The Money and Bond Markets in October

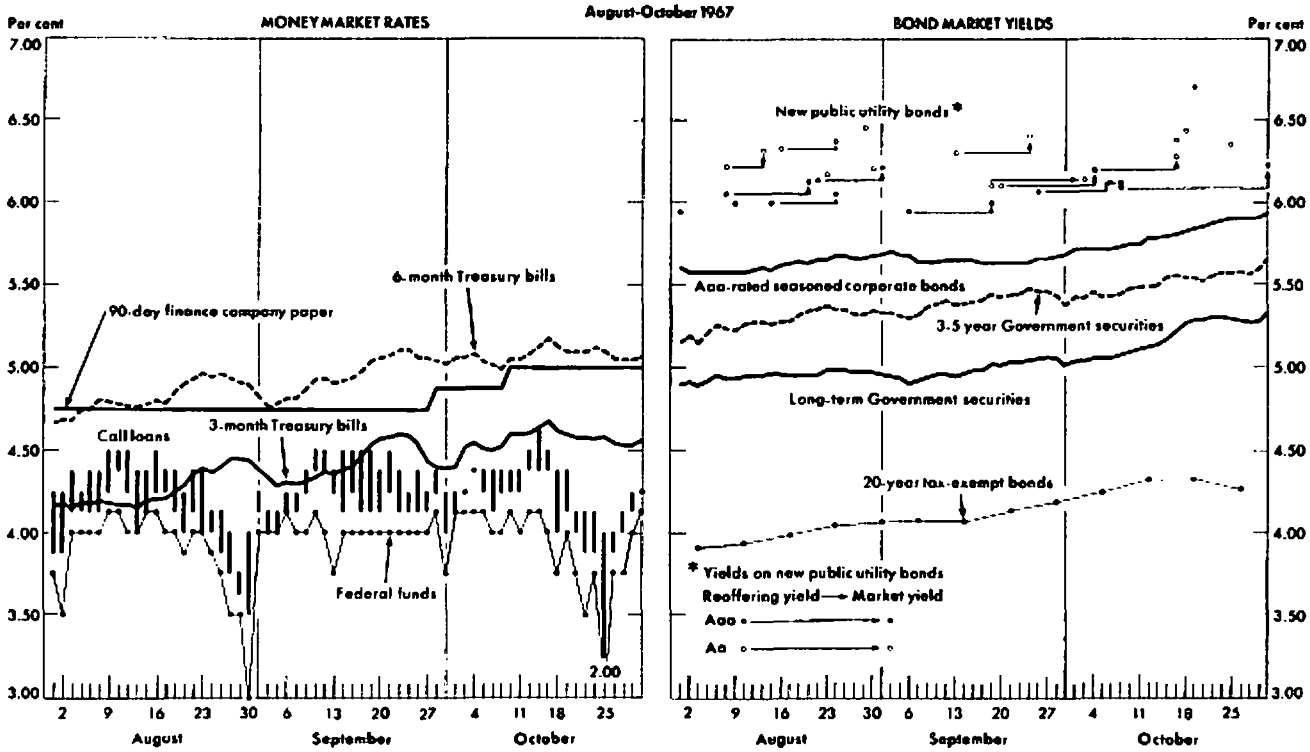
Conditions in the money market varied from moderate firmness in the first half of October to relative ease in the latter half, reflecting chiefly swings in the amount and distribution of available reserves. The average daily level of nationwide net reserve availability for the month as a whole was somewhat lower than in September. The effective rate for Federal funds was generally above the 4 per cent discount rate in the first half of the month and generally below 4 per cent thereafter. Rates posted by the New York City banks on new call loans to Government securities dealers rose considerably in the first half of October, but returned to lower levels in the second half of the period.

Other short-term rates moved higher during the month. The large New York City banks were able to replace certificates of deposit (C/D's) as they matured during October, but this required further increases in rates. Market yields on the nearest three- and six-month Treasury bill maturities rose by 17 and 4 basis points, respectively, to 4.56 per cent and 5.06 per cent.

The upward trend of capital market yields continued during October, with only a brief interruption late in the month. Market psychology underwent a pronounced deterioration at the start of the period, after an announcement by a Congressional committee that it had set aside the President's tax proposal until a program of reductions in Federal expenditures could be agreed upon between the Administration and the Congress. The market was also unfavorably affected by the seemingly dim prospects for a settlement in the near future of the Vietnam conflict and by continuing substantial additions to the corporate financing calendar. At the close of the month, market yields on outstanding Treasury securities were about 5⅝ per cent in the intermediate maturity area and 5¼ per cent in the longer term area (see chart). Late in the month, the Treasury announced that it would refund $10.2 billion

SELECTED INTEREST RATES

August-October 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.

of securities maturing on November 15 and raise an additional $2 billion of cash through an offering of two new notes, one—a seven-year maturity—bearing a coupon of 5¾ per cent, the highest for any Treasury issue in forty-six years. New issues of corporate and tax-exempt bonds were marketed during the month at progressively higher reoffering yields but, even so, most were poorly received. By midmonth, reoffering yields on corporate bonds had gone as high as 6.10 per cent on Aaa-rated bonds with five-year call protection and 6.70 per cent on A-rated bonds without call protection. Toward the end of the month, a better tone developed in the capital market and investors took up several new and slow-moving issues. This improvement proved short-lived, and bond prices dropped sharply during the last two days of the month, when it appeared that the Congress might adjourn without acting on the surtax proposal.

Late in October, the Federal Reserve Board announced a number of proposals designed to tighten the regulations governing the use of credit in securities transactions. One of the main proposals is to extend margin requirements to loans for purchasing and carrying convertible bonds. After the announcement, prices of convertible bonds fell sharply and some previously scheduled flotations of convertible corporate securities were postponed.

BANK RESERVES AND THE MONEY MARKET

Free reserves of all member banks in October averaged only moderately lower than in September, but there continued to be wide week-to-week variations in overall net reserve availability (see Table I). Reflecting the uneven distribution of reserves as well as an apparent tendency for "country" banks to keep a larger than usual amount of excess reserves, member bank borrowings from the Reserve Banks rose somewhat in the first three weeks of October before retreating to a lower level toward the end of the month. For the four statement weeks ended in October, borrowings averaged $141 million, compared with an average of $82 million in September.

The basic reserve position of banks in major money centers deteriorated sharply soon after the month began (see Table II), as these banks experienced seasonal outflows of reserves and some loss of funds through attrition of negotiable C/D's. An additional factor in this reserve loss was the payment by the money market banks to the Treasury on October 9 (partly by credits to Tax and Loan Accounts) for their awards of tax anticipation bills. Reflecting unexpectedly large reserve drains from movements in currency and other factors affecting the banks' aggregate reserve position, average free reserves dropped sharply to $133 million in the second statement week of October. In the following statement week, these conditions were reversed. Daily average free reserves rose to $341 million, and the basic reserve position of the city banks improved, partly reflecting further reductions in loans to Government securities dealers. However, uncertainties associated with the partial holiday of Columbus Day, October 12, led to unusually heavy borrowing at the "discount window" during the week. In the statement week ended on October 25, the release of a large volume of accumulated excess reserves by country banks in the Federal funds market coincided with a marked shift of reserves to the money center banks, producing comfortable money market conditions similar to those of late August.

The substantial runoff of negotiable C/D's outstanding at the New York City money market banks in September was brought to a halt during October through further upward adjustments in offering rates. By midmonth, the rate most often quoted by the city banks on new certificates maturing in one year or longer had risen to the 5½ per cent ceiling from the 5⅜ per cent rate that had prevailed since early September and the ceiling rate was available on six-month certificates. The most often quoted rate on the shortest maturity C/D's was 4⅞ per cent at the end of October, compared with 4¼ per cent at the beginning. On October 10, major finance companies raised their rates on directly placed paper by ⅛ percentage point to 5 per cent on paper maturing after January 1. On October 16, commercial paper dealers raised their offering rate on prime four- to six-month paper by ⅛ percentage point to 5⅛ per cent.

THE GOVERNMENT SECURITIES MARKET

Sentiment in the market for Treasury notes and bonds deteriorated further in October in response to many of the same international, fiscal, and credit factors that have weighed heavily on the market in recent months. Despite a temporary improvement in prices in the latter part of the period, price declines for the month amounted to more than 3 points in the long-term sector and 1 point in the intermediate area.

The market began the month with a feeling of disappointment over the lack of any signs of peace negotiations on the Vietnam conflict following a major policy address by President Johnson on September 29. Moreover, the outlook for the long-pending Congressional action on the President's August proposal for an income tax surcharge became more clouded, after an announcement on October 3 that the House Ways and Means Committee had decided to postpone consideration of the tax bill until an agreement between the Administration and the Congress could be reached on cuts in Federal spending. Market observers, disheartened by this development, felt that monetary policy might move toward less ease in the absence of fiscal measures to combat the strong inflationary tendencies in the economy.

Further upward pressure on Treasury yields resulted from the growing congestion in the markets for new corporate and tax-exempt bonds, which occurred despite a rising pattern of reoffering yields, and from the substantial volume of Federal agency offerings around midmonth. The market was only slightly affected by the increase in the discount rate of the Bank of England on October 18. In the latter part of the month, market attention focused on the forthcoming November 15 Treasury refunding operation, widely expected to include an additional offering of securities for cash.

Trading in Treasury coupon securities during October originated mainly in sales by investors of intermediate- and long-term issues, partly against purchases of higher yielding corporate and Treasury agency issues. Toward the end of the period, dealers pressed offerings aggressively on the market in order to divest themselves of securities taken from investors in preparation for the Treasury's November 15 refunding operation.

After the close of the market on October 25, the Treasury announced a $12.2 billion offering of new securities: $10.7 billion of 5⅝ per cent fifteen-month notes due February 15, 1969 and $1.5 billion of 5¾ per cent seven-year notes to mature November 15, 1974. The offering was made for the purpose of refinancing the $10.2 billion of securities maturing on November 15, of which $2.6

Table I

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

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

Factors	Changes in daily averages—week ended on Oct. 4	Oct. 11	Oct. 18	Oct. 25	Net changes
"Market" factors					
Member bank required reserves*	− 232	+ 95	− 323	+ 92	− 368
Operating transactions (subtotal)	− 173	− 789	+ 318	+ 447	− 197
Federal Reserve float	− 25	− 77	− 16	+ 162	+ 34
Treasury operations†	+ 67	− 105	+ 65	− 132	− 107
Gold and foreign account	+ 4	− 1	− 4	+ 12	+ 11
Currency outside banks*	− 169	− 544	+ 74	+ 258	− 381
Other Federal Reserve accounts (net)‡	− 40	− 64	+ 208	+ 147	+ 246
Total "market" factors	− 405	− 694	− 5	+ 539	− 565
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 524	+ 343	− 4	− 217	+ 646
Bankers' acceptances	+ 9	+ 1	− 1	—	+ 9
Repurchase agreements:					
Government securities	—	+ 237	+ 223	− 460	—
Bankers' acceptances	+ 20	− 38	− 26	− 42	− 86
Federal agency obligations	—	+ 7	+ 20	− 27	—
Member bank borrowings	+ 70	+ 1	+ 71	− 158	− 16
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 615	+ 551	+ 284	− 904	+ 546
Excess reserves*	+ 210	− 143	+ 279	− 365	− 19

	Daily average levels				
Member bank:					
Total reserves, including vault cash*	24,654	24,416	25,018	24,581	24,662§
Required reserves*	24,233	24,138	24,461	24,389	24,300§
Excess reserves*	421	278	557	192	362§
Borrowings	144	145	216	58	141§
Free reserves*	277	133	341	134	221§
Nonborrowed reserves*	24,510	24,271	24,802	24,503	24,522§

	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 558	+ 672	− 399	− 479	+ 352
More than one year	+ 59	—	—	—	+ 59
Total	+ 617	+ 672	− 399	− 479	+ 411

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 of four weeks ended on October 25.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS OCTOBER 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on Oct. 4	Oct. 11	Oct. 18	Oct. 25*	Averages of four weeks ended on Oct. 25*
Eight banks in New York City					
Reserve excess or deficiency(−)†	24	25	27	79	39
Less borrowings from Reserve Banks	—	21	93	—	28
Less net interbank Federal funds purchases or sales(−)	3	527	293	111	234
Gross purchases	*847*	*1,149*	*1,029*	*934*	*990*
Gross sales	*844*	*622*	*737*	*823*	*756*
Equals net basic reserve surplus or deficit(−)	21	− 523	− 359	− 32	− 223
Net loans to Government securities dealers	834	682	596	698	703
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)†	58	17	− 3	− 13	15
Less borrowings from Reserve Banks	51	50	39	—	35
Less net interbank Federal funds purchases or sales(−)	874	1,097	870	640	870
Gross purchases	*1,922*	*2,188*	*1,956*	*1,844*	*1,977*
Gross sales	*1,048*	*1,092*	*1,085*	*1,204*	*1,107*
Equals net basic reserve surplus or deficit(−)	− 867	− 1,130	− 912	− 653	− 890
Net loans to Government securities dealers	702	757	794	737	748

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 1967: Oct. 2	Oct. 9	Oct. 16	Oct. 23	Oct. 30
Three-month	4.514	4.564	4.676	4.597	4.542
Six-month	5.089	5.022	5.165	5.125	5.044

Maturities	Monthly auction dates—August-October 1967: August 24	September 26	October 24
Nine-month	5.098	5.145	5.313
One-year	5.100	5.124	5.302

* 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.

billion is held by the public, and raising $2 billion of new cash. The maturing securities are $8.2 billion of 4⅞ per cent notes and $2.0 billion of 3⅝ per cent bonds. Subscription books were open on October 30, and payment for the new issues, due November 15, may be made in cash or in the maturing securities. The 5¾ per cent coupon rate on the new seven-year notes is the highest interest rate on any Government security sold since June 1921.

A very good interest developed in the new issues, and there was a particularly heavy oversubscription for the seven-year notes. (On November 1, the Treasury announced that larger subscriptions would receive only 36 per cent allotments for the new 5⅝ per cent notes and only 7½ per cent allotments for the 5¾ per cent notes.) Shortly after the books closed, however, a very nervous atmosphere emerged in the markets, as it appeared that the Congress might adjourn before acting on the surtax proposal and as sizable additions were made to the corporate financing calendar. In this environment, investors and professionals pressed offerings of both the new and outstanding issues on the market, and prices closed the month on a sharp downward movement.

Contrasting with the weakness in the Treasury coupon market, the market for Treasury bills performed fairly well during October. The relative strength of the bill sector reflected a fairly persistent investment demand for shorter issues coming from corporations and public funds, along with some purchases by the System Open Market Account. At times, in fact, scarcities of issues maturing before the year-end developed. In this environment, a satisfactory reception was accorded the sale by the Treasury on October 9 of $4.5 billion of tax anticipation bills maturing next April and June and continuing additions of $100 million to the regular weekly offerings of three-month bills. Around midmonth, some caution appeared in the bill market as a result of increased bank selling of the new June tax anticipation bills, for which bidding had been relatively light, and the poor receptions accorded two newly marketed Federal agency issues. Consequently, bidding in the regular weekly auction of three- and six-month bills held on October 16 resulted in average issuing rates of 4.676 per cent and 5.165 per cent, respectively, up 11 and 14 basis points from rates established in the previous weekly auction (see Table III). Subsequently, the market steadied, and yields at the end of the month were only slightly higher than at the close of September. Bidding in the regular monthly auction of nine-month and one-year Treasury bills held on October 24 resulted in average issuing rates of 5.313 per cent and 5.302 per cent, respectively, the highest levels since November 1966.

Five new Federal agency obligations totaling $1.4 billion were offered to investors around the middle of October, wholly to replace maturing issues. Two issues of Federal Land Bank bonds, priced on October 10 to yield 5¾ per cent on a two-year maturity and 5⅞ per cent on a five-year maturity, were accorded a poor reception although the available yields were 11 basis points higher than those quoted in the secondary market on similar maturities. Initial trading in the new issues took place at prices ⅜ point lower than the original reoffering prices. Similarly, only a fair investor response was accorded two Federal Home Loan Bank issues offered a few days later, even though pricing of the later offerings had been adjusted in light of the poor performance of the earlier agency flotation.

OTHER SECURITIES MARKETS

Corporate and tax-exempt bond yields rose to successive new highs for the year through the latter part of October under the impact of a substantial increase in the volume of flotations, sizable additions to the November financing calendar, and other unfavorable influences working on the long-term markets generally. In this market environment, investors tended to ignore new issues as they were reoffered by underwriters, confident that they could acquire the same bonds in the secondary market at discounts from original reoffering prices. Briefly toward the end of the period, a better atmosphere emerged and some initially slow-moving recent offerings were sold out. On the final two days of the month, however, the market weakened again on news of substantial additions to the calendar.

In the corporate market, the volume of public offerings mounted to $1.3 billion in October from $0.8 billion in the previous month. Most issues that had been awarded in competitive bidding met with an unenthusiastic response from investors, and a number of offerings with unsold balances were freed from syndicate price restrictions. The extent of the upward yield adjustment over the month is illustrated by the performance of three public utility offerings of similar size, all rated Aa by Moody's and carrying five-year call protection. The first two of these offerings, marketed on October 4 and 17, moved slowly at reoffering yields of 6.20 per cent and 6.375 per cent, respectively, while the third, reoffered on October 18, sold out quickly at a yield of 6.44 per cent. The largest single offering of the month was a $250 million industrial issue of Aaa-rated debentures marketed on October 25. This issue, maturing in 1997 and nonrefundable for ten years, sold out rapidly at a reoffering yield of 6 per cent, equal to the peak rate on comparable offerings in 1966. Late in the month, a major steel company announced plans to sell $225 million of bonds in November, thus adding further to that month's already heavy calendar. The average yield on Moody's Aaa-rated seasoned corporate bonds rose to 5.94 per cent at the end of October from 5.68 per cent at the close of the preceding month.

On October 20, the Federal Reserve Board announced a number of proposals to broaden the coverage of its regulations governing the use of credit in securities transactions. If adopted, these proposals will be implemented through amendments to Regulations T and U and through a new Regulation G. The main proposals include one to extend margin requirements to loans for purchasing and carrying convertible bonds and one to extend margin requirements to unregulated lenders—individuals and firms other than domestic banks and brokers—who make loans for purchasing and carrying securities.

The announcement produced an immediate reaction in the convertible bond market, but left other bond markets largely unaffected. Prices of outstanding issues of convertible bonds were marked down by as much as 13 points on the day following the announcement, and two corporations postponed scheduled flotations of new convertible securities. Recently, the volume of convertible issues has risen in proportion to total corporate debt offerings, from 9 per cent in 1965 to 25 per cent in the third quarter of this year, reflecting attempts by corporations to hold down borrowing costs in a period of rapidly rising capital market yields.

In the tax-exempt sector of the bond market, most new issues marketed during the month, even though relatively small in size, were accorded poor receptions, and several scheduled offerings were postponed. The largest offering of the month, a $119 million Baa-rated New York City issue of various-purpose bonds, was awarded on October 17 at a net interest cost of 4.91 per cent, the highest for this borrower in thirty-five years and 15 basis points above the cost on the last previous borrowing by the city in October 1966. The bonds, maturing in 1969 through 1998, were reoffered at yields ranging from 4 per cent to 4.90 per cent. Distribution of this issue proceeded well in the improved market atmosphere that was developing at the time of sale. *The Weekly Bond Buyer's* average yield series for twenty seasoned tax-exempt bonds carrying ratings ranging from Aaa to Baa stood at 4.27 per cent at the end of October, compared with 4.19 per cent a month earlier.