The Money and Bond Markets in January

The money market during January readily accommodated the substantial financial flows set in motion by the Treasury's advance refunding. Banks in the money centers experienced heavy reserve pressures in the first half of the month, but managed to fill the bulk of their reserve needs in the Federal funds market where reserves were in fairly good supply at a 4 per cent rate. With the completion of the refunding, these special pressures subsided and the money market became somewhat more comfortable in the latter part of January.

The Treasury's advance refunding operation dominated activity in the Government securities market during the month. The offering was accorded an excellent reception. The exchange of $9.7 billion of shorter term securities for intermediate- and long-term bonds resulted in a significant lengthening of the average maturity of the marketable debt. Market participants took the unexpectedly large response as a manifestation of investor confidence in the viability of current interest rates, and prices of most outstanding Treasury coupon issues rose through much of the month. An element of caution crept into the market near the end of the month as concern about the balance of payments led to profit-taking in the securities recently issued.

In the market for Treasury bills, demand was strong early in the month when sellers of the eight coupon issues eligible for conversion in the advance refunding operation sought other outlets for their funds. Bill rates generally receded through midmonth, but edged irregularly higher thereafter as offerings expanded. In the markets for corporate and tax-exempt bonds, demand for new issues was good and prices generally advanced, in part because participants were encouraged by the favorable reception accorded the Treasury refunding.

THE MONEY MARKET AND BANK RESERVES

The money market had quite a firm tone through mid-January, and then became a bit more comfortable over the remainder of the month. Rates posted by the major New York City banks on call loans to Government securities dealers were in a 4¼ to 4½ per cent range in the first half of the month, and in a 4 to 4½ per cent range thereafter. As the month opened, offering rates for new time certificates of deposit issued by leading New York City banks were at the upper end of the range prevailing since the November increase in the Federal Reserve discount rate, but these rates edged lower on balance during the month. The range of rates at which such certificates traded in the secondary market also tended lower in January. Dealers' inventories of bankers' acceptances expanded during the month in the face of steady sales by commercial banks, while the investment demand for acceptances was generally light. Acceptance rates remained unchanged throughout the period.

In early January, the money market handled smoothly the unwinding of transactions connected with the year-end statement publishing date, and the credit demands occasioned by the Treasury's advance refunding. Banks in the major money centers, particularly those in New York City, were called upon to meet a sizable part of the enlarged financing needs of Government securities dealers at a time when repayments of other loans fell short of normal seasonal expectations. In such circumstances, the basic reserve deficiencies of these banks rose to very high levels.[1] The major money center banks were able, however, to recapture most of the reserves dispersed outside the money centers through expanded purchases of Federal funds at 4 per cent. System open market operations helped facilitate the increased turnover of money and securities by allowing marginal reserve availability to remain somewhat greater than had prevailed before the onset of seasonal pressures in December. Thus, although borrowings from the Reserve Banks rose from the low average level of Decem-

Table I

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1965

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

Factor	Daily averages—week ended Jan. 6	Jan. 13	Jan. 20	Jan. 27	Net changes
"Market" factors					
Member bank required reserves*	− 405	+ 589	+ 207	+ 131	+ 522
Operating transactions (subtotal)	+ 239	− 238	+ 105	− 107	− 1
Federal Reserve float	− 262	− 473	+ 100	− 408	− 1,043
Treasury operations†	+ 289	− 111	− 249	+ 17	− 54
Gold and foreign account	− 7	− 16	− 135	+ 27	− 131
Currency outside banks*	+ 355	+ 228	+ 327	+ 232	+ 1,142
Other Federal Reserve accounts (net)‡	− 130	+ 134	+ 61	+ 24	+ 89
Total "market" factors	− 166	+ 351	+ 312	+ 24	+ 521
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	− 55	—	− 112	− 69	− 236
Bankers' acceptances	+ 5	− 3	+ 1	—	+ 3
Repurchase agreements:					
Government securities	+ 177	− 242	− 244	+ 49	− 250
Bankers' acceptances	+ 32	+ 8	− 17	+ 17	+ 40
Member bank borrowings	− 195	+ 115	− 147	− 74	− 301
Other loans, discounts, and advances	—	+ 5	+ 9	+ 4	+ 18
Total	− 36	− 116	− 510	− 73	− 735
Excess reserves*	− 202	+ 235	− 198	− 49	− 214
Daily average levels of member bank:					
Total reserves, including vault cash*	22,199	21,845	21,440	21,260	21,684§
Required reserves*	21,846	21,257	21,050	20,919	21,268§
Excess reserves*	353	588	390	341	418§
Borrowings	309	424	277	203	303§
Free reserves*	44	164	113	138	115§
Nonborrowed reserves*	21,890	21,421	21,163	21,057	21,353§

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 January 27, 1965.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JANUARY 1965

In millions of dollars

Factors affecting basic reserve positions	Daily averages week ended Jan. 6	Jan. 13	Jan. 20	Jan. 27	Average four weeks ended Jan. 27
Eight banks in New York City					
Reserve excess or deficiency(−)*	4	14	46	− 11	13
Less borrowings from Reserve Banks	61	161	156	72	113
Less net interbank Federal funds purchases or sales(−)	635	829	810	443	679
Gross purchases	*970*	*1158*	*1167*	*943*	*1060*
Gross sales	*335*	*330*	*356*	*500*	*380*
Equals net basic reserve surplus or deficit(−)	− 691	− 976	− 920	− 526	− 778
Net loans to Government securities dealers	799	750	685	575	702
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)*	16	29	55	9	27
Less borrowings from Reserve Banks	137	155	55	45	98
Less net interbank Federal funds purchases or sales(−)	380	466	500	88	359
Gross purchases	*939*	*1128*	*1120*	*858*	*1011*
Gross sales	*559*	*662*	*620*	*770*	*653*
Equals net basic reserve surplus or deficit(−)	− 501	− 592	− 500	− 123	− 429
Net loans to Government securities dealers	270	524	632	394	455

* Reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.

[1] Data on basic reserve positions of these banks—included in this article for the first time — may be found in Table II. A detailed description of these data appeared in the August 1964 issue of the *Federal Reserve Bulletin*.

ber, they remained roughly in line with other recent months.

The special tensions associated with the refunding abated after January 19, the settlement date for the operation. Bank loans to securities dealers contracted sharply as the dealers exchanged the "rights" for the new issues and delivered securities sold earlier in "when-issued" trading. The basic reserve positions of the major money market banks improved, and member bank borrowing from the Reserve Banks dropped back. Contributing to the more comfortable atmosphere was the release of reserves through a sharper-than-expected decline in deposits at "country" banks.

Over the month as a whole, market factors provided \$521 million of reserves while System open market operations absorbed \$453 million. The weekly average of System outright holdings of Government securities declined by \$236 million from the final week in December through the last week in January, and average System holdings of Government securities under repurchase agreements contracted by \$260 million. Average net System holdings of bankers' acceptances, both outright and under repurchase agreements, rose by \$43 million during the period. From Wednesday, December 30, through Wednesday, January 27, System holdings of Government securities maturing in less than one year declined by \$40 million, while holdings of issues maturing in more than one year were unchanged.

THE GOVERNMENT SECURITIES MARKET

During the first half of the month, interest in the market for Government securities focused upon the Treasury's January advance refunding operation, the terms of which were announced on December 30.[2] Demand developed quickly for the refunding issues, and the operation built up momentum as it proceeded. Prices of outstanding obligations in the intermediate- and long-term maturity area—where market supplies would be enlarged by the refunding—adjusted downward immediately following the financing announcement but subsequently edged higher. Meanwhile, prices of shorter term securities not involved in the Treasury's offering rose as sellers of the refunding rights—the eight note and bond issues eligible for exchange—switched into other issues of comparable maturity. Considerable commercial bank interest also continued for low-coupon discount issues, extending the gains made in December. Participants paused briefly on January 7 to assess the implications of impending Treasury gold sales to foreign countries, but an improved tone quickly reappeared following the Treasury's January 8 warning that the London gold market remained under firm control and that "any speculation against the basic price of gold would inevitably end on the losing side".

Market activity tapered off somewhat with the closing of the refunding subscription books on January 8, and prices of outstanding notes and bonds fluctuated narrowly in anticipation of the announcement of the outcome of the operation. The very favorable results released on January 12 indicated that public subscribers converted approximately \$9.0 billion, or almost 41 per cent of their holdings, of the eligible short-term securities into the three longer term bonds offered by the Treasury, and that official accounts subscribed for \$702 million. Subscriptions from all sources totaled \$4.4 billion for the new 4 per cent bonds of 1970, \$3.1 billion for the new 4⅛ per cent bonds of 1974, and \$2.3 billion for the reopened 4¼ per cent bonds of 1987-92.

The size of the conversion far surpassed the expectations of most observers and was widely interpreted as reflecting considerable confidence in current interest rate levels, although it was generally realized that the market would take some time to digest the enlarged supply of longer term maturities. Reports that the British trade gap had narrowed considerably in December and the firmer tone of sterling also buoyed the market during subsequent trading sessions. Furthermore, Government securities became relatively more attractive when aggressive underwriter bidding for a new Aaa-rated corporate bond issue pushed its reoffering yield to 4.37 per cent, only about 14 basis points above the highest yield then available on long-term Government obligations. In this optimistic setting, prices of notes and bonds generally moved higher from January 13 through January 22. Subsequently, participants interpreted the President's Budget Message as giving promise that the Treasury's financing needs would not bear heavily on the capital markets in the coming fiscal year. Nevertheless, prices of coupon issues edged lower over the remainder of the month, partly in reaction to earlier gains and partly because the market focused once more on the balance-of-payments problem and the possible steps that might be taken to deal with it.

After the close of business on January 27, the Treasury announced the terms of its routine February refunding operation—an offering of approximately \$2.2 billion of 21-month 4 per cent notes, dated February 15, 1965 and maturing on November 15, 1966. The proceeds will be used to redeem in cash a comparable amount of 2⅝ per cent bonds coming due on February 15. Subscription books for the new notes—which were priced at 99.85 to yield

[2] For details, see this *Review*, January 1965, page 7.

4.09 per cent—were open for one day, February 1. After the close of business on February 3, the Treasury announced that subscriptions for the new notes totaled $10.6 billion of which $2.3 billion was accepted. Subscriptions from various official institutions aggregated $537 million and were allotted in full. Subscriptions from other sources were allotted in full up to $100,000, while larger subscriptions were subject to a 15 per cent allotment but were assured of a minimum award of $100,000.

The Treasury bill market opened the year with a favorable atmosphere. Rates on a few short-dated bills edged higher in the early days of 1965, as banks and corporations sold off securities that had been purchased in the final days of 1964 for year-end statement purposes, but rates on most other issues declined through January 13. Reinvestment demand for bills was widespread from sellers of rights in the Treasury's refunding operation, and scarcities for some bill issues began to develop. The rate declines, however, were limited by the expectation that bill demand would contract after the refunding, and by the Treasury's announcement on January 6 that it would sell an additional $1¾ billion of June tax anticipation bills on January 12. (Since banks were permitted to make 50 per cent of their payments for the special issue through credit to Treasury Tax and Loan Accounts, the auction attracted good commercial bank interest, and an average issuing rate of 3.711 per cent was set.) The January 12 news of the substantial size of the refunding conversion had bullish implications throughout the short-term maturity area, where market supplies would be reduced. However, the favorable reaction of the bill sector to this news was tempered when the Treasury revealed on January 13 that it planned to add $100 million of bills to the regular weekly auctions in coming weeks, commencing January 18. The Treasury's announcement noted that this action would be "helpful in counteracting a technical shortage of shorter term bills in the market, in maintaining international short-term interest rate relationships, and in covering some of the Treasury's remaining first-quarter cash needs".

Against this background, a more cautious tone emerged in the market for outstanding bills around midmonth. Toward the end of the month, increased discussion of this country's balance-of-payments problem and of the likelihood of further action to deal with it reinforced the hesitant atmosphere. Bill rates in this latter period edged slightly higher on balance. Demand tapered off while offerings expanded modestly, particularly in the shorter maturity areas where scarcities had previously existed.

At the last regular weekly auction of the month, held on January 25, average issuing rates were 3.848 per cent for the new three-month issue and 3.946 per cent for the new six-month bill, 2 and 1 basis points lower, respectively, than the average rates at the final weekly auction in December. The January 26 auction of $1 billion of new one-year bills resulted in an average issuing rate of 3.945 per cent, as against a rate of 3.972 per cent on the comparable issue sold a month earlier. The newest outstanding three- and six-month bills closed the month at bid rates of 3.87 per cent and 3.96 per cent, respectively.

OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt bonds edged higher in moderately active trading during January. Both sectors were bolstered by indications of a recovery of sterling as well as by the excellent investor response to the Treasury's advance refunding operation. The continuing light calendar of scheduled flotations also was a factor in the strong tone of the corporate sector, and substantial commercial bank demand developed during the month in the market for tax-exempts. Underwriters thus bid aggressively for several new corporate and tax-exempt bond issues marketed during the month, and sales from dealers' shelves were substantial. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds declined by 1 basis point to 4.42 per cent while the average yield on similarly rated tax-exempt bonds fell by 3 basis points to 2.96 per cent. (These indexes are based on only a limited number of issues and therefore do not necessarily reflect market movements fully.)

The volume of new corporate bonds publicly floated in January amounted to an estimated $160 million, compared with $305 million in December 1964 and $335 million in January 1964. One large new corporate bond flotation early in the period consisted of $40 million of A-rated sinking fund debentures maturing in 1990. The issue, which will not be refundable for five years, was offered to yield 4.57 per cent and was well received. Later in the month, a $40 million issue of A-rated first mortgage bonds maturing in 1993 was reoffered to yield 4.44 per cent. The bonds, which had no call protection, encountered considerable investor resistance. New tax-exempt flotations in January totaled about $735 million, as against $975 million in December 1964 and $915 million in January 1964. The Blue List of tax-exempt securities advertised for sale closed the month at $679 million, compared with $693 million on December 31. The largest new tax-exempt bond flotation during the period was a $124 million issue of A-rated municipal various-purpose bonds. Reoffered to yield from 2.25 per cent in 1966 to 3.45 per cent in 1995, the bonds were accorded a good investor reception.