The Money and Bond Markets in October

A firm tone generally prevailed in the money market in October, although easier conditions emerged from time to time during the month. The major banks in New York City and other important cities were under substantially less reserve pressure than in the previous month when they bore the brunt of special pressures associated with quarterly dividend and tax payments. Treasury bill rates edged upward at the beginning of the month, primarily in response to heavy dealer inventories and high financing costs, but then eased as investment demand reappeared and special pressures subsided.

Prices of Government notes and bonds edged narrowly lower in quiet trading during the first half of the month, as participants continued to appraise cautiously the outlook for interest rates. International developments temporarily accentuated the underlying feeling of hesitancy around midmonth, but neither these nor domestic economic and balance-of-payments considerations had any major impact on prices. Prices rebounded later in the month as market participants came to feel increasingly that a near-term rise in the British bank rate was unlikely. In the market for corporate bonds, a cautious undertone was evident through much of the month, but prices improved toward the close. Prices of tax-exempt issues showed little change until late in October when they also rose.

THE MONEY MARKET AND BANK RESERVES

Federal funds continued to trade predominantly at 3½ per cent during October, although crosscurrents in reserve distribution produced redundant reserves on some occasions, leading to considerable trading below the 3½ per cent level on several days. One such occasion arose during the week ended October 14 when float moved erratically around the Columbus Day partial holiday, providing an unexpectedly large supply of reserves that caused the Federal funds rate to drop sharply. A comparatively small volume of Federal funds traded during the month at 3⅝ per cent, ⅛ per cent above the Federal Reserve discount rate. Trading at this rate was initiated by a major New York City bank, which stated that it was seeking to introduce greater flexibility into the Federal funds market.

Rates posted by the major New York City banks on call loans (in Federal funds) to Government securities dealers were largely in a 3⅝ to 4 per cent range during the month. At the beginning of the month when dealer financing needs were quite heavy, rates were as high as 4⅛ per cent, but funds were made available to dealers at rates as low as 3¼ per cent in the easy money market environment of October 14. Offering rates for new time certificates of deposit issued by the leading New York City banks, as well as the range of rates at which such certificates traded in the secondary market, rose somewhat in early October but held generally steady thereafter. Rates on bankers' acceptances were generally unchanged throughout the month, but one dealer lowered his bid and asked rates for bills maturing prior to the year end in order to stimulate a supply of shorter maturities, which were in good demand. Early in the month, demand from nonbank investors permitted dealers to work down positions considerably, but subsequently portfolios again expanded.

Net reserve availability in the banking system as a whole averaged $88 million in the four weeks ended October 28, as against $84 million (revised) in the five weeks ended September 30. Member bank borrowings from the Reserve Banks averaged $305 million in the October period, compared with $341 million the month before. Reserve availability bulged sharply in the week ended October 14, as System open market operations absorbed less reserves during that week than were provided by unexpected movements in the market factors.[1] In this environment the major money market banks, on average, were able to increase their purchases of Federal funds and reduce their borrowings from the Reserve Banks. By the week's close, as "country" banks came to the end of their reserve averaging period, a sizable volume of excess reserves piled up unused in the money centers and Federal funds traded at

[1] Operating transactions (as detailed in the table), cash allowed as reserves, and required reserves.

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, OCTOBER 1964

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

Factor	Daily averages—week ended				Net changes
	Oct. 7	Oct. 14	Oct. 21	Oct. 28	
Operating transactions					
Treasury operations*	+ 58	— 52	— 169	+ 199	+ 35
Federal Reserve float	— 123	+ 55	+ 673	— 553	+ 52
Currency in circulation	— 125	— 256	+ 33	+ 99	— 250
Gold and foreign account	+ 32	— 3	+ 4	— 8	+ 25
Other deposits, and other Federal Reserve accounts (net)†	— 55	+ 103	+ 50	+ 45	+ 142
Total	— 224	— 150	+ 592	— 217	— 5
Direct Federal Reserve credit transactions					
Open market operations					
Purchases or sales‡					
Government securities	+ 392	— 17	— 623	+ 2	— 246
Bankers' acceptances	+ 3	+ 3	— 3	— 2	+ 2
Repurchase agreements					
Government securities	+ 181	— 79	— 131	—	— 29
Bankers' acceptances	+ 10	— 5	— 56	+ 27	— 15
Member bank borrowings	+ 92	— 131	+ 141	— 150	— 48
Other loans, discounts, and advances	—	—	—	+ 1	+ 1
Total	+ 687	— 230	— 671	— 122	— 336
Member bank reserves					
With Federal Reserve Banks	+ 463	— 386	— 79	— 339	— 341
Cash allowed as reserves§	— 344	+ 112	+ 82	+ 121	— 29
Total reserves§	+ 119	— 274	+ 3	— 218	— 370
Effect of change in required reserves§	— 74	+ 251	+ 2	+ 118	+ 297
Excess reserves§	+ 45	— 23	+ 5	— 100	— 73
Daily average level of member bank:					
Borrowings from Reserve Banks	370	239	380	230	305‖
Excess reserves§	433	410	415	316	393‖
Free reserves§	63	171	35	85	88‖

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ May also include redemptions.
§ These figures are estimated.
‖ Average for four weeks ended October 28, 1964.

rates as low as ¼ per cent. In the following week, possibly anticipating another end-of-week easing, many banks were content to accumulate sizable reserve deficiencies as the period progressed. At the end of that week, however, these banks were unable to meet their accumulated needs in the Federal funds market, and total member bank borrowings from the Reserve Banks bulged to over $1.1 billion on Wednesday, October 21. Subsequently, the distribution of reserves shifted in favor of banks in the major money centers, and total borrowings from the Reserve Banks declined.

On balance, over the four-week period ended October 28, the weekly average of System outright holdings of Government securities contracted by $246 million, while average holdings of Government securities under repurchase agreements declined by $29 million. Average System holdings of bankers' acceptances, both outright and under repurchase agreement, fell by $13 million over the period. From Wednesday, September 30, through Wednesday, October 28, System holdings of securities maturing in less than one year decreased by $205 million, while holdings of issues maturing in more than one year rose by $73 million.

THE GOVERNMENT SECURITIES MARKET

A cautious atmosphere pervaded the market for Government notes and bonds in early October, as market participants continued to appraise the interest rate outlook warily. The market was influenced by persisting uncertainties regarding prospective balance-of-payments developments and the possible emergence of inflationary tendencies. In the absence of a clear consensus about the outlook, many investors continued to postpone the commitment of funds or to limit purchases to shorter maturities. Against this background of light activity, which largely involved switching operations, prices of Government notes and bonds drifted lower through October 16. However, while investment demand was limited, selling was also light, and the price declines primarily reflected dealer efforts to stimulate some outright buying interest. Market activity was especially restrained around midmonth while participants digested the important developments reported from London, Moscow, and Peking. The market performed smoothly, however, and no real pressures emerged. Soon after mid-October, investor interest began to develop at the lower price levels and over-all activity picked up somewhat. The market's underlying sentiment improved steadily over the balance of the month. It was particularly buoyed in the final week of the month when the British authorities chose to employ selective measures to deal with the country's balance-of-payments problems and stated that they had no present intention of raising the Bank of England's rate. United States bond market participants generally interpreted this action as diminishing the likelihood of near-term interest rate increases in this country. In this improved atmosphere, investors—who had remained on the side lines earlier in the month—showed renewed interest in coupon issues. At the month's close, prices of Treasury notes and bonds maturing before 1973 were generally $\frac{6}{32}$ lower to $\frac{8}{32}$ higher than end-of-September levels, while longer term issues were generally $\frac{6}{32}$ to $\frac{18}{32}$ higher.

On October 28, the Treasury announced a cash offering of approximately $9¼ billion of new eighteen-month 4 per cent notes to be dated November 15, 1964, and priced at par. Subscription books for the new issue were open only on November 2, with payment and delivery scheduled for November 16. The proceeds of the offering will be used mainly to redeem $8.7 billion of notes scheduled to mature on November 15, of which only about $2.3 billion is publicly held.

On November 5 the Treasury announced that subscriptions for the new 4 per cent notes of 1966 totaled approximately $21.8 billion, of which $9.5 billion was accepted. Subscriptions from states, Federal Reserve Banks, and other official institutions, totaling $6.6 billion, will be allotted in full. Subscriptions from other sources will be allotted in full up to $100,000, while larger subscriptions will be subject to a 16.5 per cent allotment, although assured of a minimum allotment of $100,000. Preliminary reports indicate that subscriptions subject to allotment include about $8.8 billion from commercial banks for their own account and $6.5 billion from other sources.

A new type of instrument was floated in the market for Government agency issues in October when the Federal National Mortgage Association sold through an underwriting group $300 million of participation certificates representing beneficial interest in mortgages held in the Government's Mortgage Liquidation Trust. The offering —at yields ranging from 4.10 per cent for certificates maturing in November 1965 to 4.375 per cent for certificates maturing in November 1974—was accorded a favorable reception, with investor interest in the shorter maturities particularly good.

In the Treasury bill market, rates moved slightly higher in the early days of October. Although a moderate demand for bills was evident during this period, offerings continued to press upon the market as dealers—confronted with relatively high financing costs—attempted to trim their positions. Subsequently, an expanded demand for bills from public funds and corporations pared dealer supplies and strengthened the market's technical position. At the same time, the increasing availability of corporate funds for repurchase agreements and the occasional easing in the money market brought about a reduction in dealer financing costs. These developments contributed to a steadier tone in the bill market, and bill rates fluctuated narrowly from October 6 through October 21, with rate declines—concentrated in short-dated issues—outnumbering increases.

The market took in stride the Treasury's October 14 announcement that it would auction on October 20 $1.5 billion of 147-day March 22 tax anticipation bills to be issued on October 26. (The securities represent additions to an outstanding $1 billion issue of tax anticipation bills originally dated September 2, 1964.) Commercial banks were permitted to make 50 per cent of the payment for the bills through credit to Treasury Tax and Loan Accounts, and this had a moderate strengthening effect on market psychology. Only minor rate increases, largely in March and April maturities, followed the announcement. In the auction, commercial banks bid strongly to obtain the accompanying Tax and Loan deposits—estimated to be worth about 15 to 20 basis points in yield—and the average issuing rate was set at 3.518 per cent.

From October 22 through the end of the month, rates tended lower. The confidence in current rate levels generated by the developments noted above stimulated both investment and professional demand. Over the month as a whole, rates on outstanding bills were generally unchanged to 2 basis points lower, although most 1964 maturities registered larger declines.

At the last regular weekly auction of the month, held on October 26, average issuing rates were 3.567 per cent for the new three-month issue and 3.724 per cent for the new six-month bill, in each case 1 basis point higher than the average rates at the final weekly auction in September. The October 27 auction of $1 billion of new one-year bills resulted in an average issuing rate of 3.790 per cent, compared with a rate of 3.773 per cent on the comparable issue sold in September. The newest outstanding three-month bill closed the month at 3.55 per cent (bid), unchanged from the end of September, while the newest outstanding six-month bill was quoted at 3.71 per cent (bid) at the end of October, compared with 3.72 per cent (bid) on September 30.

OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt bonds moved narrowly in quiet trading during most of the month but rose toward the close. A somewhat hesitant undertone prevailed during much of the period, particularly in the corporate sector, as participants in these markets also assessed cautiously the outlook for interest rates. The new corporate issues publicly marketed in October as well as several previous recent offerings encountered some investor resistance, partly because private placements continued to absorb a substantial amount of investment funds from the corporate market. Syndicates marketing a number of corporate issues were terminated around midmonth, and most of the issues involved subsequently sold readily at the slightly lower prices to which they moved in free trading. In the tax-exempt sector, most new issues reportedly moved well during the month, while slight price concessions stimulated investor interest in the unsold balances of recent offerings still on dealers' shelves. The relatively light calendar of scheduled corporate and tax-exempt flotations on tap exerted a steadying influence on both sectors during the period. A sharp improvement in the tone of the corporate and tax-exempt markets occurred in the latter part of the month, largely in response to the firming of expectations regarding near-term interest rate stability noted earlier. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 1 basis point to 4.43 per cent, while the average yield on similarly rated tax-exempt bonds remained unchanged at 3.11 per cent. (These indexes are based on only a limited number of issues.)

The volume of new corporate bonds floated in October amounted to approximately $180 million, compared with $365 million in the preceding month and $510 million in October 1963. New tax-exempt flotations in October totaled approximately $735 million, as against $850 million in September 1964 and $1,245 million in October 1963. The Blue List of tax-exempt securities advertised for sale closed the month at $570 million, compared with $673 million on September 30.