The Money and Bond Markets in May

Pressures in the money and bond markets intensified during May amid international financial uncertainties and continued domestic monetary restraint. Following the resignation of President de Gaulle of France on April 28, new rumors of an impending revaluation of the German mark, coupled with a possible devaluation of the French franc, set in motion massive speculative movements of international funds into Germany. Partly as a result, rates on Euro-dollar borrowings by domestic banks rose quickly to record levels and continued to climb during most of the month. At the same time, the effective rate on Federal funds moved upward, reaching a new high of 9⅜ percent on the final day of the period. Other money market instruments also responded to the increasing tautness in the market; the costs of borrowing through commercial paper and bankers' acceptances rose in several steps during May. Moreover, as commercial banks experienced higher costs on funds raised in the Federal funds and Euro-dollar markets, they in turn raised interest rates on call loans to dealers in United States Government securities. After mid-month the situation in the foreign exchange markets quieted somewhat, but increasing discussion of the possibility of a rise in the commercial bank prime lending rate contributed to continuing unsettlement in the domestic financial markets.

Corporate bond prices moved higher during the early part of May in response to renewed interest from some major pension funds and favorable reaction on the part of investors to recent new issues. The improved tone did not, however, extend to the tax-exempt sector where both inventories and the calendar of new issues remained heavy. Attention in the Government securities market during the first week was focused on the results of the Treasury's refunding operation for which subscription books were open to holders of "rights" from May 5 through May 7. Results of the refunding show that private holders of the eligible issues subscribed for $2.1 billion of the new 6⅜ percent fifteen-month note and $2.2 billion of the 6½ percent seven-year note at an overall attrition rate of 27.6 percent. In the weeks following the Treasury's refunding, all segments of the bond markets deteriorated except for a brief rally prior to President Nixon's May 14 nationwide address, which was based on market optimism that the speech might contain news of some dramatic improvement in the Vietnam situation.

BANK RESERVES AND THE MONEY MARKET

Reflecting the heightened pressure on bank reserves during May, member bank borrowings at the discount window rose substantially from the preceding month, as did the rate range in which most Federal funds trading occurred. In the week ended on May 7, daily average borrowings from the Federal Reserve Banks climbed to $1.6 billion, the highest weekly level since the end of 1952, and for the month as a whole averaged $1.4 billion, some $300 million greater than in April. With excess reserves little changed from the previous month, average net borrowed reserves also increased by approximately $300 million in May, reaching record high levels in the final two statement weeks of the month.

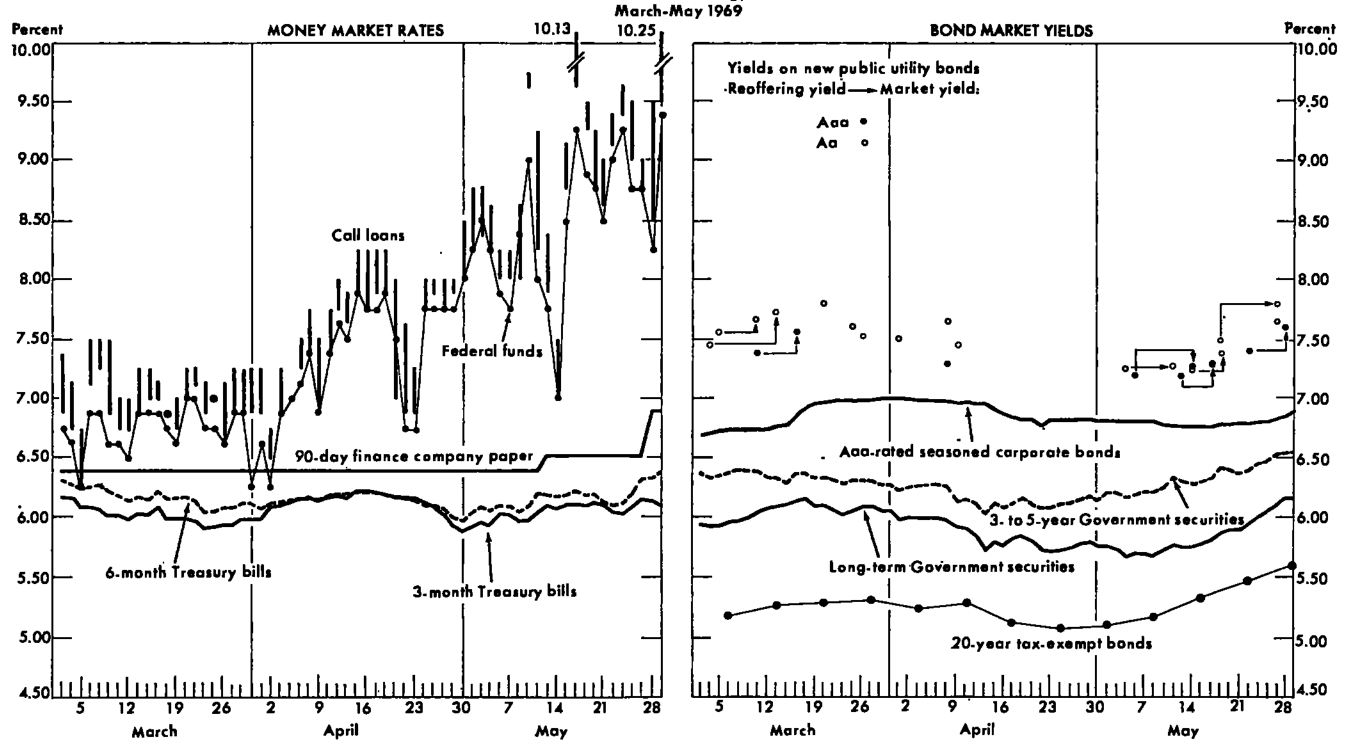
With the exception of one day, the effective rate on Federal funds was in a 7¾ to 9⅜ percent range throughout May, in contrast to the 6¾ to 8 percent range that prevailed in April following the increase in the Federal Reserve discount rate to 6 percent. A consistent intraweekly pattern prevailed during the month as the major money market banks bid aggressively for funds at the start of each week to make certain of meeting their reserve requirements early in the statement period, thus driving the Federal funds rate up. Later in each week the rate fell somewhat, as these banks reduced their demand and excess reserves reached the market (see Chart I). In part the behavior of these money center banks resulted from a substantial deterioration in their basic reserve position which was considerably more than seasonal (see Chart II). The increased deficit was particularly striking at the eight major New York City banks which increased their loans and investments by a sizable amount over the first three weeks of the period despite a runoff in all types of deposits. There was a progressive deterioration of the reserve position of the New York City banks until the final week in May.

As pressures on the reserve and liquidity positions of the major money center banks mounted, their net interbank purchases of Federal funds rose steadily although their borrowings at the discount window moved irregularly. Despite some easing at the end of each statement week, the money market was quite firm throughout the month of May, and the effective rate on Federal funds moved steadily higher with the opening of each period. The effective rate on May 1 was 8¼ percent; on May 8, 8⅜ percent; on May 15, 8½ percent; on May 22, 9 percent; and on May 29, 9⅜ percent. During the last two days of the month, some Federal funds traded at a record rate of 9¾ percent.

Due to the tendency of market factors to absorb reserves during the month as currency outside banks rose sharply and a decline in float provided an additional drain, the System injected $724 million of reserves on average in May through open market operations (see Table I). Because of the intraweekly pattern, noted earlier, of tautness in the money market at the beginning of statement weeks followed by some easing toward the close, System operations consisted largely of repurchase agreements against Treasury and Federal agency securities and bankers' acceptances, which were arranged early in the week and allowed to mature without replacement toward the close.

Daily average deposits subject to reserve requirements (the bank credit proxy) declined in May at a seasonally adjusted annual rate of about 1 percent, after a 5 percent rise in April. Although there was some increase in net demand deposits on a seasonally adjusted basis, this was more than offset by a further decline in time deposits.

Chart I
SELECTED INTEREST RATES
March-May 1969



Note: Data are shown for business days only.

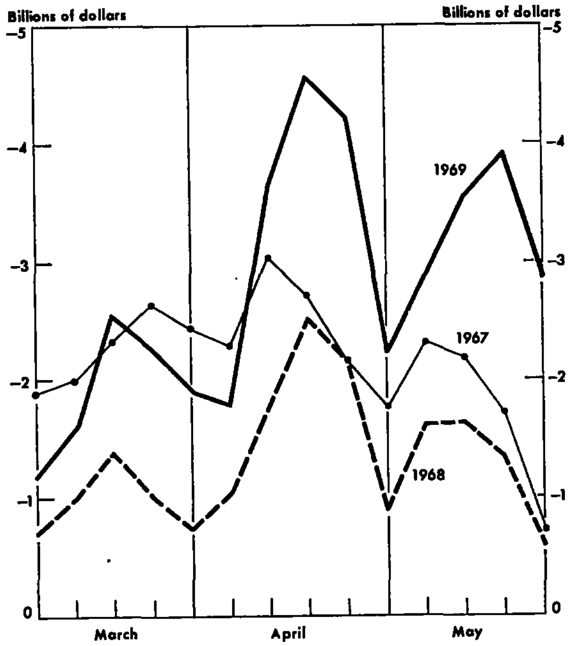
MONEY MARKET RATES QUOTED: Daily range of rates posted by major New York City banks on call loans (in Federal funds) secured by United States Government securities (a point indicates the absence of any range); offering rates for directly placed finance company paper; the effective rate on Federal funds (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 (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 seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on 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.

Chart II

BASIC RESERVE POSITIONS OF MAJOR MONEY MARKET BANKS



Note: All figures shown represent deficit positions. Calculation of the basic reserve position is illustrated in Table II.

Liquidation of large certificates of deposit continued but at a much slower pace than in the early months of the year. Commercial bank liabilities to foreign branches rose by some $300 million during the four statement weeks ended in May, after a drop of $200 million during April. Moreover, domestic banks also continued to raise additional Euro-dollar funds by sales of assets to their foreign branches. The seasonally adjusted money supply registered no further gain in May, following a large increase in April which partly reflected special factors of a technical nature.

THE GOVERNMENT SECURITIES MARKET

Yields on Government securities rose on balance during May although generally good demand, pressing on a limited market supply, restricted the increase in short-term bill rates to a narrow range (see Chart I). Part of the demand for bills arose from foreign sources in the wake of the speculative activity surrounding the German mark.

Despite the increased demand for bills and their relatively short market supply, upward pressures were exerted on bill rates by the high costs of dealer financing and the Treasury's decision to roll over rather than retire the bills that were added to six issues in the March "strip" auction. Moreover, dealers were somewhat disappointed by the volume of demand for bills arising from the Treasury's May refunding. At the final weekly auction on May 26, average issuing rates for the new three- and six-month bills were set at 6.124 and 6.218 percent, respectively, 7 and 18 basis points above the average rates established at the last weekly auction in April. At the regular monthly auction on May 27, average issuing rates on the nine- and twelve-month bills were set at 6.307 and 6.270 percent, respectively, 33 and 34 basis points higher than comparable rates at the auction a month earlier (see Table III). The auction rate on the twelve-month bill was the highest since last December.

In the market for longer term Government securities, attention was centered on the Treasury's May refunding during the early part of the month. The Treasury offered holders of notes and bonds maturing in May and June of this year the right to exchange their holdings into either a fifteen-month 6⅜ percent note yielding 6.42 percent or a seven-year 6½ percent note priced at par. The terms were considered generous by most market participants, and the overall attrition by private holders of only 27.6 percent was near the lower end of the range of market expectations. By the end of the month the longer note had fallen to a bid quotation of 19/32 below par while the shorter note was bid about 8/32 below its issue price.

Prices of outstanding intermediate-term Treasury notes declined about half a point during the first week of May in initial reaction to the terms of the Treasury refunding and moved somewhat lower over the remainder of the month. Prices of long-term bonds, in contrast, rose early in the period in response to some indications of moderating domestic economic activity and favorable press discussions concerning the Paris peace talks. In the latter part of the period, prices generally declined due to disappointment over the President's Vietnam speech, concern over the high costs of financing dealer positions, and the worsening state of the corporate and municipal bond markets. Over the month as a whole, prices on most intermediate-term issues were 1 to 1 12/32 points lower, while those on longer term issues declined by 2 22/32 to 4 18/32 points.

OTHER SECURITIES MARKETS

Yields on new and seasoned corporate bonds declined somewhat in the first week of May, largely in response to favorable investor reception of the preceding week's new

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MAY 1969

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

Factors	Changes in daily averages— week ended on				Net changes
	May 7	May 14	May 21	May 28	
"Market" factors					
Member bank required reserves	— 152	+ 170	— 94	+ 37	— 39
Operating transactions (subtotal)	— 248	— 94	— 195	— 305	— 842
Federal Reserve float	— 31	— 108	+ 288	— 351	— 202
Treasury operations*	+ 16	— 42	+ 141	+ 128	+ 243
Gold and foreign account	— 40	+ 32	— 4	+ 8	— 4
Currency outside banks	— 93	— 264	— 454	+ 151	— 660
Other Federal Reserve accounts (net)†	— 100	+ 288	— 167	— 242	— 221
Total "market" factors	— 400	+ 76	— 289	— 268	— 881
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 309	+ 139	— 38	+ 314	+ 724
Outright holdings:					
Government securities	+ 41	+ 66	+ 217	+ 339	+ 663
Bankers' acceptances	+ 1	— 1	— 1	— 4	— 5
Repurchase agreements:					
Government securities	+ 304	+ 52	— 256	— 32	+ 68
Bankers'. acceptances	— 12	+ 4	— 7	— 10	— 25
Federal agency obligations	— 25	+ 18	+ 9	+ 21	+ 23
Member bank borrowings	+ 486	— 433	+ 188	— 55	+ 186
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 794	— 293	+ 151	+ 257	+ 909
Excess reserves	+ 394	— 217	— 138	— 11	+ 28

	Daily average levels				
Member bank:					
Total reserves, including vault cash	28,175	27,788	27,744	27,696	27,851‡
Required reserves	27,731	27,561	27,655	27,618	27,641‡
Excess reserves	444	227	89	78	210‡
Borrowings	1,603	1,170	1,358	1,303	1,359‡
Free, or net borrowed (—), reserves	—1,159	— 943	—1,269	—1,225	—1,149‡
Nonborrowed reserves	26,572	26,618	26,386	26,393	26,492‡
Net carry-over, excess or deficit (—)§	6	217	160	80	116

	Changes in Wednesday levels				
System account holdings of Government securities maturing in:					
Less than one year	— 410	—1,110	+12,785	— 227	+11,038
More than one year	—	—	—10,804	+ 83	—10,721
Total	— 410	—1,110	+ 1,981	— 144	+ 317

Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ Average for four weeks ended on May 28.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MAY 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Averages of four weeks ended on May 28
	May 7	May 14	May 21	May 28	
Eight banks in New York City					
Reserve excess or deficiency(—)*	104	69	— 49	— 3	30
Less borrowings from Reserve Banks	146	121	164	59	123
Less net interbank Federal funds purchases or sales(—)	695	1,292	1,660	706	1,088
Gross purchases	*1,872*	*2,118*	*2,593*	*1,940*	*2,131*
Gross sales	*1,177*	*826*	*933*	*1,235*	*1,043*
Equals net basic reserve surplus or deficit(—)	— 738	—1,345	—1,873	— 768	—1,181
Net loans to Government securities dealers	737	611	352	317	504
Net carry-over, excess or deficit(—)†	— 22	57	48	— 2	20
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	106	1	— 31	— 27	12
Less borrowings from Reserve Banks	462	260	378	251	338
Less net interbank Federal funds purchases or sales(—)	1,810	1,996	1,623	1,819	1,812
Gross purchases	*3,335*	*3,616*	*3,564*	*3,697*	*3,553*
Gross sales	*1,525*	*1,620*	*1,941*	*1,878*	*1,741*
Equals net basic reserve surplus or deficit(—)	—2,166	—2,255	—2,032	—2,098	—2,138
Net loans to Government securities dealers	36	99	— 38	— 59	10
Net carry-over, excess or deficit(—)†	— 2	62	39	24	30

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.
† Not reflected in data above.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—May 1969			
	May 5	May 12	May 19	May 26
Three-month	5.978	6.084	6.148	6.124
Six-month	6.063	6.191	6.231	6.218

Maturities	Monthly auction dates—March-May 1969		
	March 26	April 24	May 27
Nine-month	6.058	5.977	6.307
One-year	6.132	5.931	6.270

* 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.

issues and to renewed demand from major pension funds. Reflecting underwriters' optimism, the first long-term Aaa-rated issue marketed since early March, a $40 million telephone issue, was priced on May 6 to yield 7.20 percent. This yield was 18 basis points lower than the similarly rated telephone issue of March 11. Investor response was not very enthusiastic, however, due in part to the fact that a closely competitive utility issue, marketed the previous day, was offered at 7.25 percent.

The trend of corporate bond prices was steadily downward during succeeding weeks in May except for a brief improvement prior to President Nixon's speech on May 14. Despite the fact that White House press sources had stated in advance that nothing basically new would be presented, market participants were apparently hopeful that some word concerning a quick end to the Vietnam fighting would be included. When these hopes did not materialize, the corporate bond market resumed its decline, as participants continued to respond to the heavy demand for funds, the lack of substantial progress at the Paris peace talks, and the fact that inflation in the economy had not shown any abatement according to the latest price statistics. Several corporate syndicates were terminated during the final three weeks of May, and some scheduled new issues were either reduced in size or postponed because of market conditions. Indicative of the deterioration which occurred, on May 27 a telephone company sold a $65 million issue of debentures at a cost of 7.7 percent, the highest cost for a Bell System unit since 1921. In addition, scheduled new issues for the month ahead are estimated at some $100 million more than at the end of April.

Prices on tax-exempt securities moved lower throughout the entire month, though the decline accelerated after the first week of the period as measured by *The Weekly Bond Buyer's* index of twenty municipal bond yields. At the end of May this index was at a 36-year high of 5.60 percent, an increase of 50 basis points over the month. The calendar of new municipal securities was sizable throughout the period. Moreover, commercial bank demand for new securities remained at reduced levels and some further bank sales of outstanding tax exempts were reported. Highlighting the activity in this market was the sale of $182 million of housing authority bonds on May 21 at a record net interest cost of 5.517 percent. Yields to investors ranged as high as 5.55 percent but, despite this record return for tax-exempt securities guaranteed by the Federal Government, the reception was less than enthusiastic. In this environment, syndicate terminations and price cutting began to recur during the month and an $88 million issue scheduled for marketing was withdrawn by the state of New York because of the probability that it could not be sold at or below the 5 percent interest ceiling set on it. The calendar of scheduled new issues at the close of May had declined by some $200 million over the month, possibly reflecting an unwillingness on the part of potential borrowers to announce firm dates given the unsettled market conditions.