The Money and Bond Markets in July

Continuing monetary restraint was the predominant influence on the money and bond markets in July. The average effective rate on Federal funds and member bank borrowings at the discount window were at essentially the same high levels as in June, while most monetary variables exhibited continuing weakness. A notable feature of the month was widespread interest by small investors in United States Treasury, Federal agency, corporate, and municipal obligations.

Attention in the Treasury bill market was largely focused on two $1.75 billion issues of tax anticipation bills, which were auctioned on July 9 and July 11, and the upward rate movements that occurred in this market (see Chart I) largely reflected the subsequent adjustment to this sizable supply of new issues. Concern over possible alterations which the Congress might make in the tax-exempt status of state and municipal bonds added to the continuing pressures in that market from restricted commercial bank demand. Prices eroded in the tax-exempt market following a proposal by the House Ways and Means Committee that could lead to Federal taxation of some income from municipal issues.

Prices of United States Government securities trended downward during July, with the exception of some bill and coupon issues in the very short- and longer term maturity areas. The Treasury bill market was not overly receptive to the new December 1969 and March 1970 tax anticipation bills, and an air of heaviness developed in the face of this $3.5 billion addition to its supply. The market for notes and bonds experienced a brief rally around midmonth, largely in response to some indications that counterinflationary policies might be having an effect and to encouraging reports concerning the Vietnam situation. The rally was short-lived, however, and prices for intermediate-term issues resumed their downtrend, partly reflecting the possibility that an offering in this maturity range would be included in the Treasury's August refunding. The terms and likely reception of the Treasury's impending refunding increasingly became the center of attention in the final weeks of July. On July 30 the Treasury announced that holders of the $3.4 billion 6 percent notes maturing on August 15, 1969 would be offered in exchange a 7¾ percent eighteen-month note due on February 15, 1971. The new notes are to be priced at 99.90 to yield 7.82 percent, reportedly the highest rate in over a century.

Corporate bond prices declined at the start of July but, as the month progressed, staged an upturn in response to considerable investor interest in several large new offerings by industrial corporations. Moreover, small investors particularly were attracted by the record 7.91 percent yield on the Bell System Aaa-rated telephone debenture brought to market on July 8. The corporate market did not benefit from the general enthusiasm surrounding the lunar landing on July 20, and prices trended downward for most of the remainder of the month. However, some improvement occurred on the final three days of the month, when another telephone issue was marketed and investors again responded quite favorably.

BANK RESERVES AND THE MONEY MARKET

The tone of the money market was generally firm during July, with the effective rate on Federal funds averaging approximately 8⅘ percent, slightly above the daily average in June. Member bank borrowings at the discount window amounted to $1,312 million on a daily average basis, down $44 million from the preceding month, while excess reserves averaged $4 million higher than in June. Net borrowed reserves of member banks averaged $1,078 million for July as a whole.

Banks borrowed heavily at the discount window and in the Federal funds market during the early part of the statement week ended on July 2, in preparation for the publishing of their midyear financial statements. Borrowings from the Federal Reserve Banks in that period averaged $1,634 million, the highest weekly average since December 1952. The basic reserve positions of the forty-six major money center banks showed a marked improvement during this week (see Chart II), largely because of a sizable inflow of private demand deposits and a decline in dealer loans at the eight New York City banks. The heavy borrowing associated with the midyear publication date, together with the shift in the distribution of reserves, combined to create a huge volume of excess reserves which reached the market on Wednesday, when the effective rate on Federal funds fell to 5½ percent—the lowest since late February—and some trading occurred at ¼ percent.

The banking system's recent pattern of accumulating reserves early in the settlement period and disposing of them toward the close was generally continued in the statement week ended on July 9. Thus, effective rates on Federal funds were at 9 percent and 9½ percent on the first three days of the holiday-shortened week and at 7½ percent on the final day. However, this pattern was reversed during the week ended on July 16. Having established deficit reserve positions on average over the first five days of the week, the money center banks became aggressive bidders for Federal funds as the period drew to a close, pushing their effective rate to 9⅞ percent by Wednesday, July 16, from a 9 percent level on Monday.

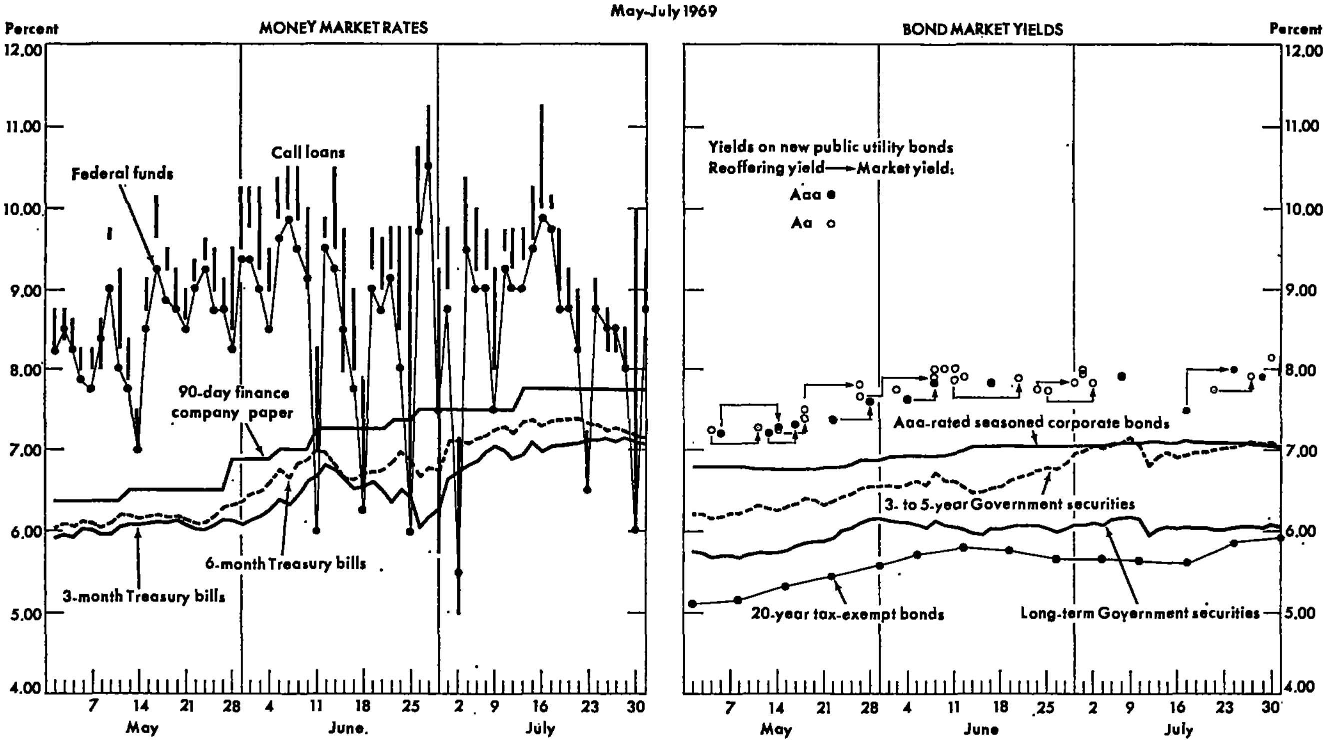
In the second half of the month the eight New York City banks continued running deficits at the start of each statement week, but the thirty-eight money center banks outside the city reverted to the more cautious management pattern of accumulating needed reserves early in each period. Since the other reserve city and "country" banks were also managing their reserves in a conservative way, the range of rates in Federal funds resumed its more common recent weekly pattern of declining on the final days of the week.

Basic reserve positions at both the eight New York City and the thirty-eight other money center banks improved in

Chart I

SELECTED INTEREST RATES

May-July 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).

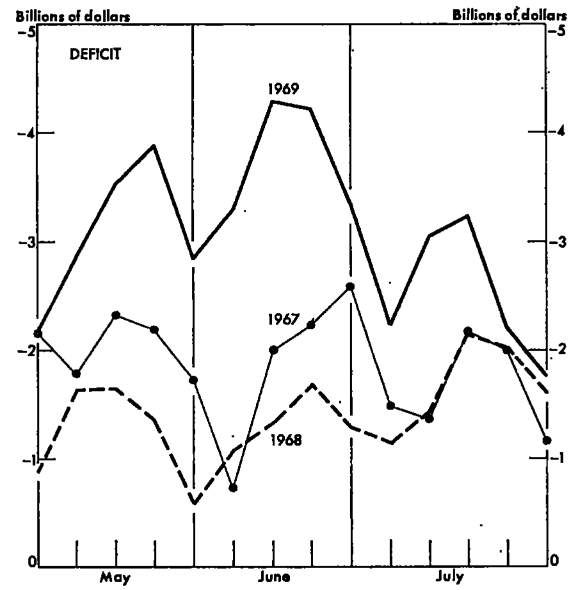
Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, and The Weekly Bond Buyer.

the July 23 statement week, aided to a considerable extent by the addition to their United States Government deposits of the proceeds from the two United States Treasury tax anticipation bill auctions. Moreover, there was a sizable inflow of private demand deposits to the New York City banks which also increased their borrowing from foreign branches by $200 million. Further improvement occurred in the basic positions of the forty-six money center banks during the week ended on July 30, primarily as a result of declines in their loans and investments and in their required reserves.

System open market operations during July offset the largely seasonal reserve influences of market factors. The System furnished reserves of $735 million on a daily average basis over the first two statement weeks (see Table 1), in large part to offset the drain on reserves customarily associated with the Fourth of July holiday weekend. Daily average reserves of $706 million were absorbed by the System through open market operations in the final three statement weeks. On balance, the System provided reserves of $29 million on a daily average basis during the five statement weeks of July.

Daily average deposits subject to reserve requirements (the bank credit proxy) declined in July at a seasonally adjusted annual rate of about 21.1 percent following declines of 13.1 percent in June and 2.5 percent in May. After adjustment to include the changes in liabilities to foreign branches, however, the July decline was reduced to 13.5 percent, compared with a 4.0 percent decline in June. (As yet there is no complete measure of liabilities such as direct sales and participations of loans to foreign branches and adjustment for such items is not included.) The major factors accounting for the decline in July were sizable runoffs in United States Government balances and private time deposits.

Chart II
BASIC RESERVE POSITIONS OF MAJOR MONEY MARKET BANKS



Note: Calculation of the basic reserve position is illustrated in Table II.

THE GOVERNMENT SECURITIES MARKET

Price trends were mixed in the market for Treasury securities during July. Notes and bonds displayed a mixed pattern, posting price gains in the very short and long maturities but declines in much of the intermediate area. Most maturities of bills registered a deterioration with the exception of the one-year bill and those due in less than a month.

All segments of the Treasury securities market declined in price following the Board of Governors' proposed regulation changes at the close of June, and prices moved lower through the July 2 statement week. Bids were accepted over a wide range in the regular weekly auction on Monday, June 30, and bill rates increased on the following day, as dealers attempted to work off an unexpectedly large volume of bills acquired in Monday's auction. In addition, with financing costs at a high level, dealers were also anxious to pare their inventories before the long July 4 holiday weekend. After the close of business on July 2, the Treasury announced plans to raise $3.5 billion of new money through the sale of $1.75 billion of December 1969 tax anticipation bills to be auctioned on Wednesday, July 9, and a like amount of March 1970 bills to be auctioned on Friday, July 11. Payment for both issues, which depository banks could make through credits to their Treasury Tax and Loan Accounts, was scheduled for July 18.

The Treasury's announcement contributed to a heavier atmosphere in much of the bill market, since the size of the issue was somewhat larger and the timing of it somewhat earlier than most market participants had anticipated. Bidding in the auctions for the tax anticipation bills was somewhat unenthusiastic, with the average issuing rate for the December bill set at 6.776 percent and for the March bill at 7.201 percent. After the auction results were known, the December bill initially traded at 7.30 percent bid and closed the month at 7.21 percent while the March bill moved from early trading at 7.49 percent to 7.36 percent

Table I

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

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

Factors	Changes in daily averages— week ended on					Net changes
	July 2	July 9	July 16	July 23	July 30	
"Market" factors						
Member bank required reserves	— 227	— 70	— 75	+ 351	+ 340	+ 319
Operating transactions (subtotal)	— 140	— 71	— 72	+ 146	— 239	— 376
Federal Reserve float	— 237	+ 386	— 118	+ 452	— 962	— 479
Treasury operations*	+ 221	+ 23	— 65	— 87	— 6	+ 86
Gold and foreign account	— 19	— 48	+ 48	— 9	+ 14	— 14
Currency outside banks	— 17	— 342	— 49	— 242	+ 713	+ 63
Other Federal Reserve accounts (net)†	— 90	— 89	+ 113	+ 31	+ 4	— 31
Total "market" factors	— 367	— 141	— 147	+ 497	+ 101	— 57
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 368	+ 367	+ 2	— 412	— 296	+ 29
Outright holdings:						
Government securities	+ 180	+ 399	+ 122	— 404	— 264	+ 33
Bankers' acceptances	— 1	—	— 2	—	+ 1	— 2
Repurchase agreements:						
Government securities	+ 117	+ 2	— 92	— 4	— 23	—
Bankers' acceptances	+ 19	— 5	— 11	—	— 3	—
Federal agency obligations	+ 53	— 29	— 15	— 4	— 5	—
Member bank borrowings	+ 309	— 615	+ 259	+ 77	— 82	— 52
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+ 678	— 249	+ 262	— 336	— 376	— 21
Excess reserves	+ 311	— 390	+ 115	+ 161	— 275	— 78

	Daily average levels					
Member bank:						
Total reserves, including vault cash	27,472	27,152	27,342	27,152	26,537	27,131‡
Required reserves	27,004	27,074	27,149	26,798	26,458	26,897‡
Excess reserves	468	78	193	354	79	234‡
Borrowings	1,634	1,019	1,278	1,355	1,273	1,312‡
Free (+), or net borrowed (—), reserves	—1,166	— 941	—1,085	—1,001	—1,194	—1,078‡
Nonborrowed reserves	25,838	26,133	26,064	25,797	25,264	25,819‡
Net carry-over, excess or deficit (—)§	110	267	89	55	181	140‡

	Changes in Wednesday levels					
System account holdings of Government securities maturing in:						
Less than one year	+ 889	— 438	+1,106	—1,152	— 686	— 281
More than one year	—	+ 58	—	—	—	+ 58
Total	+ 889	— 380	+1,106	—1,152	— 686	— 223

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 for five weeks ended on July 30.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JULY 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Average of five weeks ended on July 30
	July 2	July 9	July 16	July 23	July 30	
Eight banks in New York City						
Reserve excess or deficiency (—)*	150	— 48	58	79	48	57
Less borrowing from Reserve Banks	125	—	88	86	146	89
Less net interbank Federal funds purchases or sales(—)	207	678	558	190	— 33	320
Gross purchases	*1,541*	*1,911*	*1,838*	*1,693*	*1,558*	*1,708*
Gross sales	*1,334*	*1,233*	*1,280*	*1,503*	*1,591*	*1,388*
Equals net basic reserve surplus or deficit(—)	— 182	— 726	— 588	— 197	— 65	— 352
Net loans to Government securities dealers	626	568	341	662	682	576
Net carry-over, excess or deficit(—)†	26	73	— 7	28	27	29
Thirty-eight banks outside New York City						
Reserve excess or deficiency(—)*	103	— 42	— 96	102	— 94	— 5
Less borrowings from Reserve Banks	416	165	302	213	148	249
Less net interbank Federal funds purchases or sales(—)	1,735	2,112	2,230	1,878	1,451	1,881
Gross purchases	*3,633*	*4,084*	*4,270*	*3,737*	*3,694*	*3,884*
Gross sales	*1,898*	*1,971*	*2,040*	*1,856*	*2,243*	*2,002*
Equals net basic reserve surplus or deficit(—)	—2,048	—2,319	—2,628	—1,989	—1,693	—2,135
Net loans to Government securities dealers	— 29	46	— 56	— 39	78	16
Net carry-over, excess or deficit(—)†	23	83	22	— 29	69	34

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—July 1969			
	July 7	July 14	July 22	July 28
Three-month	7.069	7.105	7.220	7.172
Six-month	7.309	7.400	7.459	7.313

Maturities	Monthly auction dates—May-July 1969		
	May 27	June 24	July 24
Nine-month	6.307	7.387	7.407
One-year	6.270	7.342	7.313

* 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.

over the interval. Some commercial bank selling of the newly acquired tax anticipation bills occurred during the month, but the market was generally able to handle these sales partly as a result of demand from corporations and tax-exempt institutions. Dealer inventories became fairly sizable, however, and a cautious tone pervaded the market following the tax anticipation bill auctions. In the latter part of the month, a steadier tone emerged. Moderate investment demand developed, and dealer positions were reduced somewhat.

At the regular monthly auction on July 24, average issuing rates on the nine- and twelve-month bills were set at 7.407 percent and 7.313 percent, respectively, 2 basis points higher and 3 basis points lower than comparable rates at the auction a month earlier (see Table III). The rate on the nine-month bill set a new record, but the twelve-month bill rate declined from its historical high which was set last month. At the final weekly auction on July 28, average issuing rates for the new three- and six-month bills were set at 7.172 and 7.313 percent, respectively, 72 and 37 basis points above the average rates established at the last weekly auction in June. Interest from individuals was strong in all the weekly auctions in July.

The market for Treasury notes and bonds was largely dominated by professional activity during the early days of the month, and prices generally drifted lower in the absence of any significant investor demand. Prices rallied during the statement week ended on July 16, however, as long-term bonds rose by as much as 1½ points and intermediate issues by somewhat less. A better tone developed at the start of that week in response to demand from mutual funds and commercial banks. This atmosphere was strengthened further by the announcement that a major automobile company had made a sizable reduction in its capital expenditures plans, a move which many market participants interpreted as indicative of the effectiveness of monetary restraint. The market was also buoyed by the improved tone in the corporate bond sector and the possibility that interest rates might be peaking out. Enthusiasm waned somewhat after the weekend when some professional selling emerged, but prices edged higher on the final day of the statement week in response to reports that the North Vietnamese government believed negotiations could bring about peace within a year.

A more cautious tone was present in the Treasury coupon market during the July 23 statement week, when trading activity was generally quiet and attention was centered to a large extent on the Treasury's August refunding. Prices of most intermediate-term issues declined $\frac{1}{32}$ to $\frac{14}{32}$ over the period, but demand continued for the relatively thin supply of long-term bonds and these issues showed slight gains of $\frac{2}{32}$ to $\frac{8}{32}$.

As the July 30 date for the announcement by the Treasury of its refunding terms drew closer, speculation in the market as to the size and maturity of the refinancing increased and prices on most outstanding notes and bonds drifted lower. Some gains were posted following the announcement, however, as the market responded favorably to the fact that only $3.4 billion of a relatively short maturity would be offered.

OTHER SECURITIES MARKETS

The corporate bond market was in the doldrums during the early part of July but picked up interest and momentum during the second business week and continued the uptrend until the week following the Apollo 11 lunar expedition. Some hesitation then set in and continued until the last week when prices turned up. During the first three weeks of the month the market for state and municipal bonds also showed some improvement, but in an atmosphere subdued by continuing discussion of Congressional proposals related to the taxation of income from state and municipal bonds. Following the report by the House Ways and Means Committee of its tentative approval of a "minimum tax" on previously tax-free income, there was a sharp deterioration in the municipal bond market. *The Weekly Bond Buyer's* index of yields on twenty tax-exempt bonds jumped 24 basis points on July 24 to a new high of 5.86 percent, thereby eradicating the reductions which had been made since mid-June.

Reduced investor interest and an unexpectedly large buildup in the volume of offerings to the highest monthly total in 1969 resulted in lower corporate bond prices at the start of July. On July 8, however, investor interest was spurred by a new record-high yield of 7.91 percent set for a Bell System Aaa-rated debenture, and this $150 million issue was quite successful. Two days later the market again responded favorably to a $100 million A-rated issue yielding 7.75 percent, as new industrial offerings which earlier had been in short supply began to reappear. Small investor interest was a sizable factor in these sales. The improved reception to new corporate bonds continued through the next week or so, apparently aided by the transfer of funds from the declining stock market and the news of a sizable cutback in new capital expenditures planned by a major automobile corporation. Several large industrial issues were brought to market at successively higher prices during this period, and the public's response was such that the issues sold out quickly and their prices rose to premiums. Investor interest began to wane following the lunar expedition, and corporate prices trended irregularly downward partially in reaction to the minimum tax proposal of the House Ways and Means Committee. On July 29, however, another $100 million of Aaa-rated Bell System debentures was marketed to yield 7.90 percent, a rate virtually unchanged from that on the July 8 issue, and investor response was again enthusiastic. In this climate prices of some outstanding issues rose, and the market closed the month with a decidedly improved tone.

Prices of state and municipal bonds improved modestly over the first three weeks of July as the supply of new issues continued fairly light. However, investors were somewhat cautious in response to the uncertainty concerning possible Congressional reforms affecting the tax-exempt status of these bonds. Reflecting this caution, the largest new issue of the month, $146 million of New York City bonds, encountered some selling difficulty despite the fact that it was priced to yield as much as 6.05 percent. The *Bond Buyer's* index declined by 6 basis points between June 26 and July 17, continuing the moderate downtrend which began in mid-June. On July 24, however, the municipal market experienced a marked setback in reaction to the tentative proposals of the House Ways and Means Committee. Thus, the cost of a $60 million issue of Aaa-rated Connecticut bonds was set at 5.71 percent, some 22 basis points higher than an Aa-rated issue a week earlier, and several scheduled new issues received no acceptable bids. Prices of outstanding bonds also declined by a sizable amount. Following this initial response to the minimum tax proposal, the municipal bond market continued to deteriorate and several scheduled offerings either received no acceptable bids or were postponed. However, prices improved somewhat at the close of the month, largely in response to indications that interest on corporate holdings of municipal bonds might remain exempt from Federal taxation. Nonetheless, the *Bond Buyer's* index of tax-exempt bond yields (computed each Thursday) reached a new high of 5.93 percent on July 31.