal Reserve Banks. The effective rate on Federal funds was 6 per cent early in the week but fell to 2½ per cent on November 20, when some funds traded at rates as low as ⅛ per cent. In the final statement period of the month, a firmer tone reappeared in the money market but no real stress developed. Federal funds traded primarily in a 5½ to 5⅞ per cent range, although some trading occurred at higher rates late in the period. Member bank borrowings from the Reserve Banks increased somewhat, although the reserve positions of the money market banks improved further.

Rates on bankers' acceptances and some maturities of commercial paper rose by ⅛ per cent over the month as a whole. Offering rates posted by the major New York City banks on negotiable time certificates of deposit (C/D's) of two- through five-month maturity were increased in several steps during the month to the ceiling levels of 5¾ per cent for 60- to 89-day maturities and 6 per cent for 90- to 179-day C/D's, while C/D's of longer maturity were reportedly sold at times at their 6¼ per cent ceiling rate. The volume of C/D's outstanding at the weekly reporting banks in New York City rose by $523 million in November, as against a $513 million rise in October. Liabilities of United States banks to their foreign branches rose by $168 million in November, compared with a decline of $51 million in October.

THE GOVERNMENT SECURITIES MARKET

Prices of intermediate- and long-term Treasury notes and bonds moved irregularly lower in November. At the very beginning of the month, market sentiment was buoyed by hopes that the cessation of United States bombing operations in North Vietnam and expanded peace negotiations would prove fruitful. However, a less optimistic tone quickly emerged in the coupon sector, first as a reflection of domestic political uncertainties prior to the November 5 Presidential election, and then in response to indications that new obstacles might impede the Vietnam peace talks. In this atmosphere, prices of Treasury notes and bonds generally fluctuated narrowly in quiet trading during the first statement period of November.

A weaker tone subsequently predominated in the coupon sector. Market sentiment was adversely affected by increasing uncertainty over the Vietnam negotiations, by the heavy tone in the markets for corporate and tax-exempt bonds, and by some investment switching out of longer term Treasury issues into higher yielding corporate bonds. Furthermore, the persistent firmness in the money market during the first half of November made the positions of Government securities dealers relatively costly to finance and stimulated professional efforts to reduce inventories. The decision of a leading New York City bank to raise its prime lending rate on November 13 from 6 per cent to 6¼ per cent (thus bringing its rate into line with the prime rate then quoted by most other banks[2]) and the increase in the French bank rate to 6 per cent also had a minor bearish impact on the market for intermediate- and long-term Government securities.

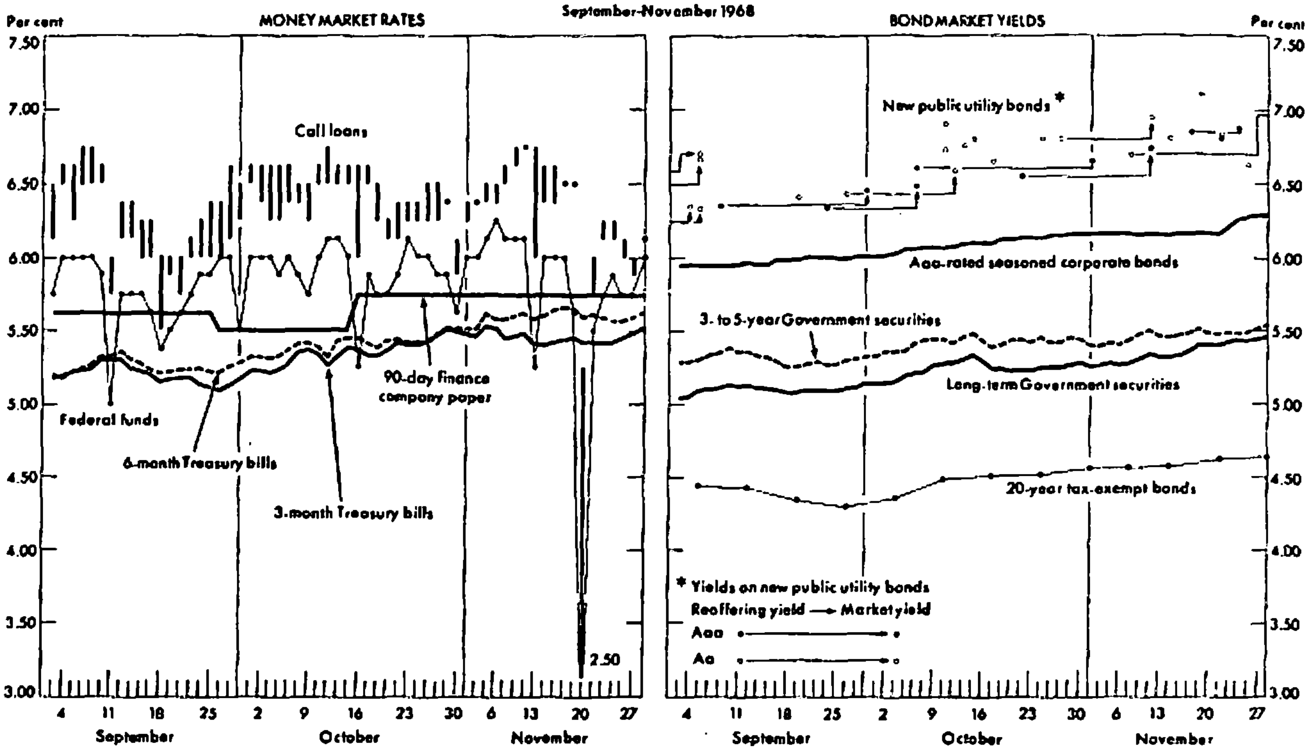
The coupon sector reacted only moderately around midmonth to news of the resurgence of speculative pressures in the foreign exchange markets and to reports of possible imminent changes in the parities of some European currencies. Investment activity diminished, and dealers cautiously marked prices of coupon issues lower. Subsequently, the tone of the market improved somewhat as participants grew confident that international consultations being held by financial officials would produce constructive measures to cope with the situation. As the month drew to a close, prices edged irregularly lower in light trading. Over the month as a whole, prices of Treasury issues maturing in two to ten years were $\frac{2}{32}$ to $\frac{19}{32}$ point lower. Prices of longer term obligations were 1⅛ to 2¾ points lower, partly in reaction to pressures evident in the corporate and tax-exempt bond markets. (Associated yield increases are illustrated in the right-hand panel of the chart.)

Mixed trends were apparent in the Treasury bill market in the first half of November. During this period, there was good investment demand for bills of short maturity, which were in relatively scarce market supply, and rates on such issues declined. At the same time, however, rates on longer term bills were under persistent upward pressure (see the left-hand panel of the chart). Commercial bank sales of tax anticipation bills accelerated. In addition, the

[2] Beginning on December 2, most major banks throughout the country raised their prime rates to 6½ per cent.

SELECTED INTEREST RATES

September-November 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.

firm tone of the money market as well as expectations that additional tax bills would be offered by the Treasury in late November led Government securities dealers to raise rates on longer term bills in order to reduce their inventories. Over the midmonth period, bill rates generally rose throughout the maturity range, partly in reaction to the new problems which were besetting the international financial markets. At the same time, market participants cautiously awaited the Treasury's late-November bill auctions — including an expected offering of tax anticipation bills.

On November 19, the Treasury announced that it would auction on November 26 (for payment on December 2) $2 billion of additional June 1969 tax anticipation bills which will be acceptable at face value in payment of income taxes due next June 15. Commercial banks were permitted to pay for their allotments through credits to Treasury Tax and Loan Accounts. The size of the offering, which only moderately exceeded the $1.8 billion of attrition in the Treasury's recent refunding operation,[3] was smaller than many market observers had anticipated. This factor contributed to the emergence of a somewhat better tone in the bill sector. In addition, market participants became more hopeful that the international financial difficulties would soon subside. Subsequently, investment demand for outstanding bills was augmented by expanded

[3] For details of the refunding, see this *Review* (November 1968), pages 232-33.

demand from professional sources, and bill rates declined irregularly for a time. In the last few days of the month, however, market supplies were swelled by bank selling of the reopened June tax bills and bill rates generally edged higher.

At the regular monthly auction of nine- and twelve-month bills held on November 22, average issuing rates were set at 5.693 per cent and 5.568 per cent, respectively, 25 and 17 basis points above average rates established a month earlier (see Table III). At the final regular weekly auction of the month held on November 25, average issuing rates for the new three- and six-month bills were set at 5.448 per cent and 5.573 per cent, respectively, 2 basis points lower and 10 basis points higher than average issuing rates at the comparable auction held in late October. At the November 26 auction of June tax anticipation bills, an average issuing rate of 5.489 per cent was set.

OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt bonds declined steadily through most of November, and yields approached or in some instances exceeded the previous record levels. Investor demand was sporadic, while the sizable calendar of scheduled flotations and heavy dealer inventories of bonds triggered widespread price cutting in both sectors. New corporate and tax-exempt bonds were marketed at progressively higher yields and were accorded mixed receptions by investors. At the same time, underwriters removed price restrictions on several slow-moving recent corporate and tax-exempt issues and prices were adjusted sharply lower. Over the midmonth period, disturbances in the international financial markets adversely affected the domestic bond market. During this period, an $85 million Aaa-rated telephone company issue with five years of call protection was priced to yield 6.85 per cent, 10 basis points above the earlier record high yield on a comparable offering in early June. Later, as yields on new and recent issues rose, investment demand occasionally improved somewhat and a slightly better tone emerged at times in the corporate and tax-exempt sectors. Prices generally continued to edge lower through the end of the period, however.

At the close of November, *The Weekly Bond Buyer's* yield index of twenty seasoned tax-exempt issues was quoted at 4.64 per cent, 8 basis points higher than a month earlier, while Moody's index for seasoned Aaa-rated corporate bonds, at 6.29 per cent, was 13 basis points higher than a month earlier. The Blue List of advertised dealer inventories of tax-exempt securities totaled $858 million at the end of the month, as against its October 31 level of $876 million.