The Money and Bond Markets in July

Interest rates moved substantially lower during July, while expectations mounted that the fiscal restraint legislation enacted in late June would moderate economic growth and reduce overall credit demands. As the month progressed, opinion in the financial markets turned increasingly to the view that the pace of economic expansion was already slowing, and there was widespread discussion in the market concerning the possibility of an easing of monetary policy. Activity in the markets for intermediate- and long-term Government securities expanded sharply since market participants, anticipating lower interest rates in the future, sought to commit funds at prevailing rate levels and to lengthen the maturity of their portfolios. Consequently, average market yields on Treasury coupon securities fell by 35 basis points on intermediate issues and 15 basis points on long-term maturities. In the corporate and tax-exempt markets, an unusually heavy volume of new securities reoffered by underwriters around midmonth, at yields considerably lower than those offered on comparable issues in recent periods, was accorded an enthusiastic reception by investors.

Rates on longer Treasury bills fell sharply during July, despite the sale of $4.0 billion of tax anticipation bills near midmonth. In the three- to six-month area, however, rate declines were relatively modest because of occasional selling pressures. Rates on bankers' acceptances, prime commercial paper, and directly placed finance company paper were reduced during the month, and the rate charged by the Federal Reserve System on repurchase agreements with nonbank Government securities dealers was also lowered. Around midmonth, rates offered by the large New York City banks on new large-denomination negotiable certificates of deposit (C/D's) with maturities of six months or more were reduced lower than the 6¼ per cent Regulation Q ceiling adopted in April. Later, offering rates on new three-month C/D's were dropped below their 6 per cent legal ceiling. At the declining pattern of offering rates, the city banks succeeded in expanding their C/D liabilities steadily over the period. Despite a moderate increase in average net reserve availability at member banks in July, the effective rate for Federal funds remained generally in a 6 to 6⅛ per cent range.

BANK RESERVES AND THE MONEY MARKET

The money market was generally steady in July, and banks were under somewhat less reserve pressure than in June. Average borrowings from the Reserve Banks fell substantially, reflecting both the improved availability of reserves and a marked decline in the average level of excess reserves carried by the "country" banks. Average net borrowed reserves of all member banks were $199 million for the five statement weeks ended in July (see Table I), compared with $397 million in June. The net reserve position of the banking system ranged widely within the month, from average net borrowed reserves of $310 million in the opening week to average free reserves of $39 million in the second week. The sharp reserve improvement in the latter week failed to produce any money market easing, however, with gains largely concentrated in banks outside the major money centers.

Throughout the month, the effective rate for Federal funds remained generally at a premium of ½ to ⅝ percentage point over the discount rate. Around midmonth, pressures from a number of sources converged on the large banks in New York City and other major money centers. Financing needs of United States Government securities dealers increased substantially, the Treasury made very heavy calls on Tax and Loan Accounts, and on July 11 the banks had to pay for large awards of both regular Treasury bills and the new tax anticipation issue. In preparation for anticipated heavy reserve losses, the New York City institutions early in the month sharply stepped up their borrowing from branches overseas. Over the first three statement weeks of the month, average Euro-dollar holdings of the city banks soared a record $720 million. Nevertheless, the average basic reserve deficit jumped to $700 million in the statement week ended on July 17 from about $250 million earlier in the month (see Table II). This deficit subsequently rose even higher, reflecting the further expansion of dealer financing and the repayment of a portion of the Euro-dollars previously acquired. Although bank demand for Euro-dollars was unusually heavy over much of the month, rates on these

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JULY 1968

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

Factors	Changes in daily averages— week ended on					Net changes
	July 3	July 10	July 17	July 24	July 31	
"Market" factors						
Member bank required reserves*	− 16	+ 253	− 240	− 133	+ 47	− 178
Operating transactions (subtotal)	− 245	+ 56	+ 386	+ 192	− 354	+ 34
Federal Reserve float	+ 94	+ 195	− 113	+ 103	− 406	− 127
Treasury operations†	− 140	+ 259	− 194	+ 88	− 19	− 6
Gold and foreign account	− 24	+ 4	+ 20	+ 13	− 13	+ 6
Currency outside banks*	− 282	− 639	+ 375	+ 207	+ 132	− 208
Other Federal Reserve accounts (net)‡	+ 108	+ 288	+ 200	− 220	− 97	+ 369
Total "market" factors	− 260	+ 319	+ 45	+ 59	− 307	− 144
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 420	− 14	− 313	+ 14	+ 180	+ 287
Bankers' acceptances	+ 6	− 1	—	− 1	+ 1	+ 5
Repurchase agreements:						
Government securities	− 140	+ 75	+ 29	− 104	+ 34	− 112
Bankers' acceptances	− 22	− 35	+ 10	− 18	+ 46	− 17
Federal agency obligations	− 66	+ 4	− 4	—	—	− 66
Member bank borrowings	− 314	− 81	+ 58	+ 169	− 37	− 205
Other loans, discounts, and advances	—	—	+ 1	− 1	—	—
Total	− 123	− 61	− 220	+ 50	+ 227	− 108
Excess reserves*	− 383	+ 258	− 175	+ 118	− 80	− 252

	Daily average levels					
Member bank:						
Total reserves, including vault cash*	25,834	25,839	26,001	26,255	26,138	26,012§
Required reserves*	25,651	25,388	25,728	25,861	25,814	25,688§
Excess reserves*	183	451	276	394	314	324§
Borrowings	493	412	470	639	602	523§
Free (+) or net borrowed (−) reserves*	− 310	+ 39	− 194	− 245	− 288	− 199§
Nonborrowed reserves*	25,341	25,427	25,531	25,616	25,536	25,489§

	Changes in Wednesday levels					
System Account holdings of Government securities maturing in:						
Less than one year	+ 136	− 192	+ 280	− 414	+ 493	+ 303
More than one year	+ 62	—	—	—	—	+ 62
Total	+ 198	− 192	+ 280	− 414	+ 493	+ 366

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 July 31, 1968.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JULY 1968

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Averages of five weeks ended on July 31*
	July 3	July 10	July 17	July 24	July 31*	
Eight banks in New York City						
Reserve excess or deficiency(−)†	67	20	22	− 9	68	34
Less borrowings from Reserve Banks	26	2	25	11	—	13
Less net interbank Federal funds purchases or sales(−)	173	404	697	704	860	568
Gross purchases	*1,152*	*1,451*	*1,337*	*1,277*	*1,488*	*1,341*
Gross sales	*979*	*1,047*	*640*	*573*	*628*	*773*
Equals net basic reserve surplus or deficit(−)	− 132	− 386	− 700	− 724	− 792	− 547
Net loans to Government securities dealers	615	737	1,231	1,823	1,595	1,200
Thirty-eight banks outside New York City						
Reserve excess or deficiency(−)†	41	59	22	29	36	37
Less borrowings from Reserve Banks	115	73	96	260	157	140
Less net interbank Federal funds purchases or sales(−)	945	1,037	1,380	1,059	698	1,024
Gross purchases	*2,268*	*2,476*	*2,475*	*2,214*	*1,984*	*2,283*
Gross sales	*1,323*	*1,439*	*1,095*	*1,155*	*1,288*	*1,260*
Equals net basic reserve surplus or deficit(−)	−1,020	−1,051	−1,454	−1,290	− 819	−1,127
Net loans to Government securities dealers	168	202	351	401	606	346

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—July 1968				
	July 1	July 8	July 15	July 22	July 29
Three-month	5.400	5.368	5.467	5.293	5.190
Six-month	5.589	5.410	5.554	5.366	5.287

	Monthly auction dates—May-July 1968		
	May 23	June 25	July 24
Nine-month	6.086	5.745	5.342
One-year	6.079	5.731	5.309

* 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.

funds declined steadily and sharply. Rates posted by the New York City banks on new call loans to United States Government securities dealers were raised to a range of 6⅜ to 6⅝ per cent at midmonth from the 5⅞ to 6 per cent range that had prevailed at the start of the month, but were subsequently lowered.

Dealers in bankers' acceptances lowered rates by ¼ percentage point through two reductions of ⅛ percentage point each on July 10 and July 18, bringing the offering rate on ninety-day paper to 5¾ per cent. The move, occurring at a time when the money market was under increased pressure, was in line with the consensus in the financial markets that interest rates were slated for a near-term decline. The Federal Reserve System reduced the rate it charges on repurchase agreements with nonbank dealers in United States Government securities in two steps, of ⅛ percentage point each on July 5 and July 17, to 5½ per cent. Near the month end, dealers in prime commercial paper lowered their offering rate on four- to six-month paper by ¼ percentage point to 6 per cent, and major finance companies reduced their offering rate on paper placed directly with investors by ⅛ percentage point to 5⅞ per cent for 30- to 270-day maturities. Large New York City banks began a gradual rollback of offering rates on new negotiable C/D's early in July, adjusting rates first on maturities of one-year or more and later on progressively shorter maturities. By the close of the month, a rate of 5¾ per cent was generally in effect on maturities of nine months or more and a 5⅞ per cent rate on maturities of three to nine months. Posted rates on longer maturities were thus ⅛ to ½ percentage point lower than the maximum permissible rates under Regulation Q. Rates on C/D's of shorter maturities, however, remained at their legal ceilings. Despite the declining trend of offering rates, large banks across the country succeeded well in attracting C/D funds: in the four weeks ended on July 24, C/D liabilities of the weekly reporting banks rose by $2.0 billion, even though an estimated $5.4 billion of outstanding issues matured during the month.

THE GOVERNMENT SECURITIES MARKET

Prices of Treasury coupon securities recorded further sharp gains during July on a greatly expanded volume of trading. Dealers were encouraged at the start of the month when selling by investors did not materialize. Such selling had been regarded as a potential influence on the market since the Congressional passage of the surtax-spending legislation on June 21 and 22. Over much of July, in fact, there was considerable investment demand for intermediate-term issues, both outright and on maturity-lengthening switches. This demand was augmented, at times, by strong professional buying for inventory purposes and by demand from speculative sources.

The generally buoyant atmosphere in the market reflected the growing conviction of participants that a decline in interest rates was inevitable now that the Federal Government's fiscal restraint program was in operation. Early in the month, reports that the monetary authorities wanted lower interest rates sparked a sharp rally. While this soon faded, optimism revived following the second reduction in the rate charged by the System on repurchase agreements with nonbank dealers. This move was interpreted in market circles as a signal that some modification of the policy of monetary restraint had been made. Expectations of lower interest rates were further reinforced by discussion in the press of the possible slowdown in the pace of economic expansion, suggested by recently released data, and by the publication of New York City banking statistics revealing a tax-period increase in business loans which was much smaller than many had expected in light of the sharp increase of corporate income tax payments. During July, corporations were required to make accelerated income tax payments and, under the recently enacted tax legislation, to pay one third of their total surtax liability for calendar 1968.

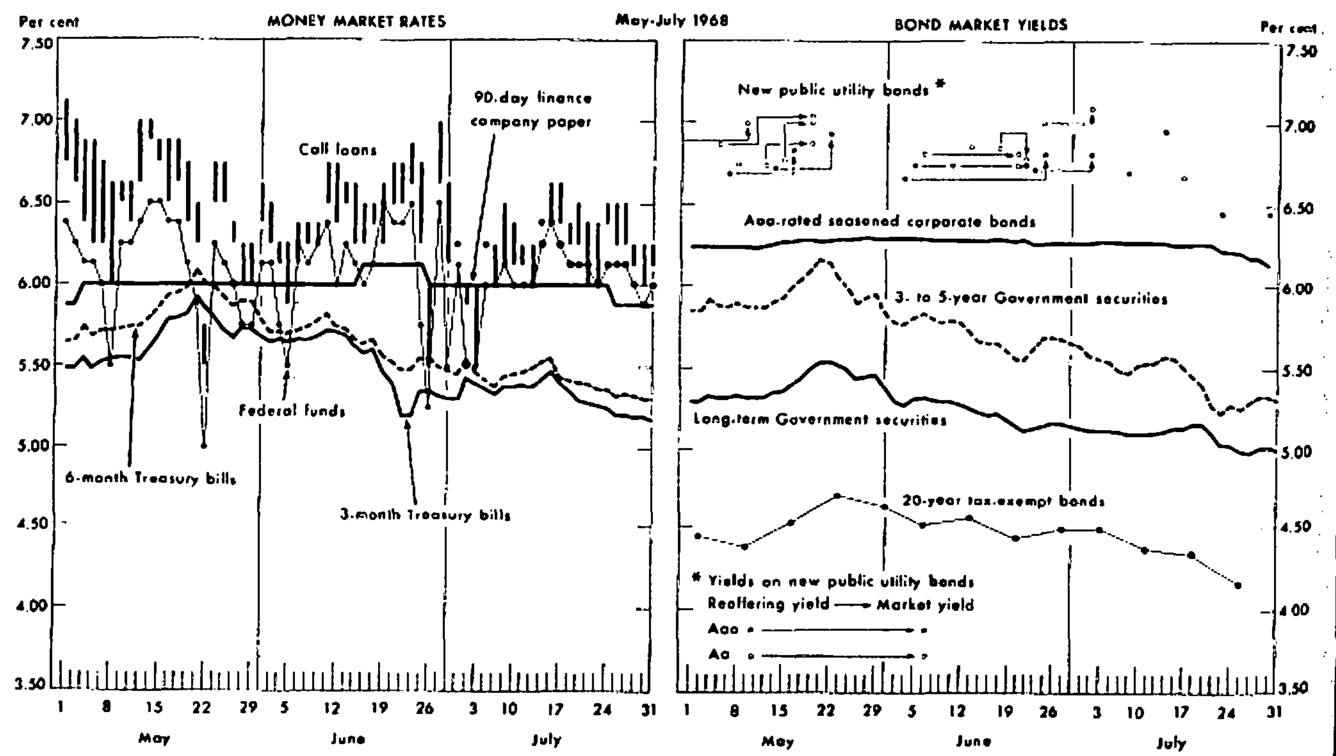
Against these favorable market influences, several factors worked to restrain coupon prices during the first half of July. The prospect of substantial Treasury cash borrowing in the latter half of the year and the month's heavy calendar of corporate and tax-exempt debt offerings exerted pressure on the long-term sector over the first half of the period. However, the sale of participation certificates by the Federal National Mortgage Association (FNMA) at midmonth served to galvanize investor interest and contribute to the downward thrust of yields. Later, market participants became more cautious with the approach of the Treasury's August refunding, but prices firmed at the close of the month as a strong interest developed for an expected long option in the financing. For the month as a whole, price increases amounted to as much as $1^{13}/_{16}$ points in the three- to five-year area and 2¼ points in longer issues.

The Treasury announced on July 31 an offering of 5⅝ per cent six-year notes to redeem $8.6 billion of securities maturing on August 15 (of which approximately $3.6 billion is publicly held) and to raise $1.5 billion of cash. The new issue is priced at 99.62 to yield 5.70 per cent, 30 basis points less than the yield on a similar offering last May. Banks will be permitted to pay for 50 per cent of their acquisitions by crediting Treasury Tax and Loan Accounts. The announcement met with a very favorable response from the market.

Market rates on Treasury bills declined on balance during July, despite the additional supply in the market resulting from the sale by the Treasury on July 11 of $4 billion of tax anticipation bills to mature in March and April of 1969. In the auction held on July 2, the new bills were awarded at average issuing rates of 5.399 per cent for the eight-month issue and 5.424 per cent for the nine-month maturity. Commercial banks, who were permitted to make payment through credits to Treasury Tax and Loan Accounts, bid aggressively for the offering and resold less of their awards of the bills than expected.

The tone of the bill market was generally firm in the early part of the month, when a strong investment demand for longer issues encountered a relatively limited supply of offerings. Shorter bills, however, came under some selling pressure during this period since commercial banks reversed purchases that had been made prior to the June 30 statement publishing date. Around midmonth, bill rates backed up temporarily throughout the list under the impact of professional profit-taking activity, a rise in dealer financing costs, and the liquidation of bills by commercial banks. Once the midmonth pressures in the money market had subsided, however, a strong tone reemerged in the bill market. Investment demand revived, and the rate decline was given further impetus on July 17 by the second cut in the System's rate on repurchase agreements. Bidding in the monthly auction of nine- and twelve-month bills, held on July 24, was aggressive, resulting in average issuing rates of 5.342 per cent and 5.309 per cent, respectively,

SELECTED INTEREST RATES



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.

down 40 and 42 basis points from rates established in the previous monthly auction (see Table III).

Prices of Federal agency issues moved moderately higher in early July, largely as a result of the temporary lull in agency financing. Around midmonth, however, prices weakened in response to the July 17 announcement of a $1.33 billion offering of participation certificates by FNMA, scheduled for the final week of the month, and to the heavy volume of new corporate and tax-exempt securities in the market. Following the initial unfavorable impact of the announcement, investor response to the offering was quite enthusiastic, and the certificates were in heavy demand at yields roughly ¼ percentage point lower than those on a similar financing last March. The FNMA issue consisted of an $800 million portion offered to the public and $530 million sold directly to Government investment accounts. The public offering included a $300 million ten-year issue, priced to yield 6.125 per cent, and a $500 million twenty-year issue, priced to yield 6.20 per cent.

OTHER SECURITIES MARKETS

Financing activity in the corporate and tax-exempt bond markets was relatively light during early July but expanded sharply around midmonth. Nevertheless, reoffering yields trended lower during the month under the impact of the spreading optimism in the capital markets over the future course of interest rates. In the corporate sector, an attitude of wariness was evident on the part of investors as the month opened. Two syndicates were dissolved with large unsold balances of public utility bonds, which had been aggressively priced by underwriters in the latter part of June immediately following the passage of the surtax-spending legislation. After the removal of syndicate pricing restrictions, yields on these issues were adjusted upward by 9 basis points. Early in the month, a public utility Aaa-rated issue with five-year call protection received an initially unenthusiastic reception at a reoffering yield of 6.70 per cent, 2 basis points lower than the yield on a similarly rated utility offering in late June. Distribution of this and several other slow-moving issues accelerated, however, in the wake of the rapid sellout on July 11 of a $250 million Aaa-rated industrial offering of 6½ per cent bonds carrying ten-year call protection.

Most corporate issues marketed during the latter half of July were accorded a favorable investor response, as expectations of lower rates spurred investor demand. Illustrating the sharp improvement in the market tone, a new Aa-rated utility issue was offered to investors at midmonth at a yield of 6.67 per cent (compared with a 7 per cent reoffering yield on a similar issue sold on May 20) and was traded in the market near the month end at prices to yield about 6.45 per cent. Prices of outstanding corporate bonds increased over the month, and the average yield on Moody's Aaa-rated seasoned issues fell over the month to 6.14 per cent from 6.27 per cent (see chart).

The market for tax-exempt securities displayed a somewhat more confident attitude during the first half of July, and a few of the relatively scant number of new offerings sold out rapidly. With the sharp expansion in the financing calendar at midmonth, however, a number of offerings (which were aggressively priced) encountered investor resistence, and some temporary congestion developed in the market. By July 17, the Blue List of dealers' advertised inventories had risen to a 1968 record of $698 million, after having been at $570 million approximately one week earlier. Among the offerings encountering initially lukewarm receptions were large issues of the State of California, New York State, New York City, and Maryland, all of which carried yields roughly 5 to 15 basis points lower than recent comparable offerings. Subsequently, the market tone improved rapidly, facilitating sales of these and other issues, and the Blue List declined gradually through the latter part of the month to $482 million, compared with $669 million at the close of June. *The Weekly Bond Buyer's* average yield series for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) declined by 32 basis points over the month to 4.16 per cent.