The Money and Bond Markets in November

An atmosphere of uncertainty continued to prevail in the Government securities market during November. The long-standing concern on the part of market participants over the interest rate outlook was reinforced by indications that the economy was expanding on a broad front, and that the volume of new corporate and Government agency securities issues was rising. Against this background, the prices of Treasury notes and bonds moved further downward in early November, reaching new lows for the year. Subsequently, the tone of the market improved when several corporate issues were accorded a favorable reception. Furthermore, successful official moves to restrain price pressures in the metals industries were seen as enhancing the prospects for interest rate stability. Near the close of the month, however, an easier undertone reappeared as the market reacted to upward revisions of estimates of the Federal deficit for the current fiscal year and to discussion of the possibility that Federal Reserve Bank discount rates and other interest rates might move higher. The tone of the corporate bond sector improved moderately during the first half of the month, when higher reoffering yields on a heavy volume of new issues attracted investor interest. Investors resisted underwriter efforts to price new issues higher, however, and yields were near their peak as the month closed. In the tax-exempt sector, considerable caution persisted. Prices declined virtually throughout the month, and new issues were offered at progressively higher yields.

Treasury bill rates tended to edge irregularly higher over the month. Yields of the scarce shorter term issues receded moderately at the beginning of the month, while rates on longer term bills edged higher. Subsequently, investment activity contracted somewhat, and rates tended to creep higher at the close of the month as the December dividend and tax dates approached and rate expectations began to shift.

The money market continued firm in November although the distribution of excess reserves shifted markedly within the month. The average level of reserve availability for the banking system was little changed during the month, although temporary reserve dislocations were caused by the power failure in the Northeast on November 9.

THE GOVERNMENT SECURITIES MARKET

Prices of Government notes and bonds receded further at the beginning of November. Uncertainty over the future course of interest rates continued to restrain investor demand and stimulate professional offerings. Market caution was increased by the unexpectedly large allotments awarded subscribers to the Treasury's November cash refunding,[1] by the substantial calendar of scheduled capital market issues, and by continuing evidence of strong business loan demand. Government securities dealers sought to reduce their inventories, while investor offerings expanded both on outright sales and on switches into corporate and Government agency bonds. Prices of many Treasury coupon issues slipped to new lows for the year. (The right-hand panel of the chart on page 264 shows the rise in yields that accompanied this decline in bond prices.)

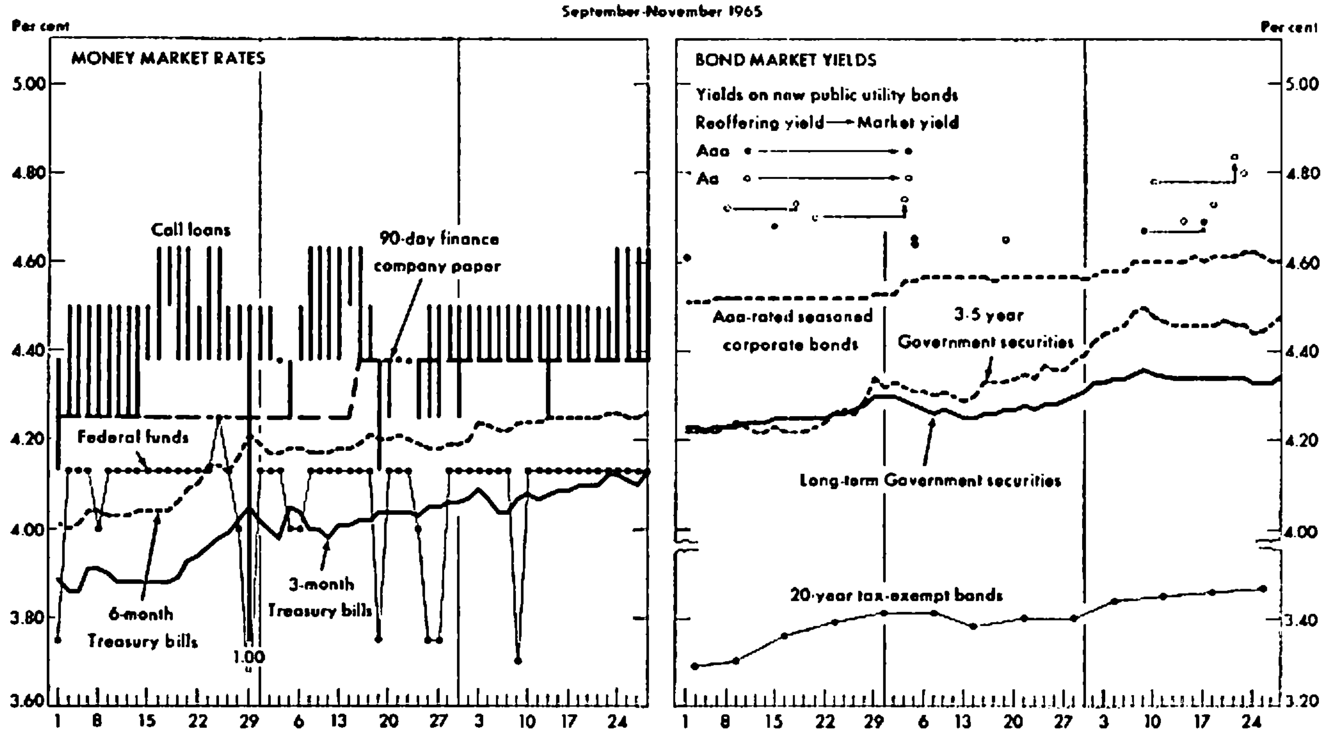
Around midmonth, the higher yields on intermediate- and long-term Government securities attracted renewed investment interest, particularly in intermediate-term issues, and stimulated dealer short-covering operations. Bond traders also derived encouragement from the favorable receptions accorded several sizable new corporate and tax-exempt offerings marketed during this period. Meanwhile, the cancellation of previously announced increases in aluminum and copper prices also aided confidence in the tenability of existing interest rate levels. Prices of Treasury coupon issues edged irregularly higher from November 10 until near the end of the month in moderately active trading, which included year-end switching for tax purposes. As November ended, the market received the news that the Federal deficit for the 1966 fiscal year would be larger than previously expected, primarily reflecting increased military spending. This news led to renewed price declines as the market weighed the possibility of higher interest rates.

In the Treasury bill sector, rates moved narrowly in

[1] For details see this *Review*, November 1965, page 233.

SELECTED INTEREST RATES *

September-November 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.

November but tended higher. In the opening days of the month, a fairly good demand from public funds and other investors for the scarce 1965 maturities as well as for bills maturing early in 1966 pushed rates on these issues lower. At the same time, rates for longer term bills edged higher on moderately large commercial bank offerings (see the left-hand panel of the chart). Investment activity contracted somewhat following the Treasury's November 12 announcement that it would sell an additional $2.5 billion of June 1966 tax anticipation bills for payment on November 24 to meet its remaining cash needs for calendar 1965. At the November 17 auction, the tax bills drew lively interest from commercial banks, which were permitted to make full payment for their purchases by crediting Treasury Tax and Loan Accounts. Banks outside New York City were particularly attracted to the issue, and its average issuing rate was set at 4.075 per cent. This was almost 20 basis points below the market rate prevailing on the June tax bills already outstanding, and reflected the value placed by the banks on acquiring additional Tax and Loan Account deposits. The auction rate, however, was considerably higher than the 3.938 per cent average issuing rate set at the earlier October auction of June tax bills, in part because of the shorter average duration expected this time for the Tax and Loan deposits.

A good interest developed in the June tax bills after the auction, and dealers and investors readily absorbed commercial bank selling. Large Federal Reserve purchases toward the end of the month to supply reserves exerted

Table I

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

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

Factors	Changes in daily averages—week ended Nov. 3	Nov. 10	Nov. 17	Nov. 24	Net changes
"Market" factors					
Member bank required reserves*	− 87	+ 250	− 87	+ 44	+ 120
Operating transactions (subtotal)	− 448	− 451	+ 48	+ 249	− 602
Federal Reserve float	− 281	+ 290	+ 63	+ 276	+ 348
Treasury operations†	+ 60	− 115	+ 27	+ 148	+ 120
Gold and foreign account	+ 8	− 25	—	− 16	− 33
Currency outside banks*	− 127	− 518	− 51	− 87	− 783
Other Federal Reserve accounts (net)‡	− 113	− 86	+ 11	− 71	− 259
Total "market" factors	− 535	− 196	− 39	+ 293	− 476
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 537	+ 420	− 201	− 260	+ 496
Bankers' acceptances	+ 2	+ 3	− 1	+ 4	+ 8
Repurchase agreements:					
Government securities	—	+ 4	− 4	—	—
Bankers' acceptances	+ 22	− 19	− 21	+ 4	− 14
Member bank borrowings	+ 148	− 162	+ 165	− 128	+ 23
Other loans, discounts, and advances	+ 13	− 12	− 2	—	− 1
Total	+ 721	+ 234	− 64	− 380	+ 511
Excess reserves*	+ 186	+ 49	− 113	− 87	+ 35

Member bank:	Daily average levels				
Total reserves, including vault cash*	22,111	21,904	21,878	21,747	21,910§
Required reserves*	21,732	21,476	21,563	21,519	21,573§
Excess reserves*	379	428	315	228	337§
Borrowings	486	334	489	361	417§
Free reserves*	− 107	+ 93	− 174	− 133	− 80§
Nonborrowed reserves*	21,625	21,570	21,389	21,386	21,493§

System Account holdings of Government securities maturing in:	Changes in Wednesday levels				
Less than one year	+ 1,039	− 229	− 5,582	+ 38	− 4,734
More than one year	—	—	+ 5,582	—	+ 5,582
Total	+ 1,039	− 229	—	+ 38	+ 848

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 24.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS NOVEMBER 1965

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended Nov. 3	Nov. 10	Nov. 17	Nov. 24	Average of four weeks ended Nov. 24
Eight banks in New York City					
Reserve excess or deficiency(−)*	18	57	12	− 9	20
Less borrowings from Reserve Banks	96	79	59	46	70
Less net interbank Federal funds purchases or sales(−)	− 114	296	379	202	191
Gross purchases	*834*	*1,066*	*995*	*927*	*956*
Gross sales	*949*	*770*	*616*	*725*	*765*
Equals net basic reserve surplus or deficit(−)	37	− 319	− 426	− 257	− 241
Net loans to Government securities dealers	521	354	550	596	505
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)*	20	29	13	26	22
Less borrowings from Reserve Banks	72	10	157	78	79
Less net interbank Federal funds purchases or sales(−)	745	802	643	584	694
Gross purchases	*1,399*	*1,494*	*1,327*	*1,235*	*1,364*
Gross sales	*654*	*692*	*685*	*651*	*671*
Equals net basic reserve surplus or deficit(−)	− 797	− 783	− 787	− 636	− 751
Net loans to Government securities dealers	156	53	147	120	119

Note: Because of rounding, figures do not necessarily add to totals.
* 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—November 1965 Nov. 1	Nov. 8	Nov. 15	Nov. 22	Nov. 29
Three-month	4.082	4.045	4.097	4.104	4.115
Six-month	4.219	4.221	4.259	4.253	4.249

	Monthly auction dates—September-November 1965 Sept. 24	Oct. 26	Nov. 24
One-year	4.236	4.192	4.276

* 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.

little influence on rates, since dealer portfolios had been built up in anticipation of these seasonal purchases. A more cautious atmosphere, however, began to appear near the close of the month, as rates on bank loans to Government securities dealers edged higher and the market began to talk of the possibility of higher rates in the future.

OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt bonds drifted lower in light trading at the beginning of the month. Market attention focused upon the increasingly heavy calendar of scheduled flotations, particularly of corporate bonds. Over the midmonth period, a better tone emerged in the corporate sector after several new issues—marketed at relatively attractive yield levels—were quickly taken up by investors. Investor resistance developed in the second half of the month, however, and yields on new issues again tended higher. Investor interest reappeared at the higher rates, although a considerable amount of unsold bonds remained on the dealers' shelves at the month end. In the tax-exempt sector, on the other hand—where investment interest from commercial banks and other sources apparently waned—a cautious tone persisted throughout the month. Activity in both sectors centered upon new issues since reoffering yields on corporate and tax-exempt flotations were generally higher than yields on outstanding bonds.

Over the month as a whole, the average yields on Moody's seasoned Aaa-rated corporate bonds rose by 4 basis points to 4.60 per cent, while *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) rose by 7 basis points to 3.47 per cent. (See the right-hand panel of the chart.) These indexes are, however, based on only a limited number of issues and do not necessarily reflect market movements fully.

THE MONEY MARKET AND BANK RESERVES

The money market remained firm in November. The effective rate on Federal funds held generally steady at 4⅛ per cent, while rates quoted by the major New York City banks on their call loans to Government securities dealers were generally within a 4¼ to 4½ per cent range. Nationwide reserve availability, on the other hand, fluctuated widely during the month in the wake of the massive power failure which beset the Northeastern United States on November 9. The unusual bulge in free reserves that occurred following the blackout, combined with a continued generally firm tone in the money market, illustrated anew the limitations of any single measure—e.g., free (or net borrowed) reserves—as a satisfactory barometer of monetary policy.

During the first statement period of the month, preceding the week of the blackout, Federal Reserve open market operations provided over $1 billion of reserves on a Wednesday-to-Wednesday basis to offset the drains stemming from movements in "market" factors. As a result, the average level of net borrowed reserves was little changed from the preceding week. Reserve distribution remained in favor of the major banks in New York City, which continued to have a basic reserve surplus. Nevertheless, total member bank borrowings from the Federal Reserve moved up from the low level of the preceding week to about the $500 million mark in the first week of the new "country" bank settlement period.

At dusk on Tuesday, November 9, an abrupt interruption in electrical transmission over a broad area of Canada and the Northeastern United States plunged most of the First and Second Federal Reserve Districts into darkness. With transportation and communications systems severely disrupted by the power failure, check-clearing operations were considerably hampered and Federal Reserve float consequently soared by over $500 million on Wednesday, November 10. This rise in float and other factors caused average nationwide reserve availability to swell by $170 million over the statement period. The bulk of the rise in excess reserves wound up as idle funds in the major money market banks in New York and Boston, but had little effect on the money market in view of the difficulties these banks had in estimating their reserve positions on Wednesday, November 10. In recognition of the special difficulties caused by the power failure, these banks were permitted by the Federal Reserve authorities to carry the reserve excesses over into the following week.

In that following statement week, once power was fully restored, the machinery of the banking system quickly returned to a normal operating basis. The reserve excesses carried over from the preceding week were quickly absorbed, partly as a result of a large seasonal buildup of reserves at country banks. Over-all reserve availability returned to the levels prevailing before the blackout, and the market remained firm throughout the week, with Federal funds trading mainly at 4⅛ per cent. Subsequently, the money market was steady, as System open market operations withdrew reserves in large volume to offset the country banks' sharp reductions in their holdings of excess reserves in the final week of this reserve averaging period. In the final statement week of the month, firmness in the money market continued as System open market operations largely offset the increase in reserves stemming from a rise in float and other market factors.