The Money and Bond Markets in September

The money and bond markets continued to feel the effects of monetary restraint during September, as new corporate issues provided record yields and rates on most commercial paper and bankers' acceptances also moved higher. The effective rate on Federal funds again averaged 9 percent, but member bank borrowings declined during the month as a result of an unusually large volume of reserves provided temporarily by Treasury operations.

A large Treasury refinancing, which included the prerefunding of a December maturity, attracted a good deal of attention during the month. On September 17 the Treasury announced that holders of $6.4 billion of Treasury notes and bonds due on October 1 and almost $2.5 billion of bonds maturing on December 15 would be offered three issues in exchange. These were a 19½-month note offered at par to yield 8 percent, a 3-year 7½-month note with a 7¾ percent coupon also offered at par, and a 7½ percent note maturing in 6 years 10½ months and priced to yield about 7.59 percent. These rates were the highest on comparable Treasury issues in more than a century, and the public gave the offering a very good reception. The attrition rate on the publicly held portion of the maturing issues was 19.7 percent, considerably lower than expected in the light of current market conditions. Of the $8.9 billion being refunded, the public held $7.6 billion.

With the exception of some short-term bill and coupon issues, prices of United States Government securities declined during September. Some brief improvement occurred from time to time in response to such factors as a statement by Chairman Martin that interest rates might have reached their highest level and optimistic speculation associated with the cease-fire in Vietnam following the death of Ho Chi Minh. Such rallies were short-lived, however, and the overall trend was downward. Concern over the current and prospective volume of Federal agency securities weighed heavily on the market toward the end of the month.

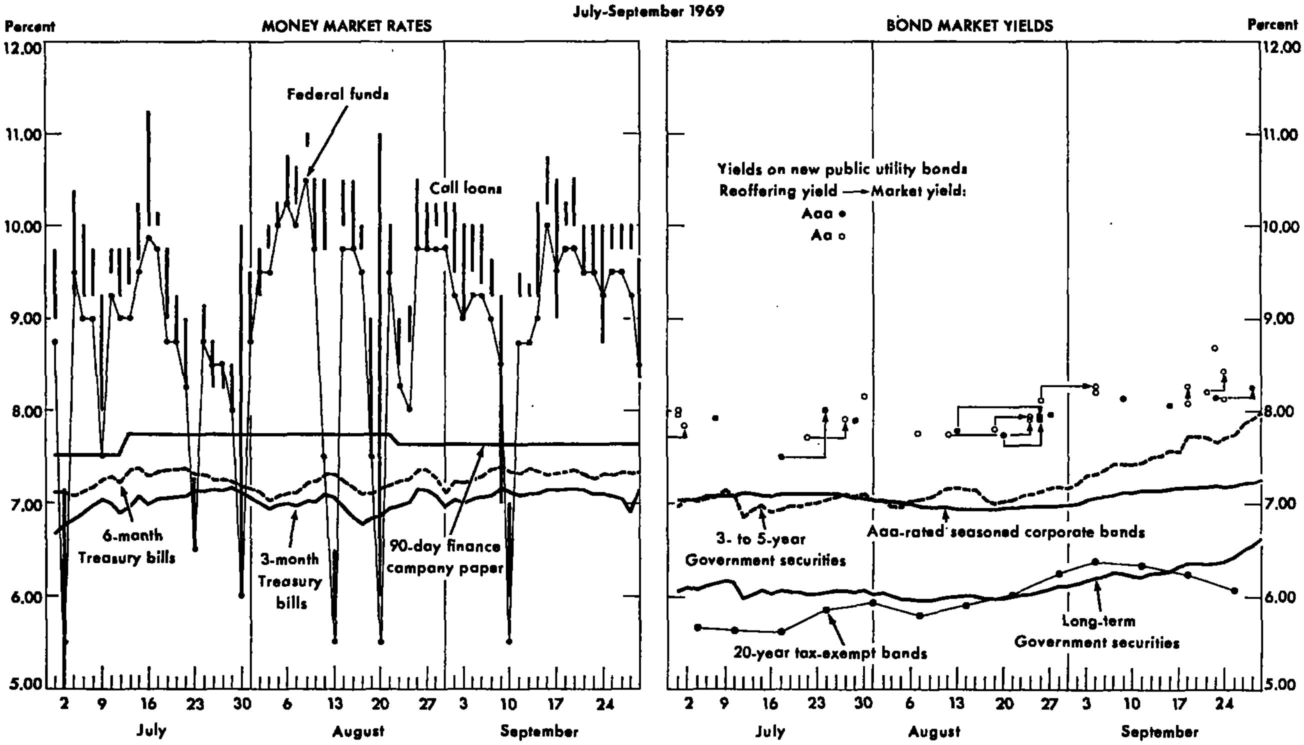
Corporate bond prices also fell in September, and record offering yields were set on many of the issues that were marketed. The volume of new corporate issues was the largest September total on record, and investor resistance was at times quite pronounced. One prime-rated Bell System issue, for example, received only a fair initial reception despite a record yield of 8.25 percent. In the municipal bond market, on the other hand, an unusually light supply of new issues resulted in a decline in yields during the month (see Chart I). Several scheduled municipal offerings were postponed because of statutory interest ceilings and others withdrawn because of unfavorable market conditions. Growing optimism about the tax reforms that would eventually emerge from the Congress relating to income from municipal securities also contributed to the better tone in that market.

BANK RESERVES AND THE MONEY MARKET

Money market conditions continued firm during September despite a large volume of reserves provided in the week ended on September 10 by a rundown of Treasury balances and the sale of $1,102 million of special Treasury certificates to the Federal Reserve. The effective rate on Federal funds averaged 9.1 percent for the month, essentially unchanged from August, while rates on commercial paper and bankers' acceptances were increased during the month. Due primarily to the unexpectedly large provision of reserves by Treasury operations, member bank borrowings at the discount window in September—amounting to $1,026 million on a daily average basis—were down $185 million from the preceding month, while excess reserves averaged $88 million higher than in August. Net borrowed reserves of member banks averaged $766 million for September as a whole.

The basic reserve positions of both the eight major New York City banks and the thirty-eight money center banks outside New York showed a deterioration over the month though their intramonthly patterns differed. The New York City banks had a basic reserve surplus averaging $285 million at the close of August but moved to a deficit position in the week ended on September 3, primarily as a result of a sizable decline in their borrowings other than from their foreign branches. The thirty-eig

Chart I
SELECTED INTEREST RATES
July-September 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.

other money center banks, in contrast, showed a slight improvement in their position.

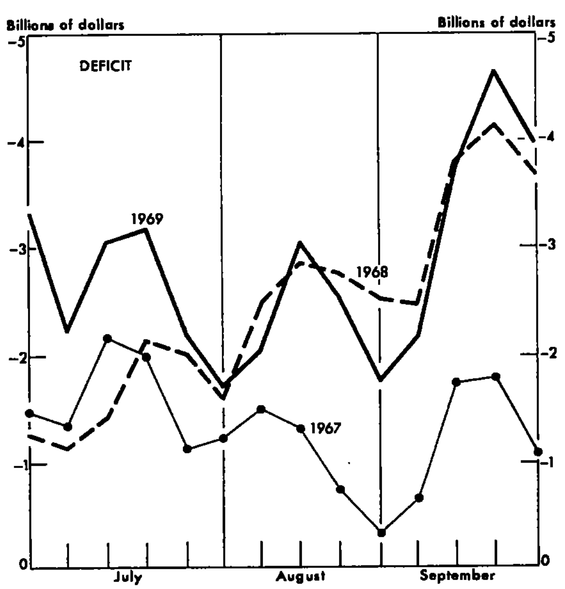
In the week ended on September 10 the basic deficit at the New York City banks increased by $1,085 million and that at the other money center banks by $433 million. A major factor contributing to the worsening in New York was a rise of $722 million in loans to Government securities dealers. That increase was to a large extent the counterpart of sizable matched sale-purchase transactions by the System to offset the effects of the large volume of reserves being supplied by Treasury operations. In addition, the Treasury made frequent calls on its accounts at money center banks. A loss of private deposits also contributed to the deterioration of the basic position at both groups of banks. Despite the fact that this was the week of quarterly corporate dividend payments as well as the sale of Alaskan oil leases, total loans and investments, other than loans to dealers, declined at the forty-six banks.

The major money center banks managed their reserve positions aggressively in the week ended on September 17, accumulating sizable reserve deficiencies over the first five days. As a result, the more usual pattern of tightness in the Federal funds market at the start of the week and some easing at the close was reversed. The effective rate on Federal funds was 8¾ percent on Thursday and Friday but then began to rise, reaching 10 percent by Tuesday as the money center banks attempted to settle their reserve positions. The volume of float was less than had been expected, and the System executed repurchase agreements which helped to reduce the effective rate to 9½ percent on the settlement date. Loans and investments at the major money center banks increased sharply during this corporate tax payment week, and the basic position of the thirty-eight banks outside New York City worsened by $773 million. The deterioration in the basic position of the eight New York City banks was considerably less, however, as sizable gains in deposits and Euro-dollar borrowings offset a large amount of the increase in loans and investments.

The tone of the money market was quite firm during the final statement week in September, and the effective rate on Federal funds was above 9 percent throughout the period. In a reversal of the pattern of two weeks earlier, Treasury operations absorbed $1,796 million of reserves on a daily average basis in the week ended on September 24, primarily in relation to tax collections. The redelivery to the System of securities from matched sale-purchase transactions executed in the previous week, and the purchase of additional securities under repurchase agreements, helped to alleviate the pressure on the banking system. The basic reserve position of the forty-six banks improved during the week (see Chart II), largely as a result of a decline in loans to Government securities dealers.

Chart II

BASIC RESERVE POSITIONS OF MAJOR MONEY MARKET BANKS



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

During the month of September, System open market operations absorbed $735 million of reserves on a daily average basis (see Table I). System operations during the first and last weeks of the month supplied reserves of $878 million on a daily average basis through repurchase agreements, but $1,613 million of reserves was absorbed during the second and third statement weeks, primarily through the use of matched sale-purchase agreements of varying maturities.

There was no change in the seasonally adjusted money supply during September following a decline of 1.8 percent (annual rate) in August. Over the third quarter as a whole the money supply grew at a rate of only 0.2 percent but at a rate of 2.9 percent for the first nine months of 1969. Total member bank deposits subject to reserve requirements (the bank credit proxy), plus banks' liabilities to their foreign branches, increased at a seasonally adjusted rate of 3 percent in September, compared with a decline of 2 percent over the first nine months as a whole. Because of the proliferation of nondeposit means of raising funds, this measure has become an increasingly poor indicator of trends in bank credit. The latter, on the basis of last-Wednesday-of-the-month figures, rose at a seasonally adjusted rate of 2 percent over the first nine months of the year. After adjustment for asset sales to affiliates and foreign branches, the rate of growth in bank credit increased to 3 percent.

THE GOVERNMENT SECURITIES MARKET

The market for United States Government securities was dominated in large part during September by the Treasury's October refunding, which included an issue coming due in December as well. Terms of the refunding were announced after the close of business on September 17, and subscription books were open September 22-24. Attention in the market, particularly early in the month, was also focused on the September 10 auction of North Slope oil leases by the state of Alaska, from which some reinvestment demand was anticipated.

The market also was affected by a sizable amount of Federal agency borrowing during September. The gross volume amounted to some $1,948 million, while net new money totaled $573 million. By far the largest single borrower was the Federal Home Loan Bank System, which sold $650 million of consolidated notes due in July 1970 and $250 million of consolidated bonds due in April 1971. Offered at par, the issues carried coupons of 8.40 percent and 8.375 percent, respectively.

Prices of most Treasury securities eroded persistently

Table I

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

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

Factors	Changes in daily averages—week ended on Sept. 3	Sept. 10	Sept. 17	Sept. 24	Net changes
"Market" factors					
Member bank required reserves	+ 148	— 7	— 142	— 25	— 26
Operating transactions (subtotal)	— 256	+1,395	+ 328	— 620	+ 847
Federal Reserve float	— 108	+ 365	+ 175	+ 195	+ 627
Treasury operations*	+ 89	+ 860	— 18	—1,125	— 244
Gold and foreign account	— 9	+ 27	— 2	— 11	+ 5
Currency outside banks	— 145	+ 35	— 72	+ 218	+ 36
Other Federal Reserve accounts (net)†	— 31	+ 106	+ 246	+ 104	+ 425
Total "market" factors	— 108	+1,888	+ 186	— 645	+ 821
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 237	— 935	— 678	+ 641	— 735
Outright holdings:					
Government securities	+ 155	—1,276	— 890	+1,254	— 757
Bankers' acceptances	— 1	—	— 3	—	— 4
Special certificates	—	+ 507	+ 154	— 661	—
Repurchase agreements:					
Government securities	+ 63	— 131	+ 50	+ 40	+ 22
Bankers' acceptances	+ 6	— 12	+ 7	—	+ 1
Federal agency obligations	+ 14	— 22	+ 4	+ 8	+ 4
Member bank borrowings	+ 38	— 499	+ 277	+ 89	— 95
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 276	—1,433	— 401	+ 728	— 830
Excess reserves	+ 168	— 45	— 215	+ 83	— 9

	Daily average levels				
Member bank:					
Total reserves, including vault cash	26,929	26,891	26,818	26,926	26,891‡
Required reserves	26,549	26,556	26,698	26,723	26,632‡
Excess reserves	380	335	120	203	260‡
Borrowings	1,239	740	1,017	1,106	1,026‡
Free, or net borrowed (—), reserves	— 859	— 405	— 897	— 903	— 766‡
Nonborrowed reserves	25,690	26,151	25,801	25,820	25,865‡
Net carry-over, excess or deficit (—)§	80	169	166	70	121‡

	Changes in Wednesday levels				
System account holdings of Government securities maturing in:					
Less than one year	— 468	—1,703	+ 48	+1,164	— 959
More than one year	—	—	—	—	—
Total	— 468	—1,703	+ 48	+1,164	— 959

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 four weeks ended on September 24.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS SEPTEMBER 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on Sept. 3	Sept. 10	Sept. 17	Sept. 24	Averages of four weeks ended on Sept. 24
Eight banks in New York City					
Reserve excess or deficiency(—)*	19	151	— 52	27	36
Less borrowings from Reserve Banks	57	64	129	84	84
Less net interbank Federal funds purchases or sales(—)	95	1,305	1,198	1,251	962
Gross purchases	*1,803*	*2,203*	*2,089*	*2,124*	*2,055*
Gross sales	*1,708*	*898*	*891*	*873*	*1,093*
Equals net basic reserve surplus or deficit(—)	— 133	—1,218	—1,379	—1,308	—1,010
Net loans to Government securities dealers	505	1,054	1,083	466	777
Net carry-over, excess or deficit(—)†	28	7	55	— 2	22
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	135	2	— 8	8	34
Less borrowings from Reserve Banks	289	39	329	306	241
Less net interbank Federal funds purchases or sales(—)	1,892	2,442	2,915	2,377	2,407
Gross purchases	*4,025*	*4,599*	*4,447*	*4,320*	*4,348*
Gross sales	*2,133*	*2,157*	*1,532*	*1,943*	*1,941*
Equals net basic reserve surplus or deficit(—)	—2,046	—2,479	—3,252	—2,675	—2,613
Net loans to Government securities dealers	— 203	26	422	— 53	48
Net carry-over, excess or deficit(—)†	— 4	81	26	2	26

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—September 1969: Sept. 8	Sept. 15	Sept. 22	Sept. 29
Three-month	7.184	7.156	7.161	7.106
Six-month	7.408	7.329	7.362	7.340

Maturities	Monthly auction dates—July-September 1969: July 24	August 26	Sept. 23
Nine-month	7.407	7.387	7.357
One-year	7.313	7.340	7.350

* 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.

during the month of September. The largest declines were in longer term bonds which were off by $3\frac{10}{16}$ to $4\frac{15}{16}$ points, while intermediate-term issues due in three to seven years for the most part fell by $2\frac{9}{16}$ to $3\frac{15}{16}$ points. Treasury bills due within two months experienced some improvement in September, but rates on all bills maturing beyond November rose from 1 to 27 basis points.

There was a weak tone in the market for notes and bonds during most of the first half of September. This resulted from several factors. Investment demand was quite light, and the growing congestion in the markets for Federal agency securities and corporate bonds provided further competition for available investor funds. Moreover, there was some concern over the approaching Treasury refunding, and dealers attempted to lighten their positions in the intermediate maturity area. A brief improvement occurred in response to the aforementioned speculation concerning an extension of the Vietnam cease-fire and to the remarks by Chairman Martin. Following this, however, dealers began to mark down prices of outstanding issues in anticipation of the terms of the Treasury's refunding. It also became gradually apparent that no further investment demand was likely to stem from the Alaska oil rights sale.

On September 18, the day following the announcement of the refunding terms, prices of outstanding Government notes and bonds moved sharply lower in adjustment to the yields set on the new issues. Market response to the terms was generally favorable, and the "when-issued" notes of 1971 and 1973 gained $\frac{7}{32}$ on the day, while those of 1976 rose by $\frac{1}{32}$. Heaviness developed as the month progressed, however, and the three notes were down $\frac{10}{32}$ to $\frac{19}{32}$ at the close of the period.

With the exception of the shorter maturities which were in thin supply, bill rates adjusted higher at the beginning of September and then fluctuated in a narrow range. Early in the month, activity was moderate and selling by foreign investors as well as dealers led to an increase in bill rates. This was tempered somewhat by the optimistic speculation about a Vietnam cease-fire.

In the week ended on September 19, bill rates fluctuated narrowly in fairly active trading, and the September 15 tax date presented no unusual pressures. Sizable investment demand from foreign central banks and considerable interest in the bills sold at the regular weekly auction contributed to a decline in rates at the start of the week. The trend was reversed on Wednesday afternoon, however, in the face of professional and investor selling, and rates moved higher over the remainder of the week.

Foreign demand was again a factor in the bill market in the week ended on September 26 and contributed to a better tone at the start of the period. Demand emanating from the refunding was less than participants had expected, however, and rates moved irregularly during the next several days. On balance most rates increased over the week, but some improvement occurred at the close of the month.

At the regular monthly auction on September 23, average issuing rates on the new nine- and twelve-month bills were set at 7.357 percent and 7.350 percent, respectively, down 3 and up 1 basis points from the comparable rates set at the auction a month earlier (see Table III). At the final weekly auction on September 29, average issuing rates for the new three- and six-month bills were set at 7.106 and 7.340 percent, respectively, 9 and 17 basis points above the average rates established at the last weekly auction in August.

OTHER SECURITIES MARKETS

Corporate bond prices moved steadily downward during most of the month as the volume of new offerings reached the highest total on record for September. The market rallied briefly on September 10 in response to Chairman Martin's comments and to hope for an extension of a cease-fire in Vietnam. Another short-lived rally occurred around midmonth, when the first prime-rated electric utility issue ever to offer investors more than 8 percent was marketed and a sizable scheduled issue of industrial bonds was withdrawn from the calendar. With the exception of these two periods, the trend in the corporate bond market was one of rising yields and successively higher records set on new issues. In the municipal bond market, the start of September saw a continuation of the previous month's deterioration, and on September 4 *The Weekly Bond Buyer's* Thursday index of yields on twenty municipal bonds jumped an additional 11 basis points to a record 6.37 percent. The calendar of new issues scheduled for the month was light, however, and further postponements, voluntary and involuntary, were continually occurring. In this situation of a relatively scarce supply of new issues, coupled with a more hopeful outlook on the part of participants regarding the future tax status of municipal bonds, yields on state and local government securities moved down. By September 25 the *Bond Buyer's* index stood at 6.08, a drop of 29 basis points from September 4. Thereafter, yields again rose, reflecting weakness in other markets.

The response of investors to new corporate bond offerings during the early part of the month was somewhat mixed despite the high level of returns. An Aa-rated issue of power company bonds yielding a record 8.20 percent was a quick sellout, but an Aaa-rated $150 million issue of Southwestern Bell Telephone Company debentures received only a fair reception on its offering date, despite a record return for a Bell System issue of 8.14 percent. (On August 20 a similar offering provided investors with only a 7.75 percent return and was an immediate success.) The Southwestern Bell debentures did sell out on the day following their initial marketing, as the market reacted favorably to optimism about a cease-fire and to Chairman Martin's remarks.

The improved tone in the corporate bond market was only temporary, however, and prices soon resumed their downtrend. Then, on September 15, it was announced that a $150 million issue scheduled for marketing on September 17 was being withdrawn because of unfavorable market conditions. Market participants responded positively to this sizable reduction in supply and to the sale on the next day of a prime electric utility issue whose yield marked the first offering of more than 8 percent on such an issue. Again, the improvement was brief and an Aa-rated offering of utility bonds which was aggressively priced a few days later met with a poor reception from investors. When the syndicate managing this issue was terminated, the yield on the bonds adjusted up to 8.21 percent from the initial offering of 8.08 percent. Those new issues which were attractively priced over the remainder of the month were generally well received, but successively higher record yields were required to achieve this. Moreover, investor response was not enthusiastic even at these levels.

Prices of state and local bonds fell sharply at the start of September, and a mounting backlog of older issues prompted underwriters to release several issues from price restrictions. The resulting upward yield adjustments ranged as high as 45 basis points. Postponements due to market conditions and failures to receive bids because of interest rate ceilings continued, thereby reducing the already light calendar even further. The "Blue List" of municipal dealers' inventories declined by $56 million from $406 million on August 29 to $350 million on September 30. Although there was still concern about the longer term outlook for the municipal markets, the immediate situation of relatively few new issues provided a respite, however temporary, and municipal bond yields began a retreat. Despite the sharp drop in the *Bond Buyer's* index of 29 basis points over the last three weeks of the month, the level of yields remains historically high. This was underscored by the fact that on September 24 the Federal Housing Assistance Administration was unable to sell $142 million of a $191 million offering of tax-exempt local housing authority bonds because of a 6 percent statutory ceiling. Earlier in the month the same restriction had resulted in less than half of two offerings of temporary housing and urban renewal notes being sold.