The Money and Bond Markets in February

Strong price advances in the money and bond markets during February carried most short- and long-term interest rates to the lowest levels since last fall. Investor belief that a turning point in interest rates might be at hand was fed by increasing conviction that economic activity was slowing and by anticipation, fostered by statements from prominent officials, that a relaxation of monetary policy was a near-term possibility.

In the market for United States Government securities, very sharp yield declines were registered in all maturity sectors. Treasury bill rates dropped precipitously as strong investment demand pressed on low dealer inventories. Rates leveled off toward the end of the month, when the supply of bills was augmented by the auction of $1,750 million of April tax anticipation bills (TAB's) and increases of $100 million and $200 million, respectively, in regular auctions of six- and twelve-month bills. Early in the month the three issues of new notes offered in exchange for issues maturing in mid-February and mid-March attracted very strong demand, and attrition was well below that expected earlier. The new notes maturing in 1971, 1973, and 1977 were quoted at rising price premiums over the month, as dealers and investors became increasingly confident that rates would continue to fall. Over the month as a whole, bid rates on almost all maturities of Treasury bills dropped around a full percentage point, three- to seven-year notes yielded from 65 to almost 100 basis points lower, and long-term bond yields declined 40 to 60 basis points.

New issues of corporate debt were aided considerably by the shift in investor sentiment, and offering yields fell steadily over most of the month. A Bell System financing in mid-February carried an 8.50 percent yield to investors, 30 basis points below that of a similar offering a few weeks earlier. Individual investors were major buyers of the new issues, but during the month large institutional investors also began to commit funds. In the buoyant atmosphere, additions to the forward calendar of flotations checked, but did not reverse, the price trend. The recovery in the tax-exempt sector was less vigorous initially but tended to pick up steam as the month progressed. Nevertheless, the large backlog of financings and the continued reserve stringency impinging on commercial banks exerted some cautionary influence.

BANK RESERVES AND THE MONEY MARKET

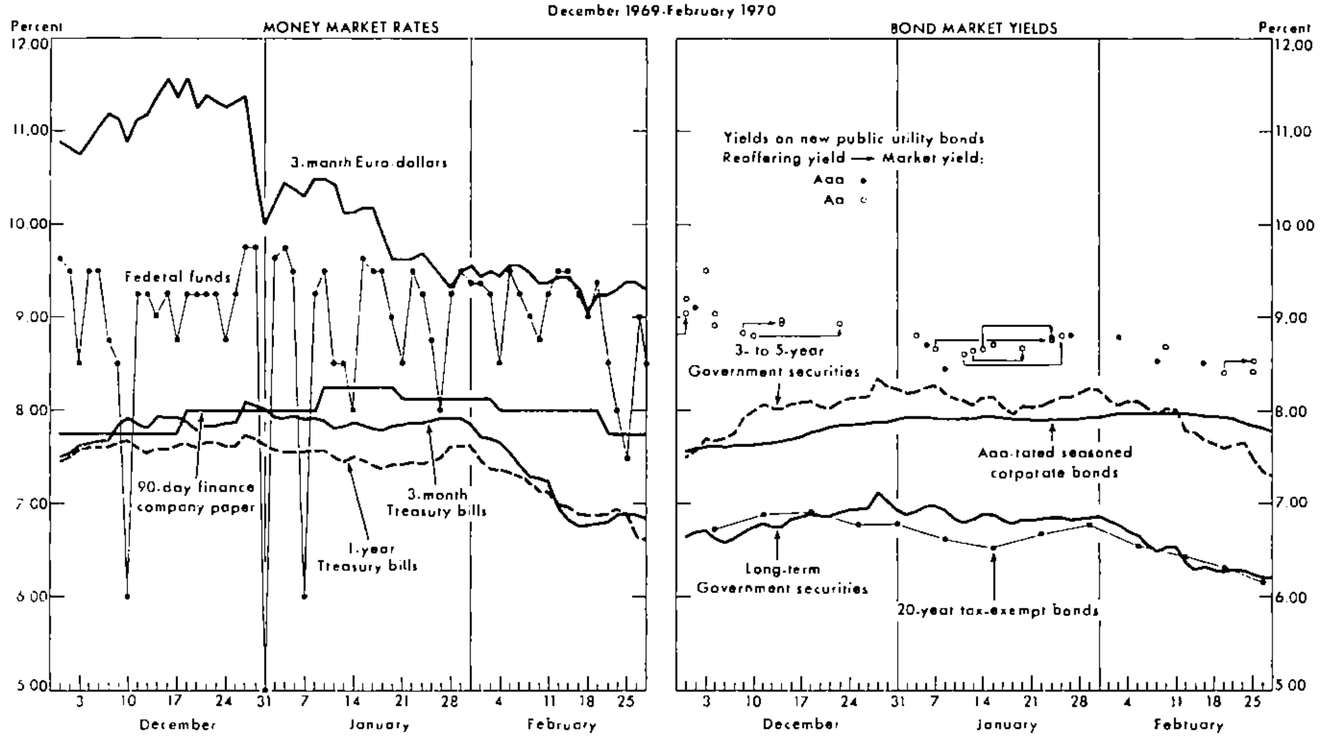
Borrowings from Federal Reserve Banks averaged above $1.1 billion in February, and net borrowed reserves were slightly below the $1 billion mark (see Table I). The effective rates on Federal funds were around 9¼ percent most of the month, but drifted as low as 7½ to 8½ percent in the last week (see Chart I). Other money market rates edged down during February. Three-month Euro-dollars were about ¼ point lower over the month, but the 9 to 9½ percent range of quotations was as much as [illegible] percentage points below rates in December. One factor in the drop of Euro-dollar interest rates since the year-end has been the slackening in demand for these funds by United States banks, which in January raised about $1.2 billion in the commercial paper market. Rates on directly placed ninety-day finance company paper eased in two steps by a total of ⅜ percentage point and closed the month at 7¾ percent.

System open market operations provided $288 million of reserves over the month. Operating transactions, which did not fluctuate so widely from week to week as they did the month before, absorbed $1,025 million, while required reserves dropped $995 million. In the aggregate, major money market banks experienced fairly typical intramonthly shifts in their basic reserve position (see Chart II). During the week of February 4, however, New York City banks enjoyed an unusual deposit inflow and were net sellers of $460 million in Federal funds (see Table II)—the largest weekly volume of net sales by these banks since the series began in 1959. Indeed, some banks tended to overestimate the size of the temporary reserve windfall, and late on the final day of the settlement period a scramble for reserves briefly pushed the Federal funds rate to 12 percent, a new record high. Succeeding weeks during February witnessed more normal deposit flows between money center banks and others, and demand

Chart I

SELECTED INTEREST RATES

December 1969-February 1970



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; 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-month and one-year 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.

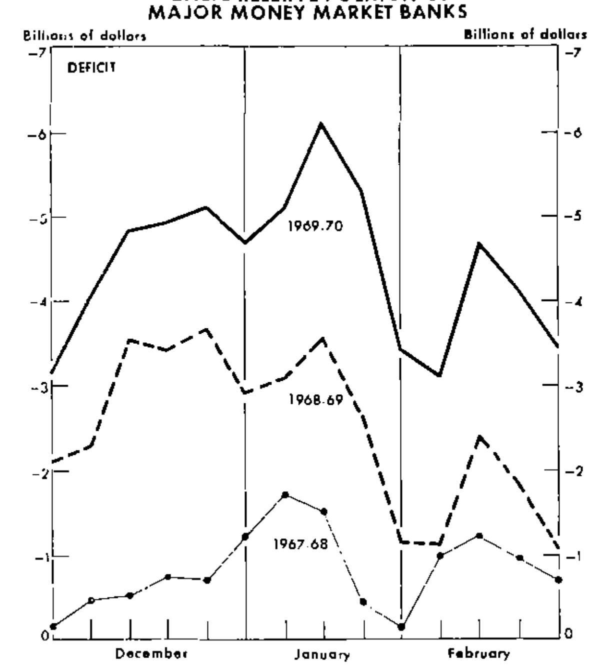
for reserves were fairly steady throughout each of the periods, with the result that rates stayed around 9 percent or above until the last week of the month. In the statement week ended on February 25, more comfortable conditions emerged before the long weekend (many banks were closed February 23 in observance of the Washington's Birthday holiday), and on the final two days of the period the availability of a large volume of excess reserves pushed the effective rate on Federal funds down to 7½ to 8 percent. A comfortable tone persisted as the month closed.

The money supply declined at a seasonally adjusted annual rate of 10 percent in February, according to preliminary data, after a 9½ percent advance in January. This month-to-month reversal was unusually large and affected the behavior of growth rates over a longer time horizon. Increases for three-month periods ranged from about zero to 2½ percent in each of the last six months of 1969, then jumped to over 4 percent in January 1970 before falling back almost to zero in February (see Chart III). The adjusted bank credit proxy (member bank deposits subject to reserve requirements plus certain nondeposit liabilities)[1] also dropped in February, bringing the rate of decline for the latest three months to nearly 3 percent as compared with a 3 percent gain in the period ended in January. While total time deposits edged down about 1

[1] The composition of these nondeposit liabilities is detailed in a footnote to Chart III.

Chart II

BASIC RESERVE POSITION OF MAJOR MONEY MARKET BANKS



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

percent in February and were 3 percent lower over the latest three months, most of the recent decline took place in January, when banks lost a sizable volume of individuals' time and savings deposits after the December interest-crediting period. By contrast, the sharp drop in time deposits during 1969 was attributable mainly to runoffs of large certificates of deposit.

THE GOVERNMENT SECURITIES MARKET

Prices of United States Government securities rallied strongly throughout February amid increasingly pervasive sentiment that the long-awaited turn in interest rates had finally materialized. Investor conviction that economic activity was slowing and public statements by Administration officials and others about the appropriate stance of monetary policy in the coming months contributed to expectations of lower interest rates. In this atmosphere, both short- and long-term Treasury issues enjoyed price advances which in many cases pushed yields to their lowest levels since last October.

The Treasury February refunding, which had dominated market attention in the latter part of January, coincident with the dramatic shift in market sentiment, and the rate of attrition on the maturing issues turned out to be well below that expected in late January.[2] To a considerable extent, strong dealer interest in the new issues accounted for the very favorable exchange results, and dealer efforts to maintain their positions subsequently contributed to the upward pressure on prices. Over the month, yields on the new notes fell between 79 and 97 basis points to close at levels between 7.15 percent and 7.30 percent.

In the market for Treasury bills, strong investor demand —in part from foreign sources and from reinvestment of proceeds from the maturing February 15 notes—encountered relatively thin dealer positions. As a result, rates dropped very sharply throughout most of the month. Bidding at the regular weekly auctions was generally aggressive and, while the average proportion of noncompetitive tenders to awards dropped below 25 percent from around 33 percent in January, participation by small investors nonetheless influenced the slide of yields.

On February 13 the Treasury announced plans to raise cash by the sale on February 25 of $1,750 million of April TAB's and by increases of $100 million in the regular weekly six-month bill auction, beginning with the February 20 auction, and $200 million in the regular monthly one-year bill auction, beginning February 24. While the new cash operations of the Treasury did not produce a rollback in the price gains in the bill market, the concentration of three bill auctions during the last few business days of February did foster a note of caution in bidding as dealers probed investor demand at the lower rate levels. After week-to-week drops of from 30 to 60 basis points in new-issue rates, yields on the new three- and six-month bills tended to level off in the last weekly auction of the month—held February 20 because of the Washington's Birthday holiday on February 23 (see Table III). The auction of nine- and twelve-month bills on February 24 received good interest, and average rates were set at 6.994 percent and 6.933 percent, respectively, 73 and 60 basis points below those a month earlier. The next day, bidding was somewhat cautious in the April TAB auction—dominated by banks which could credit

[2] Of the approximately $5.6 billion of maturing issues in the hands of the public, about $4.9 billion was exchanged into the three new issues: the 8¼ percent notes due in August 1971, the 8⅛ percent notes due in August 1973, and the 8 percent notes due in February 1977. The 12.8 percent attrition rate on this exchange was about one half the rate of the previous refunding in October.

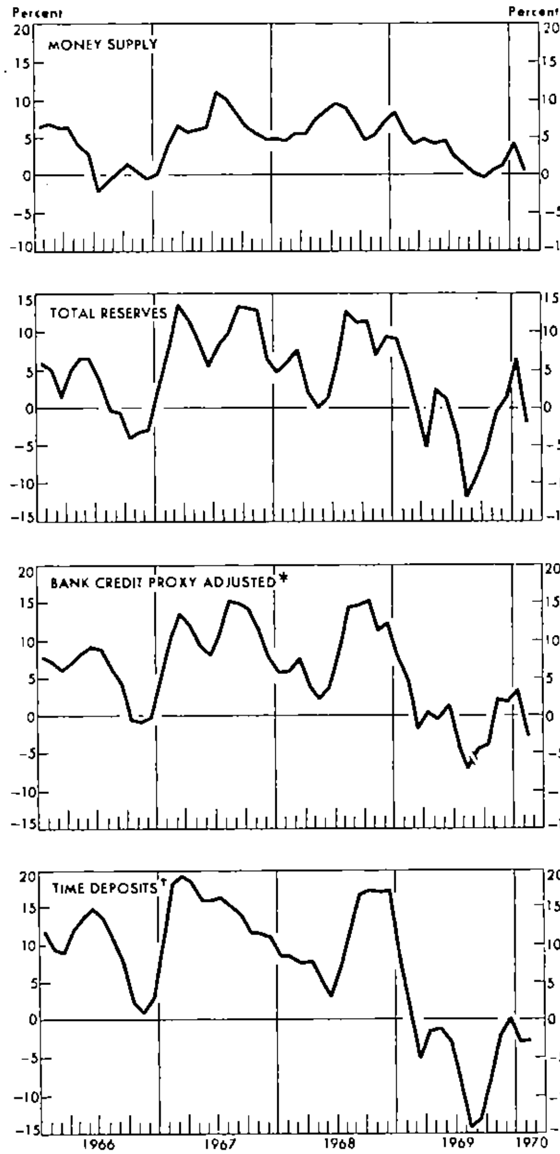
proceeds to Treasury Tax and Loan Accounts. The issue rate averaged 6.552 percent, and investor demand for the bills proved to be moderately strong.

In the market for Federal agency issues, four large offerings during February were very well received by investors at yields below those on new issues in the previous month. The largest financing for new funds came late in February, when the Federal National Mortgage Association (FNMA) raised \$800 million by offering \$500 million of 8⅛ percent 1¾-year debentures and \$300 million of 8.10 percent 3½-year debentures. These rates were around ⅝ percentage point below those paid by FNMA in a flotation in late January.

Chart III

CHANGES IN MONETARY AND RESERVE AGGREGATES FROM THREE MONTHS EARLIER

Seasonally adjusted annual growth rates



Note. Rates for the latest month are based on preliminary data.

* Total member bank deposits subject to reserve requirements plus liabilities to foreign branches and, beginning in September 1969, other nondeposit liabilities including Euro-dollars borrowed directly from foreign banks or through brokers and dealers, bank liabilities to own branches in United States territories and possessions, commercial paper issued by bank holding companies or other bank affiliates, and loans or participation in pools of loans sold under repurchase agreement to other than banks and other than banks' own affiliates or subsidiaries.

† At all commercial banks.

OTHER SECURITIES MARKETS

New issues of corporate and tax-exempt securities benefited from many of the same influences that pushed Government securities prices sharply higher. Not all offerings during the month were immediately sold out, however. The high volume of financings, aggressive pricing by underwriters, and somewhat reluctant institutional participation until after midmonth all combined to produce a succession of tests of the markets' absorptive capacity. Throughout the period, of course, the record \$1.57 billion debenture offering by American Telephone and Telegraph Company, scheduled for April, continued to cast a very sizable shadow.

After disposing of the remnants of some late-January market congestion, the corporate market quickly reflected the shift in investor expectations. In many cases, new flotations were marketed at yields well below levels anticipated only days before. For example, \$80 million of 25-year Aaa-rated bonds offered by Philadelphia Electric Company on February 3 sold out quickly at a yield to investors of about 8.78 percent, compared with earlier estimates of from 8.80 percent to 8.90 percent. The receptions of other new offerings during the first half of February were mixed, however, but a brief easing in the volume of new financings during this period gave underwriters an opportunity to work inventories down.

The highlight of the month's new issue activity was provided at midmonth by a \$150 million offering of forty-year debentures by Michigan Bell Telephone Company. The 8.50 percent yield to investors set on these debentures was 30 basis points lower than that on a Bell System financing in late January. Initially, smaller investors responded well to the offering, and large institutional buying later entered the market and absorbed the balance. Although financing activity slackened briefly toward the month end, on balance new issue yields held

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, FEBRUARY 1970

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

Factors	Changes in daily averages— week ended on				Net changes
	Feb. 4	Feb. 11	Feb. 18	Feb. 25	
"Market" factors					
Member bank required reserves	+ 183	+ 395	− 3	+ 415	+ 996
Operating transactions (subtotal)	− 631	− 208	− 264	+ 78	−1,025
Federal Reserve float	− 561	+ 17	− 107	+ 137	− 514
Treasury operations*	+ 145	− 70	+ 130	− 25	+ 180
Gold and foreign account	− 20	+ 7	+ 10	+ 44	+ 41
Currency outside banks	− 102	− 135	− 383	− 27	− 647
Other Federal Reserve liabilities and capital	− 92	− 26	+ 86	− 51	− 83
Total "market" factors	− 443	+ 187	− 267	+ 493	− 30
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 414	− 130	+ 575	− 571	+ 288
Outright holdings:					
Government securities	+ 9	+ 10	+ 22	− 56	− 15
Bankers' acceptances	− 4	+ 1	− 1	+ 2	− 2
Repurchase agreements:					
Government securities	+ 330	− 104	+ 454	− 454	+ 226
Bankers' acceptances	+ 28	− 7	+ 45	− 43	+ 23
Federal agency obligations	+ 51	− 30	+ 55	− 20	+ 56
Member bank borrowings	+ 230	− 187	+ 40	− 47	+ 80
Other Federal Reserve assets†	− 128	+ 98	− 274	+ 48	− 250
Total	+ 516	− 219	+ 341	− 570	+ 68
Excess reserves	+ 73	− 32	+ 74	− 77	+ 38

	Daily average levels				
Member bank:					
Total reserves, including vault cash	28,391	27,964	28,042	27,525	27,931‡
Required reserves	28,211	27,816	27,819	27,404	27,813‡
Excess reserves	180	148	223	140	174‡
Borrowings	1,258	1,071	1,111	1,064	1,126‡
Free, or net borrowed (−), reserves	−1,078	− 923	− 888	− 918	953‡
Nonborrowed reserves	27,133	26,893	26,931	26,461	26,855‡
Net carry-over, excess or deficit (−)§	64	117	81	153	104‡

	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 736	− 93	− 404	− 622	− 383
More than one year	—	—	+ 564	—	+ 564
Total	+ 736	− 93	+ 160	− 622	+ 181

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 February 25.

§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS FEBRUARY 1970

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Averages of four weeks ended on Feb. 25
	Feb. 4	Feb. 11	Feb. 18	Feb. 25	
Eight banks in New York City					
Reserve excess or deficiency (−)*	24	13	22	− 2	14
Less borrowings from Reserve Banks	75	130	218	—	106
Less net interbank Federal funds purchases or sales (−)	− 460	707	565	177	247
Gross purchases	1,537	2,011	1,934	1,807	1,822
Gross sales	1,997	1,303	1,369	1,630	1,575
Equals net basic reserve surplus or deficit (−)	+ 409	− 824	− 761	− 179	− 339
Net loans to Government securities dealers	359	608	366	594	482
Net carry-over, excess or deficit (−)†	—	15	12	54	20
Thirty-eight banks outside New York City					
Reserve excess or deficiency (−)*	30	11	57	36	35
Less borrowings from Reserve Banks	388	350	258	276	318
Less net interbank Federal funds purchases or sales (−)	3,178	3,636	3,158	3,066	3,235
Gross purchases	4,993	5,608	5,379	4,832	5,178
Gross sales	1,815	1,972	2,221	1,766	1,943
Equals net basic reserve surplus or deficit (−)	− 3,530	−3,970	−3,359	−3,305	−3,518
Net loans to Government securities dealers	12	39	− 46	41	1[illegible]
Net carry-over, excess or deficit (−)†	6	28	− 4	24	1[illegible]

Note: Because of rounding, figures do not necessarily add to totals.

* Reserves held after all 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 percent

Maturities	Weekly auction dates—February 1970			
	Feb. 2	Feb. 9	Feb. 16	Feb. 20
Three-month	7.754	7.312	6.777	6.812
Six-month	7.718	7.387	6.917	6.975

Maturities	Monthly auction dates—December-February 1970		
	Dec. 23	Jan. 27	Feb. 24
Nine-month	7.801	7.725	6.934
One-year	7.561	7.533	6.933

* 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.

ady. The announcements of several large industrial offerings scheduled for early March added to an already sizable calendar and contributed to investor caution.

In the tax-exempt sector, interest rates generally moved lower as dealers were able to maintain workable inventories in spite of a heavy volume of financings. Offerings with short maturities appeared to be relatively more attractive to investors, and the largest rate declines were on those issues. On February 10 local urban renewal agencies under the auspices of the Department of Housing and Urban Development (HUD) sold $263 million of eight-month project notes at an average cost of 4.89 percent, 66 basis points below the January level and also the lowest rate since the spring of last year. A week later local housing authorities sold (also under HUD auspices) eight-month project notes totaling $440 million at a net interest cost of 4.83 percent, 85 basis points below the rate in a January financing.

Issuers of longer term obligations benefited a bit less from the renewed optimism over the course of interest rates—in part because banks continue to be under severe liquidity pressures. Early in February an offering rated Aaa moved slowly at yields to investors from 4.90 percent in 1971 to 6.15 percent in 1990, around 10 basis points below rates on comparable maturities in a similarly rated financing in mid-January. Two weeks later, however, demand had strengthened and a flotation of Aa-rated bonds with equivalent yields and maturities sold out quickly. During the last week of February another Aa-rated offering sold at yields of from 4.60 percent for short maturities to 5.90 percent for maturities around 1990. The Blue List of dealer-advertised holdings drifted down to $346 million at the month end, $94 million below the end-of-January level. *The Weekly Bond Buyer's* index of yields on twenty municipal bonds closed February at 6.16 percent, 62 basis points lower over the month.