The Money and Bond Markets in November

The high points of interest in the money and bond markets in November were important monetary policy changes on both sides of the Atlantic, and a massive cooperative international effort in defense of the pound sterling—all of which occurred in the week beginning November 23. The pound sterling had been under pressure in the international markets for some time, and this pressure became particularly intense on Friday, November 20. Against this background, the Bank of England on Monday morning, November 23, raised the bank rate from 5 per cent to 7 per cent in order to stem further speculative pressures. Yields in United States markets promptly rose on Monday as market participants, taken by surprise by the British action, generally anticipated that the Federal Reserve would follow sooner or later with an increase in the discount rate.

After the close of business that afternoon, the Board of Governors of the Federal Reserve System announced approval of actions by the Boards of Directors of the Federal Reserve Banks of New York, Boston, Philadelphia, Chicago, and St. Louis in raising these Banks' discount rates from 3½ per cent to 4 per cent, effective November 24. On subsequent days, the other seven Federal Reserve Banks followed suit: the Federal Reserve Bank of Atlanta on November 25; the Federal Reserve Banks of Dallas, San Francisco, Richmond, and Cleveland on November 27; and the Federal Reserve Banks of Minneapolis and Kansas City on November 30. The discount rate change was the first since July 1963, when Federal Reserve discount rates were raised from 3 per cent to 3½ per cent. The Board of Governors also announced that effective November 24 it was increasing the maximum rates that member banks are permitted to pay on savings deposits and time deposits, while the Federal Deposit Insurance Corporation stated that these new ceilings would also apply to insured nonmember banks.

The Board noted that these actions were taken "to maintain the international strength of the dollar". The moves were "aimed at countering possible capital outflows that might be prompted by any widening spread between interest rates in this country and the higher rates abroad and also at ensuring that the flow of savings through commercial banks remains ample for the financing of domestic investment". (See box below for the full statement.)

On Tuesday, November 24, yields on Treasury bills, notes, and bonds rose further early in the day but then steadied at the higher rate levels. The increase in the Bank of Canada's rate to 4¼ per cent from 4 per cent had no perceptible effect on the United States Government securities market. Sizable speculative pressure against the pound sterling reappeared on the same day, however, and early on Wednesday yields again increased in the United States Government securities market as investors sold on a moderate scale. Subsequently, trading dried up as market participants waited to see what further official actions might be forthcoming. Around 2 p.m. Wednesday, the Federal Reserve System and the United States Treasury issued a statement noting that arrangements had been made to provide a $3 billion fund to defend sterling. (See box below for the full statement.) Following this announcement, the atmosphere in the market for Treasury securities improved, although remaining cautious, and prices and yields moved narrowly over the remainder of the month.

STATEMENT ON FEDERAL RESERVE BANK DISCOUNT RATE AND REGULATION Q CHANGES ISSUED BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ON NOVEMBER 23

The Federal Reserve System took action today on two fronts to maintain the international strength of the dollar.

The Board of Governors in Washington approved actions by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Chicago, and St. Louis increasing the discount rates of those Banks from 3½ per cent to 4 per cent, effective tomorrow (Tuesday, November 24, 1964). The change was the first since July 1963, when Federal Reserve discount rates were increased from 3 to 3½ per cent.

The Board of Governors also increased the maximum rates that member banks are permitted to pay on savings deposits and time deposits—including certificates of deposit—to the following levels:

1. On savings deposits, 4 per cent, regardless of the time the funds have been on deposit. The maximum rates previously permissible were 3½ per cent on savings deposits in the bank for less than one year and 4 per cent on those on deposit for one year or more.

2. On time deposits and certificates of deposit, 4 per cent for maturities of less than 90 days and 4½ per cent for all longer maturities. The maximum rates previously permissible were 1 per cent for maturities of less than 90 days, and 4 per cent for longer maturities.

The actions were taken following a rise in official and market rates in London, where an increase in the bank rate from 5 to 7 per cent was announced by the Bank of England today. They also follow recent advances in rates on the European continent.

The Federal Reserve actions were aimed at countering possible capital outflows that might be prompted by any widening spread between interest rates in this country and the higher rates abroad and also at ensuring that the flow of savings through commercial banks remains ample for the financing of domestic investment.

* * *

STATEMENT ON THE DEFENSE OF STERLING, ISSUED BY THE FEDERAL RESERVE SYSTEM AND THE UNITED STATES TREASURY ON NOVEMBER 25

Eleven countries and the United Kingdom today made arrangements providing $3 billion to back up Britain's determination to defend the pound sterling.

Today's funds are in addition to the $1 billion drawing the United Kingdom will obtain from the International Monetary Fund at the end of this month under an existing stand-by.

Austria, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, and the United States, joined by the Bank for International Settlements, moved quickly to mobilize a massive counterattack on speculative selling of the pound.

The International Monetary Fund drawing, which can have a maturity up to three years, will enable the British to pay off all outstanding short-term credits from central banks, including the Federal Reserve. The currency swap arrangement with the Federal Reserve System has been raised by $250 million to $750 million, and a $250 million credit has been made available by the United States Export-Import Bank. (These amounts are included in the total package of $3 billion.)

Earlier in the month—during the period which preceded the official actions noted above—the money market had been generally firm, and most Treasury bill rates had moved narrowly. Prices of Government notes and bonds continued to rise in the beginning of November, following indications in October that a change in the British bank rate was unlikely at that time. Later, they backed off on professional profit-taking and subsequently moved within a narrow range, reflecting widespread market confidence that domestic economic forces were not likely to disturb the existing structure of rates over the near term.

Movements in the prices of corporate and tax-exempt bonds roughly paralleled those of Government securities during November. Prices moved irregularly higher prior to the change in the British bank rate, dropped on the news of official action abroad and at home, and steadied at the lower price levels as the month drew to a close.

THE MONEY MARKET AND BANK RESERVES

The tone of the money market was consistently firm during the first three weeks of November, with very little trading in Federal funds at rates below the 3½ per cent discount rate. Around midmonth, Federal funds traded predominantly at 3⅝ per cent on several days as major New York City banks became strong bidders for funds, in part to meet the heavy financing needs of Government securities dealers, while "country" banks built up sizable reserve excesses. Dealer loan rates posted by the major New York City banks over the three-week period were generally in a 3¾ to 4 per cent range, though the top of the range rose to 4⅛ per cent after midmonth. Offering rates for new time certificates of deposit as well as the secondary market rates on such deposits showed little change over the three-week period, and rates on bankers' acceptances remained at about the October level.

After the change in the discount rate and in Regulation Q, money market rates adjusted upward. The effective rate on Federal funds rose to 4 per cent, although not before it had dipped below 3½ per cent late in the statement week ended November 25 as country banks drew down the excess reserves piled up in the preceding week. After this period of temporary ease, dealer loan rates posted by the major New York City banks moved up to a range of 4⅛ to 4⅜ per cent. Several New York City banks announced increases in the rates they would pay on negotiable time certificates of deposit, as well as on savings deposits. By the month end, dealers in bankers' acceptances had raised their rates by ¼ of a per cent, making the rate on 1- to 90-day unendorsed acceptances 4⅛ per cent (bid). On November 25, commercial paper dealers increased their rates on prime 4- to 6-month paper by ⅛ of a per cent to 4⅛ per cent (offered). Late in the month, the major sales finance companies raised their rates on 30- to 89-day directly placed paper by ⅛ of a per cent to 3⅞ per cent (offered).

Reflecting the ebb and flow of money market pressures, weekly average member bank borrowings from the Federal Reserve Banks fluctuated during November between a high of $590 million and a low of $159 million. In the early part of the month nation-wide reserve availability contracted, mainly as a result of an unexpected strength in member bank required reserves. After the November 11 (Veterans Day) holiday net reserve availability improved somewhat, but country banks built up unusually high levels of excess reserves in the week ended November 18. Confronted with a decline in the available supply of Federal funds at a time when dealer financing was exerting pressure on the money market banks, the reserve city

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

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

Factor	Daily averages—week ended Nov. 4	Nov. 11	Nov. 18	Nov. 25	Net changes
"Market" factors					
Member bank required reserves*	− 305	+ 124	− 40	− 131	− 352
Operating transactions (subtotal)	− 633	− 407	+ 201	+ 91	− 745
Federal Reserve float	− 360	+ 77	+ 251	+ 171	+ 142
Treasury operations†	+ 115	+ 97	− 47	+ 20	+ 185
Gold and foreign account	+ 15	− 16	+ 8	− 50	− 43
Currency outside banks*	− 206	− 510	− 1	+ 11	− 712
Other Federal Reserve accounts (net)‡	− 196	− 50	− 7	− 62	− 316
Total "market" factors	− 938	− 282	+ 164	− 40	− 1,097
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 731	+ 29	+ 27	+ 169	+ 956
Bankers' acceptances	+ 2	+ 1	+ 1	+ 2	+ 6
Repurchase agreements:					
Government securities	+ 69	+ 246	− 100	− 90	+ 125
Bankers' acceptances	+ 20	− 12	− 13	+ 33	+ 28
Member bank borrowings	+ 246	− 49	+ 163	− 431	− 71
Other loans, discounts, and advances	—	− 1	+ 1	—	—
Total	+ 1,068	+ 214	+ 80	− 318	+ 1,044
Excess reserves*	+ 130	− 69	+ 244	− 358	− 53
Daily average levels of member bank:					
Total reserves, including vault cash*	21,211	21,018	21,302	21,075	21,152§
Required reserves*	20,770	20,646	20,686	20,817	20,730§
Excess reserves*	441	372	616	258	422§
Borrowings	476	427	590	159	413§
Free reserves*	− 35	− 55	26	99	9§
Nonborrowed reserves*	20,735	20,591	20,712	20,916	20,739§

Note: Because of rounding, figures do not necessarily add to totals.
* These figures are estimated.
† Includes changes in Treasury currency and cash.
‡ Includes assets denominated in foreign currencies.
§ Average for four weeks ended November 25, 1964.

banks turned to the Federal Reserve "discount window" to fill their residual needs. Subsequently, as over-all reserve availability improved and the supply of Federal funds from country banks expanded in the second week of their reserve settlement period, member bank borrowings from the Reserve Banks fell appreciably in the final statement week of the month. Over the four-week period as a whole the weekly average of System outright holdings of Government securities rose by $956 million, while average holdings of Government securities under repurchase agreements increased by $125 million. Average System holdings of bankers' acceptances, both outright and under repurchase agreement, expanded by $34 million during the period. From Wednesday, October 28, through Wednesday, November 25, System holdings of Government securities maturing in less than one year rose by $1,034 million, while holdings of issues maturing in more than one year increased by $28 million.

THE GOVERNMENT SECURITIES MARKET

The upsurge in prices of Government notes and bonds, which had developed in mid-October, reached its high watermark just after Veterans Day, and prices receded somewhat thereafter. Contributing to the price firmness in the early part of the month was the continuing belief that, over the near term, there was not likely to be any increase in interest rates abroad requiring higher domestic rates. In addition, the temporary slowdown in economic activity, caused by the interruption of automobile production and forecasts by some economists of less business buoyancy in 1965, led a number of market participants to feel that economic forces might work in favor of lower interest rates over the months ahead. In this environment, broad investment demand—both outright and on tax swaps—was supplemented by professional purchases, and prices moved higher in active trading. By November 12, prices of most issues maturing in five years or more were $\frac{9}{32}$ to $\frac{19}{32}$ higher than they had been on October 30, and many issues stood at their peak prices of the year. At the higher price levels, investment demand slackened and profit-taking developed as professionals appeared to conclude that the advance had about run its course. Prices of coupon issues declined gradually around midmonth, and then fluctuated narrowly through Friday, November 20.

On Monday morning, November 23, following the announcement of the increase in the British bank rate, prices of most intermediate- and long-term Treasury issues initially dropped $\frac{6}{32}$ to $\frac{16}{32}$, as the market sought a new trading level. Activity was light and largely professional in character, however, as customer selling failed to develop and some demand subsequently appeared at the lower price levels. The increase in the discount rates of five Federal Reserve Banks, announced after the close of business Monday afternoon, contributed to further price reductions of $\frac{2}{32}$ to $\frac{8}{32}$ Tuesday morning, but prices steadied and closed the day above their lows. On Wednesday, November 25, selling by banks and other investors exerted pressure on prices, especially in maturities of under five years. As time went on that same day, the severity of the pressure being experienced by the pound sterling in the exchange markets became more evident. Trading in Treasury issues ebbed as participants withdrew until they could better assess developments. The announcement of the $3 billion credit being made available to the United Kingdom brought a quick improvement in bond market atmosphere; trading expanded, and prices rose. Thereafter, prices moved narrowly and, at the end of the month, prices of Government notes and bonds were generally $\frac{2}{32}$ to $\frac{14}{32}$ below end-of-October levels.

The Treasury bill market had an optimistic tone at the beginning of the month, which then gave way to a somewhat more hesitant atmosphere around midmonth. In the early part of the month, there was good demand for scarce shorter maturity bills—particularly issues coming due in November and December. By November 12, rates in this maturity area had declined moderately from their end-of-October levels while rates on longer bills had fluctuated narrowly. Investor demand contracted somewhat in the period after November 12, and dealers were willing sellers as high financing costs associated with the firm conditions that had developed in the money market made their inventories more burdensome. As a result, bill rates generally rose, particularly in the shorter maturity area where rate declines had been most pronounced earlier in the month.

On November 10 the Treasury announced that it would auction on November 17 $1.5 billion of 210-day tax anticipation bills to be dated November 24, 1964 and to mature on June 22, 1965. Since an offering of this magnitude had been generally expected by the market, the announcement produced hardly a ripple in rates on outstanding bills. Under the terms of the offering, commercial banks were permitted to make 50 per cent of their payments for the new bills through credit to Treasury Tax and Loan Accounts. The bills were sold at an average issuing rate of 3.639 per cent and traded thereafter around a 3.79 per cent rate, as banks sold bills in the expectation that the losses incurred would be more than offset by the value of the deposits acquired.

Following the November 23 interest rate action by the United Kingdom, Treasury bill rates initially rose 10 to 24 basis points as the market adjusted to this new factor affecting the interest rate outlook. Bidding in the regular weekly auction that same day, November 23, was quite cautious, resulting in an average issuing rate of 3.758 per cent on the new three-month bill, up nearly 16 basis points from the rate set in the preceding week's auction. Following the announcement of ½ of a per cent rise in the discount rates at five Federal Reserve Banks after the close of business Monday, bill rates rose further on Tuesday before steadying. The Treasury's sale that day of $1 billion of new one-year bills resulted in an average issuing rate of 4.068 per cent, up 28 basis points from the rate set in the preceding monthly auction. On Wednesday, November 25, the bill market was affected by the nervousness generated by the pressure on sterling, but recovered after the special $3 billion credit package was announced. Thereafter, the higher cost of financing exerted a continued upward pull on bill rates, and at the last regular weekly auction of the month, held on November 30, average issuing rates were 3.868 per cent for the new three-month issue and 4.030 per cent for the new six-month bill; these rates were 30 and 31 basis points higher, respectively, than the average rates in the final weekly auction in October. The newest outstanding three-month bill closed the month at 3.84 per cent (bid), compared with 3.55 per cent (bid) at the end of October, while the newest outstanding six-month bill was quoted at 4.00 per cent (bid) at the end of November, compared with 3.71 per cent (bid) on October 30. The closing rates on the outstanding three- and six-month bills were the highest since March 1960.

OTHER SECURITIES MARKETS

Prior to the bank rate increases by the Bank of England and the Federal Reserve, the markets for corporate and tax-exempt bonds continued to display the basically confident tone that had developed the month before. In the corporate sector, where the volume of new and recent public bond flotations remained extremely light, a steady investor demand confronted scarcities in supply and prices edged higher. Prices also moved upward in the tax-exempt sector on fairly good demand. Following the announcement on November 23 of the increase in the British bank rate, and in response to growing uncertainty over the international financial situation, prices of corporate and tax-exempt bonds declined. The tax-exempt sector was encouraged, however, by the upward revision of maximum rates which most commercial banks are permitted to pay on savings and time deposits, apparently in anticipation of increased bank buying of tax-exempt issues. In the closing days of the month, a steadier tone developed in both the tax-exempt and corporate markets. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 1 basis point to 4.44 per cent, while the average yield on similarly rated tax-exempt bonds fell by 2 basis points to 3.09 per cent. (These indexes are based on only a limited number of issues.)

The volume of new corporate bonds publicly floated in November amounted to only about $25 million, compared with $180 million in the preceding month and $200 million in November 1963. The few small corporate bond issues which reached the market during the month were generally well received. New tax-exempt flotations in November totaled approximately $485 million, as against $735 million in October 1964 and $665 million in November 1963. The Blue List of tax-exempt securities advertised for sale closed the month at $576 million, compared with $570 million on October 30. Most new tax-exempt bond issues floated in November were accorded good investor receptions.

ESSAYS IN MONEY AND CREDIT

The Federal Reserve Bank of New York has just published a 76-page booklet, entitled *Essays in Money and Credit*. It is designed to furnish the student of money and banking with information, not readily available elsewhere, on the national money and credit markets. The eleven essays in the booklet had been published initially in the *Monthly Review*, but have now been revised to bring them up to date.

In the foreword, Alfred Hayes, President of the Bank, notes that: "*Essays in Money and Credit* deals with a variety of financial subjects that are given relatively little attention in general texts on money and banking. Several articles help the reader gain an insight into some of the technical problems involved in the administration of monetary policy and into Treasury debt and cash operations and their interrelations with the Federal Reserve's daily work. Others describe and analyze money and securities market instruments or deal with banking problems and policies."

Copies of the booklet are available from the Publications Section, Federal Reserve Bank of New York, New York, N. Y., 10045, at 40 cents per copy. Educational institutions may obtain quantities for classroom use at 20 cents per copy.