The Money and Bond Markets in November

The money and bond markets were subject to strong crosscurrents during November. In the first part of the month, bond prices fell sharply, reflecting increasing concern over rapidly expanding demands for capital funds and the uncertain outlook for monetary and fiscal policy. Prices of corporate and tax-exempt bonds and Treasury coupon issues rebounded strongly around midmonth. The improvement was triggered by rumors of possible peace moves in Vietnam and by the news that one large corporate offering had been postponed and another halved, leading market participants to feel that some of the demands in the capital sector might be abating. The recovery halted on November 17, when the British pound came under increasing pressure in the foreign exchange markets, and the attention of the domestic money and bond markets shifted to the developing international currency crisis.

On November 18, the British government announced a 14.3 per cent devaluation of the pound from $2.80—its official value since 1949—to $2.40 and an increase in the discount rate of the Bank of England from 6½ per cent to 8 per cent (the third boost in this rate since mid-October). In the wake of the British action, the Board of Governors of the Federal Reserve System approved actions by the directors of the Federal Reserve Banks of Boston, New York, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco increasing their discount rates to 4½ per cent from 4 per cent, effective Monday, November 20. (The Federal Reserve Banks of Philadelphia and St. Louis subsequently followed suit.) The discount rate change was the first since April when the rate was lowered by ½ percentage point to 4 per cent. The Board statement explained that:

> In the light of the action of the British government to change the parity of the pound, the Federal Reserve System . . . had taken actions to assure the continued orderly functioning of United States financial markets and to maintain the availability of reserves to the banking system on terms and conditions that will foster sustainable economic growth at home and a sound international position for the dollar.
>
> . . . the Board affirmed that borrowing by member banks for purposes of making adjustments to market pressures is an appropriate use of the discount mechanism.
>
> At the same time, the Federal Reserve Board expressed its confidence in the basic economic and financial strength of the United States and pledged to do its full share in maintaining the soundness of the dollar, both domestically and internationally.

On Monday, November 20, prices of United States Government securities and corporate and tax-exempt bonds fell steeply in early trading in response to the British action and the increase in the Federal Reserve discount rate. Because of the uncertain financial situation, several corporate and tax-exempt issues which had been scheduled to be offered over the rest of the month were postponed. Market conditions remained orderly, however, and activity was largely confined to the professionals. Bond prices subsequently recovered some of their earlier losses when hopes for a tax increase and reductions in Government expenditures were revived. Treasury bill rates moved narrowly in early November and then edged lower around midmonth in response to a fairly good demand. Rates rose by 23 to 35 basis points following the discount rate increase and stabilized in the higher range. Rates on other money market instruments also quickly adjusted upward, and on November 21 most of the major commercial banks across the country raised their prime lending rates to 6 per cent from 5½ per cent.

BANK RESERVES AND THE MONEY MARKET

Money market conditions remained relatively comfortable during the first half of November. Nationwide reserve availability (see Table I) was little changed on average from the predominant October level. However, reserve distribution generally favored banks located outside the major money centers, and the basic reserve positions

Table I

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

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

Factors	Changes in daily averages—week ended on					Net changes
	Nov. 1	Nov. 8	Nov. 15	Nov. 22	Nov. 29	
"Market" factors						
Member bank required reserves*	— 61	+ 4	+ 246	— 234	+ 116	+ 71
Operating transactions (subtotal)	+ 4	— 623	— 129	+ 10	— 561	—1,299
Federal Reserve float	—275	+ 118	+ 80	+ 290	— 245	— 32
Treasury operations†	+ 152	—	— 159	+ 64	— 522	— 465
Gold and foreign account	— 34	— 74	— 6	— 10	— 25	— 155
Currency outside banks*	+ 108	— 631	— 120	— 178	— 46	— 807
Other Federal Reserve accounts (net)‡	— 7	— 34	+ 75	— 152	+ 276	+ 158
Total "market" factors	— 57	— 619	+ 117	— 224	— 445	—1,228
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 122	+ 490	+ 3	— 1	+ 635	+1,249
Bankers' acceptances	—	+ 1	—	—	+ 1	+ 2
Repurchase agreements:						
Government securities	—	+ 141	+ 12	— 31	— 75	+ 47
Bankers' acceptances	—	—	—	—	—	—
Federal agency obligations	—	+ 14	— 12	+ 1	— 1	+ 2
Member bank borrowings	+ 22	+ 52	+ 30	— 35	— 8	+ 61
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+ 146	+ 697	+ 32	— 64	+ 551	+1,301
Excess reserves*	+ 88	+ 78	+ 149	— 288	+ 106	+ 133

Member bank:	Daily average levels					
Total reserves, including vault cash*	24,698	24,772	24,675	24,621	24,611	24,675§
Required reserves*	24,420	24,416	24,170	24,404	24,288	24,340§
Excess reserves*	278	356	505	217	323	336§
Borrowings	80	132	162	127	119	124§
Free reserves*	198	224	343	90	204	212§
Nonborrowed reserves*	24,618	24,640	24,512	24,494	24,492	24,551§

System Account holdings of Government securities maturing in:	Changes in Wednesday levels					
Less than one year	+ 443	+ 157	—1,110	+ 160	+ 369	+ 19
More than one year	—	—	+1,227	+ 186	—	+1,413
Total	+ 443	+ 157	+ 117	+ 346	+ 369	+1,432

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 five weeks ended on November 29.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS NOVEMBER 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Averages of five weeks ended on Nov. 29*
	Nov. 1	Nov. 8	Nov. 15	Nov. 22	Nov. 29*	
Eight banks in New York City						
Reserve excess or deficiency(—)†	17	27	22	10	38	23
Less borrowings from Reserve Banks	5	—	36	29	8	16
Less net interbank Federal funds purchases or sales(—)	73	299	312	— 85	— 233	73
Gross purchases	*897*	*985*	*967*	*916*	*874*	*928*
Gross sales	*824*	*686*	*655*	*1,001*	*1,107*	*855*
Equals net basic reserve surplus or deficit(—)	— 61	— 271	— 326	66	263	— 66
Net loans to Government securities dealers	927	800	670	861	757	803
Thirty-eight banks outside New York City						
Reserve excess or deficiency(—)†	15	18	21	31	— 16	14
Less borrowings from Reserve Banks	11	49	54	28	40	36
Less net interbank Federal funds purchases or sales(—)	476	973	858	924	449	736
Gross purchases	*1,636*	*1,949*	*1,795*	*2,060*	*1,673*	*1,823*
Gross sales	*1,159*	*977*	*936*	*1,136*	*1,224*	*1,086*
Equals net basic reserve surplus or deficit(—)	— 473	—1,004	— 891	— 920	— 505	— 759
Net loans to Government securities dealers	677	630	590	601	506	601

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—November 1967			
	Nov. 6	Nov. 13	Nov. 20	Nov. 27
Three-month	4.672	4.648	4.989	4.957
Six-month	5.180	5.155	5.517	5.536

Maturities	Monthly auction dates—September-November 1967		
	September 26	October 24	November 22
Nine-month	5.145	5.313	5.422
One-year	5.124	5.302	5.430

* 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.

of "city" banks deteriorated (see Table II). In order to cover mounting reserve deficiencies, reserve city banks purchased a substantial amount of Federal funds (generally at rates ranging from 4 per cent to 4⅛ per cent) and also borrowed from the Federal Reserve Banks.

The money market functioned smoothly in the wake of the devaluation of the pound sterling, the rise in the British bank rate, and the increase in the Federal Reserve discount rate. Federal funds traded chiefly around the higher discount rate. The money market was essentially comfortable despite some decline in average nationwide free reserves. Reserves shifted heavily toward the major money center banks, and the excess reserves of "country" banks remained on the low side.

Other money market rates advanced following the discount rate increase. By the close of the month, bankers' acceptance rates had risen ¼ percentage point above their late October levels, dealer offering rates on prime four- to six-month commercial paper had moved ⅜ percentage point higher, rates on many maturities of directly placed finance company paper had increased ¼ percentage point, and the New York City banks were generally quoting the 5½ per cent ceiling rate on new time certificates of deposit maturing in ninety days or more. On November 20, a large commercial bank in Chicago announced an immediate increase in its prime loan rate from 5½ per cent to 6 per cent, a rise matched by most major commercial banks the following day.

THE GOVERNMENT SECURITIES MARKET

A very cautious atmosphere persisted in the market for Treasury notes and bonds during the early part of November. Participants became increasingly apprehensive over the extremely large financing calendar in other sectors of the capital market. The conviction also grew that the fading prospects for enactment of the Administration's tax increase proposal might necessitate some tightening in monetary policy in order to combat inflationary pressures. Against this background, offerings from dealers and others expanded and prices declined sharply through November 13. (The corresponding rise in yields is illustrated in the right-hand panel of the chart.) Losses recorded by coupon issues maturing within five years ranged as high as a full point, while prices of longer term issues fell by ¾ point to more than 3 points. To a considerable extent, the price declines represented markdowns in dealer quotations as they attempted to reduce their inventories in the face of light demand.

A better tone emerged in the coupon sector around midmonth—first in response to rumors that the outlook for Vietnam peace negotiations might be brightening. The market was further buoyed when the United States Steel Corporation postponed a $225 million offering of thirty-year debentures which had been scheduled to reach the market on November 14. This action, together with the reduction in the size of another large corporate offering, removed some immediate pressure from the heavily burdened capital market and prompted professional short covering in Government securities. At the same time, investor interest in coupon issues broadened, partly reflecting reinvestment of the proceeds of Treasury securities which matured on November 15. Thus, from November 14 through November 16, prices rallied sharply and some long-term issues recorded gains of more than a point.

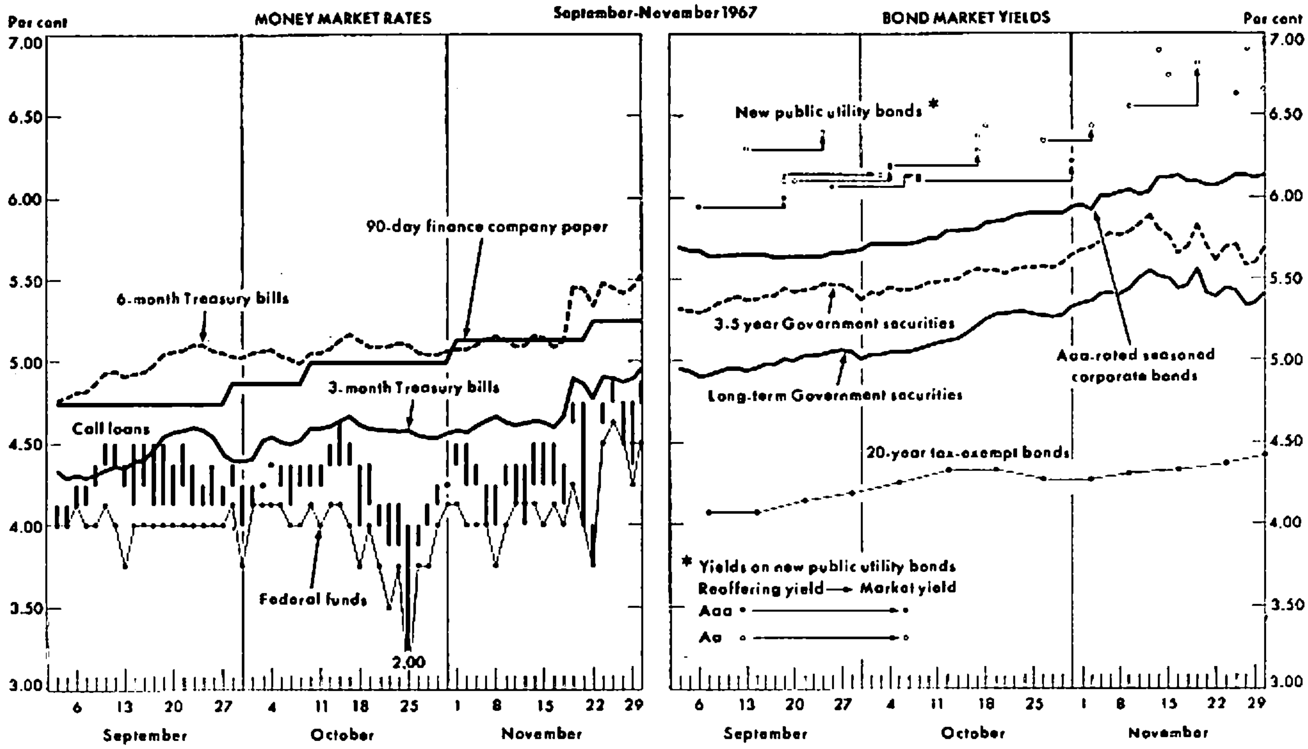
On Friday, November 17, the British pound came under severe pressure in foreign exchange markets. Prices of Treasury notes and bonds fell in response to rumors that the pound might be devalued and to official comments that, if taxes were not increased, the budget deficit might rise as high as $30-35 billion. At the lower price levels for coupon issues, some professional short covering took place and prices steadied late in the day.

When trading opened on Monday, November 20, prices of coupon issues initially plummeted on the weekend news of the British actions and the Federal Reserve discount rate increase. Subsequently, however, the market steadied and the price losses were pared. Early action by the System Open Market Account facilitated an orderly adjustment by the market to the new situation. At the close of trading on November 20, prices of coupon issues due within two years were $\frac{2}{32}$ to $\frac{8}{32}$ lower for the day, intermediate-term issues were down $\frac{8}{32}$ to $\frac{20}{32}$, and prices of longer term bonds were from ¾ point to a full point lower (after having dropped as much as 1⅝ points earlier that day). Prices of coupon issues rebounded on November 21 and 22 after the announcement that the House Ways and Means Committee would meet the following week to examine new Administration fiscal proposals. This development sparked optimism in the bond sector that a tax increase might yet materialize. In this buoyant atmosphere, reports of the rise in the prime loan rate of the major commercial banks had little adverse effect. The rally was interrupted by concern over the heavy demand for gold in London on November 24, but prices largely retraced their declines after speculative demands for gold died down. However, at the very end of the month, prices again came under heavy downward pressure as hopes faded for Congressional action on the Administration's surtax proposal before the end of the year.

The pattern of price movements in the market for Government agency obligations generally paralleled the be-

SELECTED INTEREST RATES

September-November 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.

havior of the coupon sector during the month. Prices declined sharply early in the period, but a better tone emerged around midmonth when new offerings from the Federal Home Loan Banks and the Banks for Cooperatives were accorded good investor receptions. In the wake of the British devaluation and the increase in the Federal Reserve discount rate, prices of agency obligations first moved lower and then recovered a portion of their earlier losses. On November 28, a Federal National Mortgage Association (FNMA) offering of new participation certificates reached the market. The financing consisted of \$350 million which was placed directly with Government investment accounts and \$650 million which was publicly floated. The public offering included \$450 million of certificates maturing in February 1970, which were priced at par to yield 6.35 per cent, and \$200 million (priced at par to yield 6.40 per cent), which will come due in December 1987. At the attractive offering yields, considerable demand developed for the certificates and they were rapidly sold.

A fairly good atmosphere persisted in the Treasury bill market during the first half of November. Early in the month, bill rates fluctuated irregularly when the weak tone of the Treasury coupon sector occasionally triggered expanded bill offerings. As the month progressed, however, a broadly based demand for bills developed, particularly for shorter maturities and tax anticipation issues, and rates generally edged lower from November 8 through November 16 (see the left-hand panel of the chart). On November 17, bill rates fluctuated quite widely, mainly in professional trading, as the international financial situation became more uncertain.

After the events of the November 18-19 weekend, rates on outstanding bills moved upward by 23 to 35 basis points. Timely System action aided the adjustment in this sector, and a steadier tone quickly emerged. At the regular weekly auction held on Monday afternoon, a good demand developed at the high prevailing rate levels. Average issuing rates were set at 4.989 per cent for the new three-month bills and 5.517 per cent for the new six-month bills (see Table III)—34 and 36 basis points higher, respectively, than the average issuing rates at the November 13 auction and 45 and 47 basis points higher, respectively, than rates set at the last weekly auction in October. The tone of the bill market quickly strengthened in response to good demand, and rates generally receded on November 21 and 22. Over the remainder of the month, rates fluctuated around the higher levels.

At the final regular weekly auction of the month on November 27, average issuing rates were set at 4.957 per cent for the three-month bills and 5.536 per cent for the six-month bills, 42 and 49 basis points, respectively, above rates set at the final weekly auction in October.

OTHER SECURITIES MARKETS

A mood of apprehension continued to plague the markets for corporate and tax-exempt bonds in early November. During this period, market attention was focused upon the steady stream of financing announcements—which swelled an already substantial calendar of scheduled new corporate and tax-exempt bond offerings to nearly $2 billion. In addition, FNMA revealed plans for its November 28 sale of participation certificates. As the bond sector became increasingly unsettled by the burgeoning demands for capital funds and the uncertain outlook for monetary and fiscal policy, several slow-moving corporate issues were released from syndicate price restrictions with subsequent upward adjustments in yields of as much as 45 basis points. Prices of tax-exempt bonds were also cut sharply.

The gloom which had pervaded the corporate and tax-exempt sectors for weeks began to lift on November 13. The improvement reflected reports that a new Vietnam peace move might be under way, together with news that the United States Steel Corporation had decided to postpone a $225 million offering of thirty-year debentures originally scheduled to reach the market on November

14, and that another corporate offering of convertible debentures which was floated on November 13 had been cut in half to $100 million. Subsequent flotations drew a lively response from underwriters and investors, while investment demand for seasoned issues also expanded. Prices of outstanding issues rebounded by as much as a point on November 14 and 15.

After the financial developments of the November 18-19 weekend, prices of corporate and tax-exempt bonds fell as much as 2 points or more on November 20. As was the case in the Treasury coupon sector, price losses were quite sharp in early trading, but steadier market conditions developed as the day progressed. One corporate issue was released from syndicate with an upward adjustment of about 28 basis points in yield. A week later a sizable Aaa-rated utility issue was sold out at a 6⅝ per cent yield at a time when market participants were hopeful of Congressional tax action. The month closed on a more somber note as these hopes seemed to be fading.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 19 basis points to 6.13 per cent, while *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) rose by 15 basis points to 4.42 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.