The Money and Bond Markets in October

The note of caution which pervaded the Government securities market in September receded somewhat during the first half of October and a steadier tone gradually emerged. Market participants derived some encouragement from the widely circulated view that the Administration was continuing to emphasize the importance of interest rate stability, although the market also noted that selective interest rate increases were taking place. An undertone of uncertainty persisted and became more pronounced in the second half of the month. The continuing strength in the economy and in business demands for funds seemed to some observers to suggest the possibility that the balance of market forces might eventually work toward somewhat higher interest rates. The renewed air of hesitancy during the later period also reflected a pause in investment activity as the market awaited the announcement of the terms of the Treasury's November refunding.

Against this background, prices of Treasury notes and bonds moved generally upward in fairly active trading through mid-October, but then receded again in the last half of the month. A better tone was also evident in the corporate and tax-exempt markets in the first half of

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, OCTOBER 1965

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

Factors	Changes in daily averages—week ended				Net changes
	Oct. 6	Oct. 13	Oct. 20	Oct. 27	
"Market" factors					
Member bank required reserves*	— 57	+ 205	— 381	+ 141	— 92
Operating transactions (subtotal)	— 632	— 216	+ 774	— 22	— 96
Federal Reserve float	— 177	— 4	+ 493	— 294	+ 18
Treasury operations†	— 70	+ 38	— 32	+ 88	+ 24
Gold and foreign account	+ 11	+ 9	+ 9	+ 8	+ 37
Currency outside banks*	— 364	— 291	+ 164	+ 172	— 319
Other Federal Reserve accounts (net)‡	— 33	+ 33	+ 139	+ 5	+ 144
Total "market" factors	— 689	— 11	+ 398	+ 119	— 183
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 776	— 101	— 325	— 132	+ 218
Bankers' acceptances	+ 4	—	—	—	+ 4
Repurchase agreements:					
Government securities	—	+ 30	+ 32	— 62	—
Bankers' acceptances	+ 27	— 19	— 18	+ 21	+ 11
Member bank borrowings	— 17	— 41	+ 96	— 253	— 215
Other loans, discounts, and advances	+ 5	+ 1	+ 8	+ 14	+ 28
Total	+ 795	— 131	— 207	— 411	+ 46
Excess reserves*	+ 106	— 142	+ 186	— 292	— 142
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	22,053	21,706	22,273	21,840	21,968§
Required reserves*	21,613	21,408	21,789	21,648	21,615§
Excess reserves*	440	298	484	192	354§
Borrowings	536	495	591	338	490§
Free reserves*	— 96	— 197	— 107	— 146	— 136§
Nonborrowed reserves*	21,517	21,211	21,682	21,502	21,478§
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 222	+ 109	— 700	+ 38	— 331
More than one year	—	—	—	—	—
Total	+ 222	+ 109	— 700	+ 38	— 331

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 October 27.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS OCTOBER 1965

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended				Average of four weeks ended Oct. 27*
	Oct. 6	Oct. 13	Oct. 20	Oct. 27*	
Eight banks in New York City					
Reserve excess or deficiency(—)†	3	29	7	2	10
Less borrowings from Reserve Banks	—	83	32	11	32
Less net interbank Federal funds purchases or sales(—)	— 41	466	152	— 46	133
Gross purchases	*808*	*1,183*	*819*	*1,005*	*954*
Gross sales	*849*	*717*	*666*	*1,051*	*821*
Equals net basic reserve surplus or deficit(—)	44	— 520	— 177	37	— 154
Net loans to Government securities dealers	332	489	647	499	492
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)†	11	23	20	5	15
Less borrowings from Reserve Banks	290	193	238	29	188
Less net interbank Federal funds purchases or sales(—)	885	857	859	738	835
Gross purchases	*1,482*	*1,682*	*1,376*	*1,469*	*1,502*
Gross sales	*597*	*825*	*517*	*731*	*668*
Equals net basic reserve surplus or deficit(—)	—1,164	—1,026	—1,077	— 762	—1,007
Net loans to Government securities dealers	51	149	230	133	141

Note: Because of rounding, figures do not necessarily add to totals.
* Estimated reserve figures have not been adjusted for so-called "as of" debits and credits. These items are taken into account in final data.
† Reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In per cent

Maturities	Weekly auction dates—October 1965			
	Oct. 4	Oct. 11	Oct. 18	Oct. 25
Three-month	4.050	4.006	4.034	4.040
Six-month	4.201	4.180	4.214	4.192

Maturities	Monthly auction dates—August-October 1965		
	Aug. 24	Sept. 24	Oct. 26
One-year	4.006	4.236	4.192

* 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.

October, but the tax-exempt sector subsequently weakened as an unusually heavy volume of new flotations drew a somewhat disappointing investor response. In the shorter term markets, demand for Treasury bills was strong during the first half of the month and bill rates generally declined. Around midmonth, rates edged a bit higher, but then fluctuated narrowly over most of the remainder of the month.

Conditions in the money market remained generally firm in October, although there were some variations in tone and sizable fluctuations in reserve distribution during the month. Nationwide reserve availability was little changed on average in October, as System open market operations offset reserves absorbed by "market" factors. Most Federal funds trading was at 4⅛ per cent, but limited amounts of funds traded at rates as low as 3½ per cent and as high as 4¼ per cent.

THE GOVERNMENT SECURITIES MARKET

In the wake of considerable declines in September, prices of Treasury notes and bonds first steadied and then moved higher in the first two weeks of October. (The right-hand panel of the chart on page 234 shows the decline in yields which accompanied this rise in bond prices.) As the month opened, market participants displayed some nervousness over the interest rate outlook. They warily assessed the announcement by a major New York City bank that it was boosting by ¼ of 1 per cent its lending rates on loans to nonbank financial institutions—a move which was followed by other selective lending rate adjustments by a number of banks. Moreover, traders continued to ponder the possibility that a shift in monetary policy might soon take place. A somewhat more confident tone gradually emerged, however, as participants apparently concluded that, at least in the short run, interest rates would remain generally stable and rate increases selective. Prices rebounded and trading was dominated by professionals, as aggressive short-covering operations by dealers pressed upon a rather light supply of coupon issues in the market. Modest investor demand was concentrated in purchases of the 2½ per cent deep-discount wartime issues, both on an outright basis and in connection with commercial bank switching operations. The biggest price gains during this period were recorded by selected issues at the longer end of the maturity scale.

From midmonth onward, a hesitant tone again emerged in the coupon sector as participants awaited news about the Treasury's approaching mid-November refinancing. With investment activity light, prices tended to react to current news developments, including variations in reserve availability. The buoyancy of the economy and of stock prices, as well as the indifferent response accorded the sizable volume of new tax-exempt bond issues, tended to revive some uncertainty about the future course of interest rates. Against this background, offerings expanded and prices of notes and bonds again gave ground, carrying yields to their highest levels in five years.

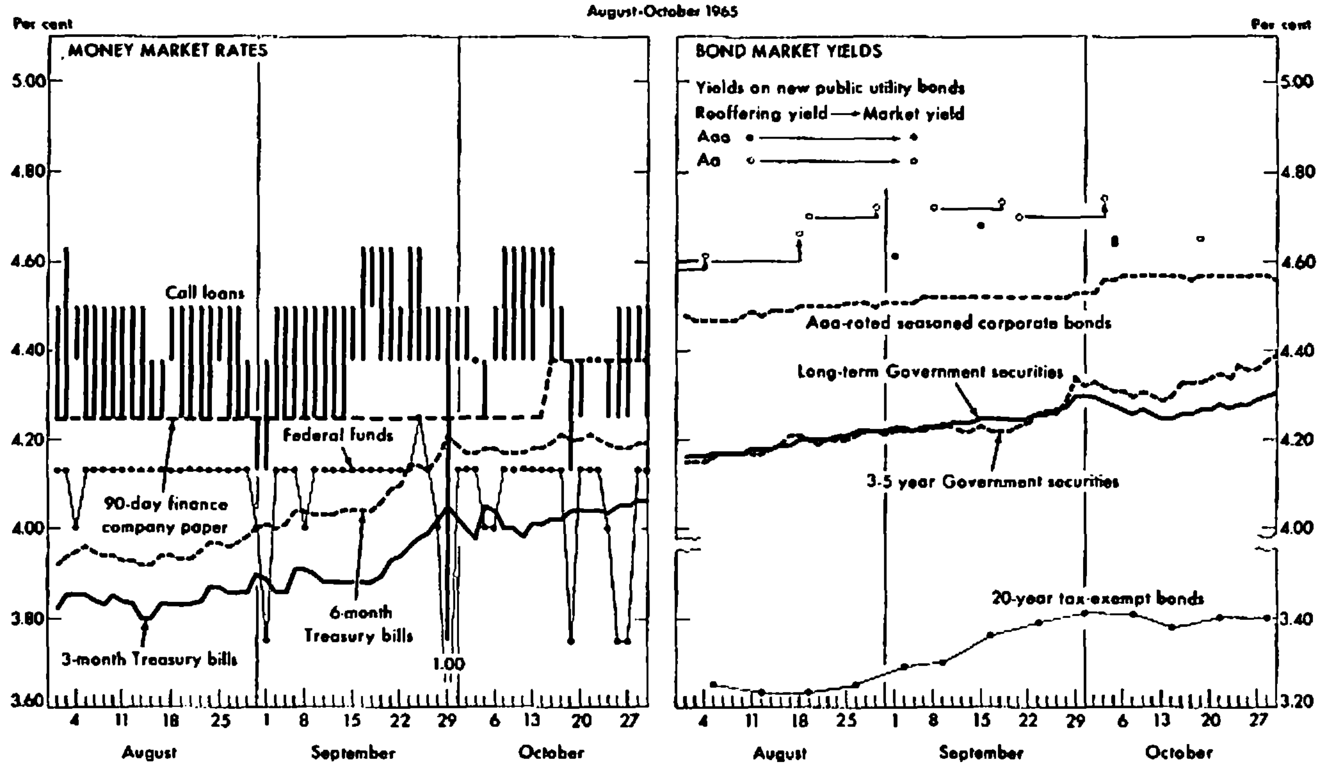
After the close of business on October 27, the Treasury announced the terms of its November refinancing operation. It offered for cash a new issue of 4¼ per cent notes dated November 15 and maturing in May 1967 priced at 99.83 to yield 4.37 per cent, the highest initial yield for any Treasury offering in some time. The proceeds from the sale of the new notes will be used to redeem $9.7 billion of Treasury notes maturing on November 15. Subscription books for the new notes were open only on November 1. The refunding terms were closely in line with earlier market expectations, but only moderate interest in the new issue developed. In the final days of the month, prices of outstanding issues due in from one to two years were only slightly changed. At the same time, prices of other outstanding issues continued to decline as professional offerings increased.

On November 3, the Treasury announced the results of the refunding. Subscriptions for the new 4¼ per cent notes totaled approximately $12 billion, of which $9.7 billion was accepted. Subscriptions in amounts of $200,000 or less were allotted in full, as were subscriptions from various official organizations. All other subscriptions were subject to a 48 per cent allotment (but assured of a minimum award of $200,000).

The tone of the Treasury bill market also improved in early October, following the sharp upward adjustment in rates which had occurred in late September. Demand from investor and official sources expanded, so that dealer inventories contracted and the technical position of the bill market strengthened markedly. At the Treasury's October 5 auction of $3 billion of March and $1 billion of June tax anticipation bills, a lively interest developed, particularly from commercial banks which were permitted to pay for their purchases in full by crediting Treasury Tax and Loan Accounts. The market valued the Tax and Loan deposits that would be created in connection with the operation at approximately 40 to 45 basis points for the March bills and 25 basis points for the June bills. In recognition of this factor, the average issuing rates of 3.783 per cent and 3.938 per cent, respectively, for the March and June tax bills were far below prevailing market rates for outstanding bills of comparable maturities. A strong corporate and professional demand appeared for the new bills in "when-issued" trading prior to the Oc-

SELECTED INTEREST RATES*

August-October 1965



Note: Data are shown for business days only.

* MONEY MARKET RATES QUOTED: Daily range of rates posted by major New York City banks on new call loans (in 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 of new Aaa- and Aa-rated public utility bonds are plotted around a line showing daily average yields of seasoned Aaa-rated corporate bonds (arrows point from underwriting syndicate reoffering yield of a given issue to market yield of the same issue immediately after it has been released from syndicate restrictions); daily averages of yields of long-term Government securities (bonds due or callable in ten years or more) and of Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields of 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.

tober 11 payment date, and commercial bank offerings were readily absorbed at prevailing market rates. Investor interest in outstanding bills was also good during this period—particularly for those bills maturing within three months. As market supplies were rapidly absorbed, acute scarcities developed in certain bill maturities, and rates generally moved lower. During this period, the shorter maturities generally recorded the larger declines.

Around midmonth, bill rates edged a bit higher on increased bill offerings from commercial banks and dealers. Late in the month, bill rate movements were narrowly mixed. Although investor interest was modest, dealers appeared willing for a time to maintain their inventories in the expectation that enlarged bill demand would soon arise from the Treasury's November refunding and from anticipated seasonal bill purchases by the System Account. Rates tended to edge higher at the close of the month, reflecting some professional disappointment that the Treasury's refunding would be on a cash basis rather than on a "rights" basis and, consequently, would not generate any immediate reinvestment demand from holders of the maturing issues. The three- and six-month Treasury bills closed the month at 4.06 per cent and 4.19 per cent bid, respectively.

OTHER SECURITIES MARKETS

The same factors which bolstered the tone of the Government securities market in early October also contributed to the emergence of a steadier atmosphere in the markets for corporate and tax-exempt bonds. In the corporate sector, there was a resurgence in the demand for recent issues with relatively attractive yields. At the same time, the excellent reception accorded two high-grade utility bonds marketed at the beginning of the month, coupled with the light calendar of scheduled flotations, resulted in a more confident tone which prevailed during most of the month. Toward the end of October, however, caution emerged again in the corporate sector when investor demand became more restrained as the calendar of scheduled flotations expanded. In the tax-exempt sector, dealers made considerable headway in reducing their inventories of state and local bonds as demand expanded following the recent downward price adjustments. Some hesitancy persisted in the tax-exempt sector, however, as participants were faced with an unusually heavy calendar of impending issues. This cautious tone became more prevalent later in the month when a substantial volume of new issues encountered a lackluster investor response. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 3 basis points to 4.56 per cent, while *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) declined by 1 basis point over the month to 3.40 per cent. (See right-hand panel of the chart.) These indexes are based on only a limited number of issues and do not necessarily reflect market movements fully.

THE MONEY MARKET AND BANK RESERVES

Nationwide net reserve availability was little changed on average in October, while member bank borrowings from the Reserve Banks fluctuated from week to week in response to sharp shifts in the distribution of reserves from reserve city to "country" banks and then back again. The over-all tone of the money market was slightly more comfortable on average in the first week of the month, turned firm over most of the remainder of the period, and then eased slightly late in the month. The major sales finance companies raised their offering rates on 60- to 270-day directly placed paper by ⅛ of a percentage point to 4⅜ per cent on October 15. Rates on new call loans to Government securities dealers posted by the major New York City banks were generally in a 4¼ to 4⅝ per cent range, while rates on renewal call loans were quoted in a 4¼ to 4½ per cent range.

System open market operations released substantially more reserves to the market during the week ended October 6 than were absorbed by net movements of market factors, with the result that net borrowed reserves contracted by $123 million to $96 million. This was accompanied by the accumulation of a small basic reserve surplus at the major New York City banks. The bulk of the remainder of the available reserves, however, was lodged at country banks, while money market banks outside New York City found themselves under reserve pressure. Since these other reserve city banks turned increasingly to the "discount window" to meet their reserve needs, total member bank borrowings receded only slightly to an average of $536 million for the week.

Reserve positions at money center banks outside New York City remained under pressure in the following week, and pressures also mounted on the New York City banks. These developments reflected both the increased financing provided to Government securities dealers (who acquired from the commercial banks the March and June tax anticipation bills auctioned by the Treasury on October 5) and the sharp expansion in required reserves as the banks paid for the bills by crediting Treasury Tax and Loan Account deposits. Nevertheless, as country banks unloosed a part of the reserve excesses built up in the preceding week, the reserve city banks were able to fill a sizable portion of their reserve needs through purchases of Federal funds generally at 4⅛ per cent. Total member bank borrowings from the Reserve Banks actually declined a bit during the October 13 statement week.

In the second half of the month, the sequence of events in the money market closely mirrored the pattern of early October. Thus, once again the alternative accumulation and redistribution of excess reserves by the country banks contributed to opposite movements in net borrowed reserves and in member bank borrowings from the Federal Reserve. Early in the statement period ended October 20, country banks built up a substantial volume of excess reserves and the reserve positions of the New York City banks improved somewhat as nationwide reserve availability expanded. At the same time, pressures upon the reserve positions of other reserve city banks remained heavy, and consequently member borrowings from the Federal Reserve Banks bulged temporarily. Subsequently, as country banks released a portion of their reserve excesses, the flow of Federal funds improved and reserve pressures on the money center banks slackened. Thus, in the later part of the month the tone of the money market was relatively comfortable—with the effective rate on Federal funds varying from 4⅛ per cent to as low as 3¾ per cent—and member bank borrowings from the Federal Reserve contracted.