The Money and Bond Markets in May

The money and capital markets exhibited divergent movements in May. Conditions in the money market remained generally comfortable and some short-term interest rates declined further, but yields in the intermediate- and long-term sectors—which had begun to climb sharply in April—continued to advance until the last week of the month. At their late May highs, offering yields on new corporate issues were very close to their 1966 peaks, and yields on tax-exempt issues were within about ½ percentage point of last year's peaks. Yields on long-term Treasury issues reached 4.84 per cent in late May, before falling somewhat over the final week of the month.

The upward pressure on bond yields during May largely reflected the same factors that pervaded the capital markets in April. In particular, congestion persisted in both the corporate and tax-exempt sectors under the weight of the heavy flow of current and prospective flotations. Only a few of the new issues in May were accorded good investor receptions despite progressively higher yields. In addition, there was growing apprehension over anticipated large Treasury financing needs (including sales of participation certificates) in the months ahead, especially in view of possibly increased military spending for the Vietnam war. While the statistics released during the month indicated little change in the level of economic activity, and resulted in some temporary improvement in market sentiment around mid-May, most market participants generally looked for an early strengthening in the economy. The better market tone that emerged late in the month was most pronounced in the Treasury sector. The technical position of that market had improved considerably, reflecting the cumulative effects of sizable official purchases during the month. There were also expectations—stimulated by discussion in the press—that the Federal Reserve might continue to purchase some Treasury coupon issues over succeeding weeks in the course of meeting the midyear reserve needs of the banking system. In addition, investors began to find the prevailing high yields on corporate and municipal securities attractive, and underwriters were able to clear out some of their inventories of unsold new issues.

In the Treasury bill market, rates declined throughout the month with some issues falling to their lows of the year. There was good demand from investors and other sources. Demand particularly favored shorter maturities, in part reflecting generally cautious investor attitudes, and thus there was a progressive widening in the rate spread between short- and long-term bills.

Free reserves continued to fluctuate in the range of recent weekly variations during May, and the distribution of reserves shifted in the second half of the month toward banks in the money centers, who apparently were making preparations for loan demands expected in connection with mid-June corporate tax payments. Banks had little difficulty in covering most of their residual needs in the Federal funds market at rates generally at or below 4 per cent, and borrowings from the Federal Reserve System were light. A heavy volume of negotiable certificates of deposit (C/D's) matured during May, and to stem further attrition some banks moved up their offering rates, especially on longer maturities. This contrasted with movements in other short-term rates, which generally declined during May.

THE GOVERNMENT SECURITIES MARKET

Early in May, attention in the market for Treasury notes and bonds was centered on the Treasury's refunding of up to $22.1 billion of notes and bonds maturing in May, June, and August (of which $9.0 billion was held by the public). Holders of May and June maturities were offered the right to exchange them for either a 4¼ per cent fifteen-month note or a 4¾ per cent five-year note; holders of August maturities were given the opportunity to exchange them for the latter note only.[1] Market reaction to the terms of the refunding, announced on April 26, was somewhat hesitant for a while but gradually became more positive. By the time the subscription books were closed on May 3, the public had exchanged 81½ per cent of its

[1] For further details of the offering, see this *Review* (May 1967), page 90.

holdings of May and June maturities and about 26½ per cent of its holdings of August maturities, taking a total of $2.0 billion of the new fifteen-month note and $2.7 billion of the five-year note.

The improved tone of the market extended through May 4, when a reduction in the British bank rate from 6 per cent to 5½ per cent was announced. Investor activity subsequently contracted, however, and as a weaker overall tone reemerged, dealers became increasingly restive with their newly enlarged positions of refunding issues. In this atmosphere, professional offerings expanded and prices of Treasury coupon issues declined throughout the list.

The downward movement in prices of outstanding coupon issues accelerated somewhat on May 8 and 9, as professional offerings of intermediate-term issues—where dealer positions were largest—weighed heavily on the market and as prices of Government securities were strongly affected by further deterioration in the corporate and tax-exempt markets. In addition, there was widespread apprehension that the size of the Treasury cash financing needs might be larger than previously anticipated in the last half of this calendar year and in fiscal 1968 generally, particularly in view of newspaper reports of the possibility of further escalation of the Vietnam conflict. However, sizable investment orders from official accounts as well as other buying at the lower price levels on these two days removed some of the heavy overhanging supply of securities on dealers' shelves, and prices of intermediate-term issues subsequently moved back up somewhat, with some of the gains also carrying over into the longer term sector. Reports of lower retail sales in March than had previously been estimated, a large drop in bank loans to businesses in the statement week ended on May 10, and the absence of any significant selling prior to the refunding settlement date helped reinforce this improved atmosphere.

A heavier tone returned to the market again on May 15—the settlement date for the Treasury's refunding. Sentiment was initially dampened by Secretary Fowler's request for two revisions affecting the 4¼ per cent interest rate ceiling on long-term Treasury issues. Specifically, the requests were to extend from five to ten years the maximum maturity on Treasury notes, to which the ceiling does not apply, and for authority to sell up to $2 billion of bonds annually without regard to the interest ceiling.[2] Treasury requests for an increase in the debt ceiling and its estimates of budgetary deficits had largely been anticipated and had only a limited initial effect on quotations, but over succeeding days more and more attention was focused on the prospects of very large Treasury cash needs in the second half of this calendar year. Of immediate concern, moreover, was the likelihood of another sizable sale of participation certificates before the end of the current fiscal year. Pressure on long-term rates eased somewhat during the last week of the month, and the heavy atmosphere that had been in the market earlier gradually lifted. Market participants took heart from indications of concern within the Administration over the recent steady rise in interest rates and from increased discussion of the possibility of a tax rise later this year. System purchases of coupon issues around this time contributed to a further improvement in the technical position of the market, and overall sentiment was buoyed by discussion of the likelihood of additional System buying in the course of meeting reserve needs over the weeks ahead.

Treasury bills were in strong demand during May. Over the month as a whole, market rates declined generally by 15 to 30 basis points on outstanding bills maturing within five months and by 4 to 20 basis points on longer maturities. Demand as a rule favored the shorter maturities, and consequently the rate spread between three- and six-month bills widened to 28 basis points at the end of the month, the largest differential since November 1966. The broad-based demand for bills reflected in part expectations by some investors of continued upward pressure on long-term rates. Additional demand for bills came from commercial banks and from other financial institutions rebuilding their liquidity, while corporations were active buyers of the June tax anticipation bills. In addition, some of the proceeds of recent corporate and tax-exempt bond flotations apparently have been invested temporarily in Treasury bills. Bidding in the five weekly bill auctions held in May was aggressive, as dealers sought to rebuild their generally depleted positions. At the final weekly auction, average issuing rates on the new three- and six-month issues were set at 3.477 per cent and 3.733 per cent, respectively, down about 24 and 4 basis points from the rates established in the last auction in April. Demand was not so insistent for the longer maturities, however. In the auction of nine-month and one-year Treasury bills in late May, average issuing rates were set at levels about 10 basis points above the rates set a month earlier, though they remained below the levels of March. (For information on average issuing rates of other Treasury bill auctions in May, see Table III.)

Movements in the market for Government agency securities during May closely paralleled those in the market for

[2] Later in the month, the House Ways and Means Committee voted approval of an extension of the maximum maturity of Treasury notes to seven years but did not approve the sale of bonds outside the interest ceiling.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MAY 1967

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

Factors	Changes in daily averages—week ended on					Net changes
	May 3	May 10	May 17	May 24	May 31	
"Market" factors						
Member bank required reserves*	− 89	+ 159	+ 89	+ 226	+ 40	+ 425
Operating transactions (subtotal)	− 291	− 451	+ 304	− 184	− 219	− 841
Federal Reserve float	− 52	− 57	+ 128	+ 20	− 382	− 343
Treasury operations†	− 109	+ 146	+ 102	− 114	+ 230	+ 255
Gold and foreign account	− 7	− 16	+ 21	+ 1	− 37	− 38
Currency outside banks*	− 139	− 485	+ 109	+ 133	− 19	− 401
Other Federal Reserve accounts (net)‡	+ 16	− 38	− 59	− 222	− 10	− 313
Total "market" factors	− 380	− 292	+ 393	+ 42	− 179	− 416
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 197	+ 174	− 226	+ 287	+ 127	+ 559
Bankers' acceptances	− 1	+ 3	—	− 2	+ 1	+ 1
Repurchase agreements:						
Government securities	+ 253	+ 163	− 157	− 300	+ 69	+ 28
Bankers' acceptances	+ 43	− 8	− 42	− 18	− 28	− 53
Federal agency obligations	+ 5	− 5	− 8	—	—	− 8
Member bank borrowings	+ 36	− 71	+ 60	− 73	+ 52	+ 4
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+ 533	+ 255	− 369	− 105	+ 222	+ 536
Excess reserves*	+ 153	− 37	+ 24	− 63	+ 43	+ 120

	Daily average levels					
Member bank:						
Total reserves, including vault cash*	23,627	23,431	23,366	23,077	23,080	23,316§
Required reserves*	23,228	23,069	22,980	22,754	22,714	22,949§
Excess reserves*	399	362	386	323	366	367§
Borrowings	134	68	123	50	102	94§
Free reserves*	+ 265	+ 294	+ 263	+ 273	+ 264	+ 273§
Nonborrowed reserves*	23,493	23,363	23,243	23,027	22,978	23,222§

	Changes in Wednesday levels					
System Account holdings of Government securities maturing in:						
Less than one year	+ 763	− 352	−3,161	− 83	+ 427	− 2,406
More than one year	—	—	+2,878	+ 102	+ 109	+ 3,089
Total	+ 763	− 352	− 283	+ 19	+536	+ 683

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 five weeks ended on May 31.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MAY 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Average of five weeks ended on May 31*
	May 3	May 10	May 17	May 24	May 31*	
Eight banks in New York City						
Reserve excess or deficiency(−)†	29	62	13	16	38	32
Less borrowings from Reserve Banks	39	21	36	—	—	19
Less net interbank Federal funds purchases or sales(−)	681	960	864	691	329	705
Gross purchases	*1,292*	*1,446*	*1,326*	*1,332*	*1,038*	*1,287*
Gross sales	*611*	*486*	*462*	*641*	*709*	*582*
Equals net basic reserve surplus or deficit(−)	− 692	− 920	− 887	− 676	− 291	− 693
Net loans to Government securities dealers	865	684	607	577	591	665
Thirty-eight banks outside New York City						
Reserve excess or deficiency(−)†	4	127	10	− 46	4	20
Less borrowings from Reserve Banks	60	2	46	22	56	37
Less net interbank Federal funds purchases or sales(−)	1,035	1,432	1,267	1,137	917	1,158
Gross purchases	*1,832*	*2,176*	*1,991*	*2,022*	*1,768*	*1,958*
Gross sales	*797*	*744*	*723*	*886*	*852*	*800*
Equals net basic reserve surplus or deficit(−)	−1,092	−1,307	−1,303	−1,205	− 969	−1,175
Net loans to Government securities dealers	731	677	640	577	476	620

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—May 1967				
	May 1	May 8	May 15	May 22	May 29
Three-month	3.770	3.671	3.628	3.493	3.477
Six-month	3.907	3.831	3.802	3.692	3.733

Maturities	Monthly auction dates—March-May 1967		
	March 28	April 25	May 24
Nine-month	4.078	3.842	3.944
One-year	4.074	3.832	3.933

* 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.

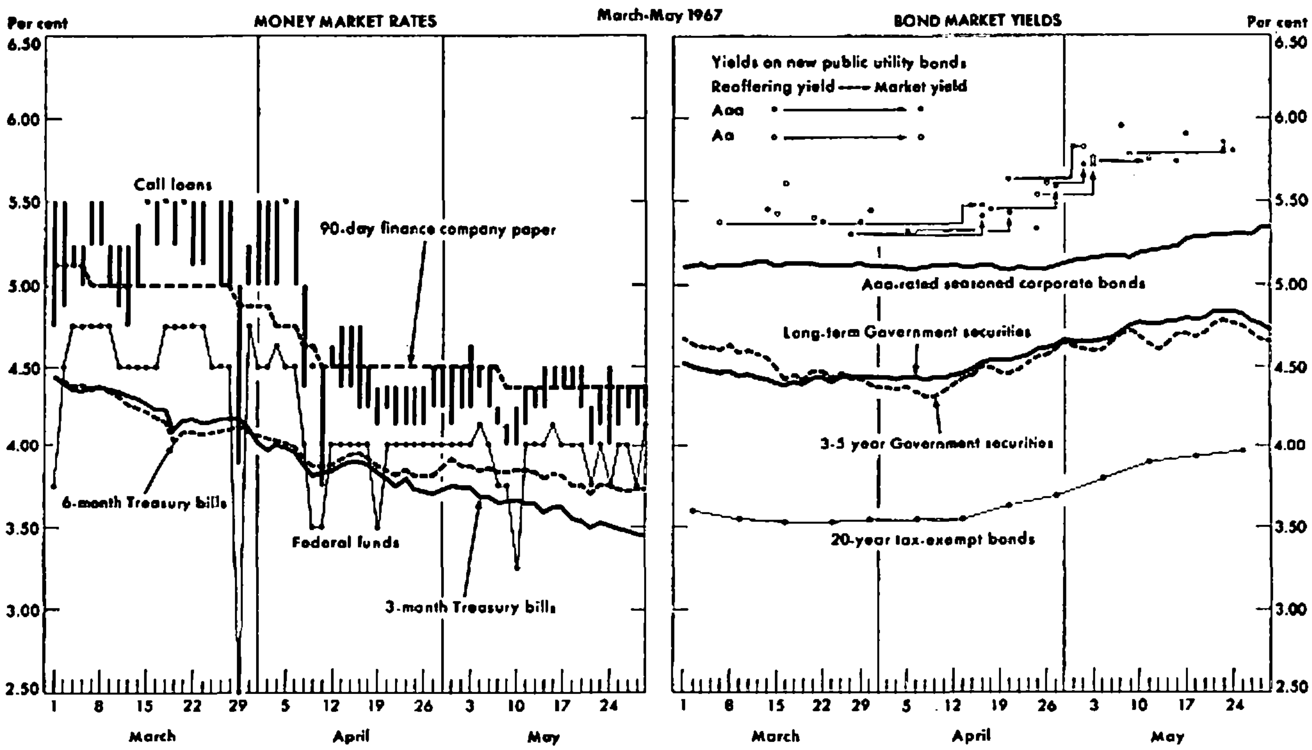
direct Treasury coupon securities. Prices generally moved lower over the month, with the largest changes in the longer maturity area, which was especially affected by concern over expected further sales of participation certificates in the next several weeks. These expectations were confirmed on May 31, when the Federal National Mortgage Association announced that it would sell $900 million of participation certificates on June 15, $250 million of which would be sold directly to Government trust accounts. Only two issues due beyond a year were offered during the month. One was a $341 million offering of twenty-month Federal Land Bank bonds priced to yield 4⅞ per cent. This offering, which was made on May 10, raised $161 million of new money; it was well received. On May 16, the Tennessee Valley Authority sold $70 million of twenty-five year bonds on a competitive basis to an underwriting syndicate. The issue afforded five-year call protection and was reoffered to investors at a 5.70 per cent yield. The offering was well received. A total of approximately $1.1 billion of shorter term agency issues was marketed during the period and most were generally accorded good initial receptions by investors.

OTHER SECURITIES MARKETS

Prices continued to decline in other sectors of the capital market during May, as the volume of current and prospective new corporate and tax-exempt offerings remained at near-record levels. An improved tone in the market for corporate securities developed temporarily early

SELECTED INTEREST RATES*

March-May 1967



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 on new Aaa- and Aa-rated public utility bonds are plotted around a line showing daily average yields on seasoned Aaa-rated corporate bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); daily averages of yields on 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 on 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.

in the month, when investor interest expanded at the higher yield levels that were reached following a spate of syndicate terminations. News of the reduction in the British bank rate also encouraged market participants briefly. With indications of heavy future demands for capital funds continuing to mount, however, the pessimistic climate reappeared and persisted through the remainder of the month despite announcements around mid-May of postponements of a total of $328 million of corporate securities. The respite was generally expected to be short-lived, and indeed $100 million of the postponed bonds was offered the following week. The $935 million of new corporate bonds that came to market during the month was typically offered at progressively higher yields but, even so, only a few issues were completely sold at the original reoffering yields. Near the end of the month, two A-rated industrial issues were offered at about 5.70 per cent with ten years of call protection, near the highest yield on any comparable issue marketed last year. Significant additions to the forward calendar of corporate debt offerings were made during the month, including one issue of $250 million of telephone company debentures scheduled for August 1. Corporate bonds on the calendar for June totaled $1.4 billion, and heavy offerings loom in later months as well.

The market for tax-exempt bonds was also generally weak throughout May, and dealers were able to move bonds only at rather substantial price reductions; after several syndicate terminations, price adjustments resulted in yields 20 to 45 basis points higher than original reoffering yields. These price cuts enabled dealers to reduce the volume of tax-exempt offerings advertised in the Blue List to $576 at the end of May, compared with the recent peak of $847 million reached on April 26. The largest tax-exempt offering of the month was the $100 million issue of State of California bonds (Aa-rated) at reoffering yields of 25 to 45 basis points above those on comparable maturities in the state's previous issue marketed March 21. The bonds met a fairly good reception. Several tax-exempt bond issues scheduled for offering during May were canceled or postponed because of market conditions. The largest such postponement, announced on May 23, was that of a $96.3 million issue of New York City bonds.

The average yield on Moody's Aaa-rated seasoned corporate bonds rose substantially during May, closing the month at 5.35 per cent. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying ratings ranging from Aaa to Baa, rose by 27 basis points to 3.96 per cent (see the right hand panel of the chart). These indexes, however, are based on only a limited number of seasoned issues and do not necessarily reflect market movements fully, particularly in the case of new and recent issues.

BANK RESERVES AND THE MONEY MARKET

Conditions in the money market were generally comfortable during May. The Federal Reserve System supplied a large volume of reserves through open market operations, and a decline in member banks' required reserves tended to increase excess reserves as bank credit showed only moderate growth. Free reserves averaged $273 million during the five weeks ended on May 31, in the upper part of the range of variation in April. Federal funds, trading in a narrow range around 4 per cent, accommodated most short-term needs of banks in reserve deficit, and borrowings from the System averaged a relatively light $94 million over the period. (See Table I.)

The major money market banks remained in a basic reserve deficit during May, but moved into a considerably more comfortable reserve position toward the end of the month, as they apparently began to prepare for loan demands expected around the June tax date. In the final week of the month, the forty-six major money market banks had a basic reserve deficit aggregating only $1.3 billion, the smallest deficit since November 30, 1966. Several of the major money market banks moved to stem attrition in their outstanding C/D's during the month by bidding somewhat more aggressively for large deposits. Some banks in New York City raised posted rates by ¼ to ½ percentage point during May, and some were reportedly paying as much as 5 per cent on a negotiated basis for six- or seven-month maturities. In contrast, the highest rate available in New York City at the end of April was reportedly 4½ per cent. New York City banks recorded a $224 million rise in their outstanding C/D's in the five weeks ended on May 31, following a drop of $257 million in April.

Most other short-term rates declined during May. In addition to the easing in rates on the three- and six-month maturities of Treasury bills noted above, rates on prime commercial paper declined by ⅛ per cent in May, while yields on call loans to Government securities dealers and bankers' acceptances showed no overall change despite a large volume of acceptances being offered on the market.