The Money and Bond Markets in October

Interest rates on intermediate- and long-term securities began to decline sharply in early October after successively reaching new record highs during September. Fresh hopes of peace in Vietnam and a growing belief that domestic inflationary pressures were easing led many investors to conclude that interest rates had reached their peaks. The shift in sentiment spurred demands for longer term issues especially, and by the third week of the month their prices had more than retraced the steep declines posted in September. At the peak of the market rally, yields on intermediate- and long-term Treasury coupon issues had declined from 50 to 100 basis points, and new corporate and tax-exempt offerings were being marketed at yields as much as 25 basis points below their earlier highs.

While a swing in sentiment was sufficient to trigger the rise in bond prices, the more substantive support needed to sustain the advance proved lacking. Underwriters, aware that prior market rallies based on expectations of lower interest rates had been short-lived, became somewhat more cautious in bidding for new debt issues as the month wore on. At the same time, the President's impending address on the Vietnam situation, scheduled for November 3, became a source of uncertainty to the market, and earlier data pointing to an economic "cooling" were followed by contrary news. Big September jumps in the consumer price index, housing starts, and durable goods orders, all reported after mid-October, were disappointing reminders of the strength of inflationary forces. As a consequence, late October witnessed sharp upward readjustments in securities yields, in some cases back to the levels early in the month.

In the money market, restraint on bank reserves continued during October. Member banks' net borrowed reserve positions remained deep, and Federal funds traded above 9 percent through midmonth, then dropped below for a time before firming a bit (see Chart I). Short-term rates declined on balance, and longer term Treasury bill rates were lower over the month as well.

BANK RESERVES AND THE MONEY MARKET

Money market conditions remained generally unchanged during October, although an easier tendency appeared when reserves shifted to the money center banks. Member bank net borrowed reserves averaged $1,017 million (see Table I), $274 million deeper than in September when Treasury cash management had resulted in a temporary easing of bank reserve positions around midmonth. Excess reserves declined $109 million to a level of $173 million, and borrowings averaged $1,190 million, an increase of $164 million.

The monetary aggregates were mixed during October. Total member bank deposits subject to reserve requirements (adjusted to include Euro-dollar liabilities) fell at a 9 percent annual rate, although sales of commercial paper by bank holding companies provided a partial offset. On the other hand, the narrow money supply advanced at a 1.2 percent annual rate in October, after declining in the previous two months.

Despite continued monetary restraint, domestic short-term market rates did tend to move a bit lower over the month. For instance, dealer-placed prime four- to six-month commercial paper at the month end was quoted at 8⅛ percent, off ¾ percentage point from late September, and bankers' acceptances edged down ¼ to ⅜ percentage point. Short-term Euro-dollar rates also moved lower during October. After closing September at about 11¼ percent, the three-month rate fell almost without pause throughout most of October, although some of this decline was retraced in the closing days of the month and the rate ended the month around 10 percent. Part of the drop reflected a reflux of funds out of Germany into the Euro-dollar market when speculative positions in marks were unwound after the mark was allowed to float. At the same time, additions to Euro-dollar borrowings became relatively more expensive for United States banks by virtue of the new marginal reserve requirement, established under Regulations D and M, which had to be met beginning with the week ended on October 22. However, United States banks were able to attract foreign official funds to domestically issued certificates of deposit (CD's). These are not subject to the interest-rate ceilings of Regulation Q, and reserve requirements on time deposits are 4 percentage points less than the 10 percent applying to increases in Euro-dollar liabilities. At New York City banks, for example, CD's issued to "others" (a category which includes foreign governments and international institutions) advanced almost $450 million between October 1 and October 29. In contrast, large CD's subject to the Regulation Q ceilings fell by more than $50 million during the same period.

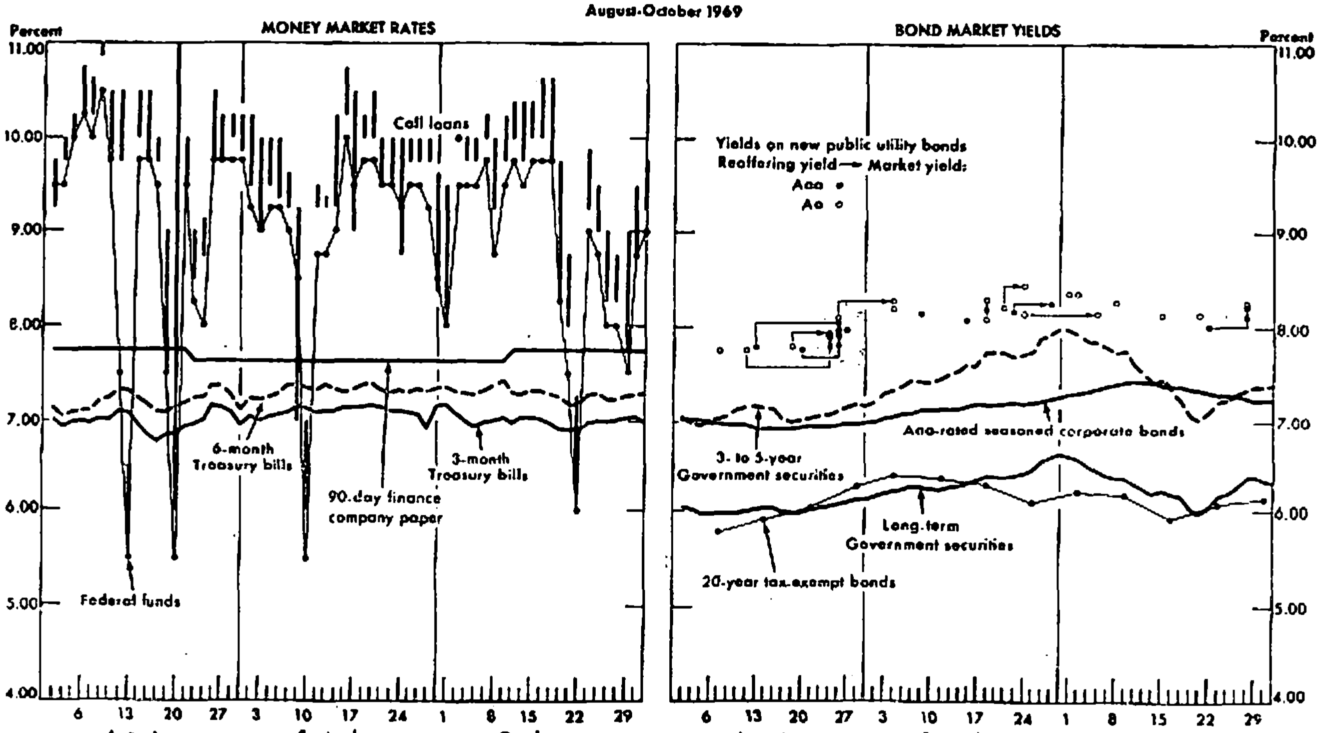
On balance, operating factors tended to absorb bank reserves during all but one of the statement weeks ended in October. Week-to-week swings in float were somewhat larger than usual. For instance, movements in float added almost $900 million to bank reserves during the week ended on October 22 and then absorbed about $600 million during the following week. Borrowings at the discount window also tended to fluctuate from week to week in response to the reserve impact of market forces, the thrust of open market operations, and the distribution of reserves between large money market banks and others.

In general, the nationwide distribution of reserves followed a fairly regular pattern during the month. The large money market banks experienced outflows until midmonth, principally from calls on Treasury deposits (see Chart II). Thereafter, the Treasury's cash position improved as proceeds from the auction of April tax bills

Chart I

SELECTED INTEREST RATES

August-October 1969



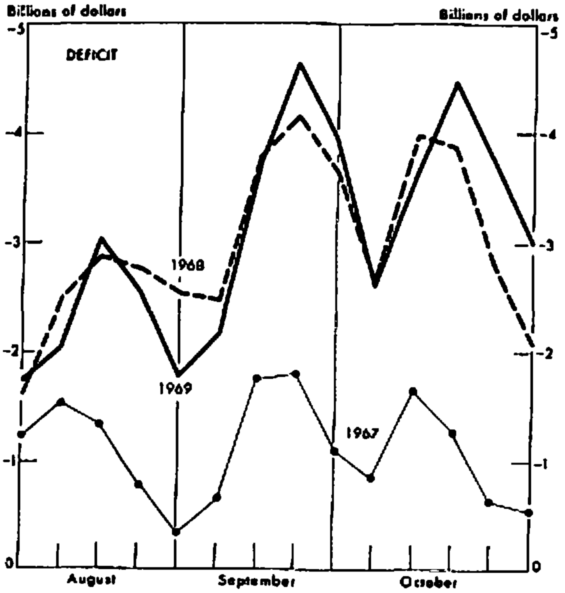
Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Daily range of rates posted by major New York City banks on call loans (to 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 POSITION OF MAJOR MONEY MARKET BANKS



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

flowed in. Also, private demand deposits began to increase at the major money market banks after midmonth, with the basic reserve position of New York City banks benefiting a little sooner than that at large banks elsewhere (see Table II).

Pressures in the market for Federal funds were at their peak during the weeks ended on October 8 and October 15, when the large banks moved to cover their reserve deficiencies. In the first of these two periods, the rate on Federal funds was mostly 9½ percent to 9¾ percent before declining on the final day of the period. In the October 15 week, demands were strong throughout the period. Some trading took place at rates as high as 10½ percent, when a buildup of deficiencies coincided with the large aggregate reserve absorption by "market" forces. Open market transactions injected reserves, primarily through outright purchases of Government securities, to offset much of these pressures.

Aggregate market factors reversed course after midmonth, and positions at money market banks began to improve at the same time. The week ended on October 22 was the first during which reserves had to be maintained on Euro-dollar liabilities under the new provisions of Regulations D and M. This development added about $400 million to total required reserves for that week. Reserve strategy by large banks appeared to be cautious as the week opened; reserve excesses were built up through the weekend and Federal funds held at the 9¾ percent level. The subsequent distribution of these excesses, aided by a jump in float of almost $900 million, pushed the funds rate down to a range of 6 to 8¼ percent for the last three days of the week. Reserve pressures were also less severe during the final October statement week. Federal funds traded mostly between 7½ percent and 9 percent, as large-bank reserve deficiencies were again pared and market factors added to reserve availability. Under these circumstances, the Federal Reserve absorbed reserves through matched sale-purchase transactions.

THE GOVERNMENT SECURITIES MARKET

Short-term Treasury bill rates were mostly steady to lower throughout October, while longer term issues generally moved down rather sharply during the first three weeks and then turned upward as the month drew to a close. The technical position of the bill market was strong throughout most of the month, and dealer interest in regular weekly auctions was usually on the aggressive side (see Table III). Distribution of the new bills encountered little investor resistance at the lower levels. The three-month bill closed October at a 6.99 percent rate, little changed over the month. Demands for longer bills mounted strongly toward midmonth, bringing yields on six-month and one-year maturities down by as much as 26 to 39 basis points. Much of this movement appeared to be the result of expectations of reduced inflationary pressure and progress in Vietnam.

The Treasury raised $5 billion in new funds during October through the sale of two issues of tax anticipation bills (TAB's). On October 8, $2 billion of TAB's maturing in April was auctioned at an average rate of 7.283 percent and, on October 23, $3 billion of June TAB's was sold at an average rate of 7.205 percent. Both auctions were dominated by banks, which could make payment by crediting their Treasury Tax and Loan Accounts to the extent of 50 percent of their purchases in the first auction and 100 percent in the second. While these new TAB offerings did not produce a strong upward thrust to rates, the process of distribution by the banks did inhibit somewhat the easing of longer bill rates.

Rates on longer bills, as well as coupon issues, turned back up in the final ten days of the month amid a sharp reversal of market sentiment. The Defense Department statement on October 22 expressing opposition to any

Table I

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

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

Factors	Changes in daily averages—week ended on Oct. 1	Oct. 8	Oct. 15	Oct. 22	Oct. 29	Net changes
"Market" factors						
Member bank required reserves	— 353	+ 25	— 137	— 259	+ 367	— 357
Operating transactions (subtotal)	— 154	— 98	— 679	+ 621	— 311	— 521
Federal Reserve float	— 630	+ 122	— 163	+ 864	— 594	— 410
Treasury operations*	+ 64	+ 222	— 198	+ 174	+ 8	+ 270
Gold and foreign account	+ 11	— 11	+ 18	— 1	—	+ 17
Currency outside banks	+ 270	— 225	— 410	— 410	+ 439	— 336
Other Federal Reserve accounts (net)†	+ 128	— 206	+ 74	— 7	— 64	— 65
Total "market" factors	— 507	— 73	— 816	+ 362	+ 156	— 878
Direct Federal Reserve credit transactions						
Open market instruments	+ 291	+ 318	+ 515	— 51	— 348	+ 725
Outright holdings:						
Government securities	+ 87	+ 217	+ 536	+ 172	— 181	+ 831
Bankers' acceptances	—	+ 1	+ 3	— 1	—	+ 3
Repurchase agreements:						
Government securities	+ 211	—	+ 12	— 205	— 108	— 90
Bankers' acceptances	— 4	+ 32	— 2	— 18	— 15	— 7
Federal agency obligations	— 3	+ 68	— 34	+ 1	— 44	— 12
Member bank borrowings	+ 332	— 474	+ 384	— 333	+ 168	+ 77
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+ 623	— 156	+ 899	— 384	— 180	+ 802
Excess reserves	+ 116	— 229	+ 83	— 22	— 24	— 76

Member bank:	Daily average levels Oct. 1	Oct. 8	Oct. 15	Oct. 22	Oct. 29	
Total reserves, including vault cash	27,400	27,146	27,366	27,603	27,212	27,345‡
Required reserves	27,080	27,055	27,192	27,451	27,084	27,172‡
Excess reserves	320	91	174	152	128	173‡
Borrowings	1,438	984	1,348	1,015	1,183	1,190‡
Free, or net borrowed (—), reserves	—1,118	— 893	—1,174	— 863	—1,055	—1,017‡
Nonborrowed reserves	25,962	26,162	26,018	26,588	26,029	26,155‡
Net carry-over, excess or deficit (—)§	118	171	101	148	108	127‡

System account holdings of Government securities maturing in:	Changes in Wednesday levels Oct. 1	Oct. 8	Oct. 15	Oct. 22	Oct. 29	
Less than one year	— 818	+ 376	+1,049	—1,505	+ 890	— 8
More than one year	+ 695	+ 128	—	—	—	+ 823
Total	— 123	+ 504	+1,049	—1,505	+ 890	+ 815

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 October 29.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS OCTOBER 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on Oct. 1	Oct. 8	Oct. 15	Oct. 22	Oct. 29	Averages of five weeks ended on Oct. 29
Eight banks in New York City						
Reserve excess or deficiency (—)*	58	— 18	30	— 56	17	6
Less borrowings from Reserve Banks	95	170	211	—	52	106
Less net interbank Federal funds purchases or sales(—)	782	967	1,271	632	419	814
Gross purchases	*1,814*	*1,882*	*2,367*	*1,858*	*1,575*	*1,899*
Gross sales	*1,031*	*915*	*1,096*	*1,226*	*1,153*	*1,084*
Equals net basic reserve surplus or deficit (—)	— 819	—1,155	—1,452	— 688	— 454	— 914
Net loans to Government securities dealers	502	344	400	519	499	453
Net carry-over, excess or deficit (—)†	27	40	15	44	— 16	22
Thirty-eight banks outside New York City						
Reserve excess or deficiency (—)*	39	— 11	— 27	30	— 53	— 4
Less borrowings from Reserve Banks	531	113	397	275	322	328
Less net interbank Federal funds purchases or sales(—)	1,306	2,245	2,570	2,834	2,167	2,224
Gross purchases	*3,579*	*4,380*	*4,705*	*4,490*	*4,101*	*4,251*
Gross sales	*2,271*	*2,135*	*2,135*	*1,656*	*1,934*	*2,026*
Equals net basic reserve surplus or deficit (—)	—1,798	—2,369	—2,994	—3,079	—2,542	—2,556
Net loans to Government securities dealers	127	87	45	283	235	155
Net carry-over, excess or deficit (—)†	33	42	21	24	16	27

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—October 1969 Oct. 6	Oct. 10	Oct. 20	Oct. 27
Three-month	7.046	7.042	6.975	7.030
Six-month	7.289	7.327	7.265	7.263

Maturities	Monthly auction dates—August-October 1969 Aug. 26	Sept. 23	Oct. 28
Nine-month	7.387	7.357	7.244
One-year	7.340	7.350	7.127

* 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.

unilateral cease-fire in Vietnam prompted some reassessment of the military outlook, and the flow of bullish reports on the state of the economy quickly eroded earlier optimism about an easing of inflationary pressures. Investment demand for bills did moderate the scale of subsequent yield advances in the longer sector, however. At the regular monthly auction on October 28 the new nine- and twelve-month bills sold at average rates of 7.244 and 7.127 percent, respectively, the lowest levels for both maturities in five months. Six-month and one-year bills yielded 7.30 percent and 7.03 percent, respectively, at the end of October, 3 and 39 basis points below levels of a month earlier.

Prices on Treasury coupon issues advanced steadily for three weeks, but thereafter market optimism began to evaporate and a sharp reversal took place, offsetting more than half of the earlier declines in yields. The initial upsurge in prices of recently issued Treasury notes was particularly marked. The three notes issued in the September refunding, which at their issue date carried record-setting yields, had moved to discounts ranging from 9/32 to 15/32 point in "when-issued" trading at the end of September.[1] These losses were quickly erased in early October, however, and the bid price on the 7½ percent issue maturing in 1976 moved to a premium as high as 4 points before the market decline set in late in the month. The widely followed 4¼ percent bond of 1987-92 surged almost 6 points in price over the first three weeks, with a corresponding fall in yield of 59 basis points, but it too fell back sharply in late-month trading.

OTHER SECURITIES MARKETS

Prices and yields on corporate and agency securities underwent wide swings in October. Rates on both new and seasoned taxable issues dropped dramatically until the last ten days of the month, when heightened expectations of a substantial reduction in the United States involvement in Vietnam and optimism over progress in reducing domestic inflation contributed to sentiment that interest-rate peaks had been reached. The inflows of long-term funds began to dry up toward the end of the month, however, and the optimistic atmosphere quickly evaporated as the indicators of economic activity took on renewed strength and peace negotiations remained shrouded with uncertainty.

The sharp new-issue yield declines carried through the first three weeks of October, and lows were registered around October 21, when a $100 million offering of 25-year bonds by Southern California Edison was oversubscribed at an 8⅛ percent yield. This level was about 23 basis points below the record 8.35 percent yield on Aa-rated issues, set October 1. On the next day Mountain States Telephone and Telegraph, a Bell System unit, offered $100 million of 40-year debentures to yield 8 percent to investors—fully 25 basis points lower than another Bell unit offering at the end of September. The issue was fairly well received by investors but did not sell out immediately.

The abruptness of the yield declines and the paucity of evidence supporting predictions of economic slowing made the lower yield levels unsustainable. Price restrictions on the unsold Mountain States Telephone debentures were released October 28, and quotations subsequently fell as much as 2½ points. At that stage the issue yielded 8.21 percent, 21 basis points above the original offering and only 4 basis points below the September record. Investor response to new offerings marketed at rising yields during the last week of the month was mixed.

Federal agency flotations again exerted strong demand pressures on the capital markets in October. Rates on issues maturing in one year and over generally declined with other market rates during the first three weeks, but then rebounded sharply. On October 2, a $600 million financing by the Federal National Mortgage Association commanded record-high rates of 8¾ percent and 8.70 percent, respectively, for 16- and 29-month notes. The excellent response to these attractive rates marked a turning point in sentiment, and in secondary market trading the notes were quoted to yield 7.65 percent and 7.50 percent at low points during the month; however, each rose around 35 basis points over the last ten days. At the end of the month, FNMA marketed two more issues totaling $600 million—a $400 million offering of 18-month debentures carried a yield of 8.20 percent and $200 million of 37-month debentures yielded 8 percent to investors.

Price advances in the tax-exempt sector were considerably less pronounced, in large measure because of concern over the status of tax legislation under consideration by the Congress. This uncertainty was eased on October 9, when the Senate Finance Committee rejected the provisions of a House bill which imposed levies on currently tax-exempt securities. In addition, commercial banks, a major source of funds, continued to face reserve strin-

[1] On October 10 the Treasury announced a revision of subscription results for this refunding. The total amount reported as exchanged was reduced $352 million to $7,012 million. This raised the rate of attrition on the publicly held portion of the maturing issues to 24.3 percent from the 19.7 percent initially reported.

gency, while a huge backlog of demands for funds still overhung the market. Interest-rate ceilings have been responsible for a large volume of postponed flotations, and there is evidence that some issuers are amending ceiling statutes to facilitate financings.

On October 7, local public housing authorities sold over 90 percent of an offering of $374 million five-month Federally guaranteed notes. The average rate approximated 5.86 percent, around 7 basis points below that in September when less than half an offering of $316 million was sold. The market outlook brightened subsequently on news of the Senate Finance Committee action on tax legislation. A few days later, various urban renewal agencies, under the auspices of the Department of Housing and Urban Development, sold a total of $250 million of project notes at an average yield of 5.59 percent, over 30 basis points below the cost of a mid-September offering.

Investors began to resist the heavy volume of tax-exempt offerings after midmonth. The limited absorptive capacity of the market was reflected in a sharp upswing in dealer holdings. During the first half of October the Blue List of dealer-advertised inventories ranged between $300 million and $350 million—not far above the year's low. By the end of the third week, however, holdings had jumped to about $540 million, and in the final week they briefly reached $625 million—the year's highest level. In this atmosphere, yields began to rise again. At the close of October, *The Weekly Bond Buyer's* index of twenty municipal bond yields stood at 6.13 percent, only 6 basis points lower than at the beginning of the month.