The Money and Bond Markets in August

A sizable volume of debt offerings produced considerable congestion in the capital markets during August despite continued confidence among market participants that fiscal restraint would lead to lower interest rates over the months ahead. An enthusiastic reception was accorded the Treasury's sale to the public on August 5 of a 5⅝ per cent six-year note (priced to yield 5.70 per cent) to refinance $3.6 billion of publicly held issues maturing on August 15 and to raise an estimated $1.5 billion of cash. Subsequently, the very size of the issue—the largest cash offering of comparable maturity since World War II—served to restrain prices of intermediate- and longer term Government coupon securities as distribution of the new note to investors proceeded. The technical reduction of the Federal Reserve discount rate to 5¼ per cent from 5½ per cent, which began at midmonth, aligned the rate with changes in money market conditions which had resulted from increased fiscal restraint. This action helped sustain market long-term expectations of lower rates, but prices of most Government coupon securities maturing beyond four years were lower over the month as a whole. The new 5⅝'s closed at 99$^{30}/_{32}$ bid, a premium of about $^{10}/_{32}$ over its issuing price, after having traded as high as 100$^{6}/_{32}$ immediately after the discount rate cut.

Yields on new tax-exempt bonds rose during August, as approximately $1.7 billion of new offerings followed the July buildup of professional inventories. *The Weekly Bond Buyer's* index of yields on twenty tax-exempt bonds rose from the year's low of 4.07 per cent on August 8 to 4.38 per cent on August 29. In the corporate bond market, investor resistance to lower yields led to mixed receptions for the month's new issues. However, the moderate volume of offerings during August, an estimated $660 million, tempered the tendency of corporate yields to work higher.

Most short-term interest rates moved sharply lower at the beginning of the month, as the Treasury's refunding of August 15 maturities into a six-year issue shifted a large volume of debt out of the short-term area. The rate on three-month Treasury bills plummeted from 5.17 per cent bid on July 31 to as low as 4.88 per cent bid on the morning of August 5. However, the large financing needs of dealers in Government and other securities continued to converge on the major money market banks, which were also accumulating securities and experiencing large Treasury calls on Tax and Loan Accounts. These banks were consequently under heavy reserve pressure as reflected in the Federal funds market where effective rates of 6 per cent or above persisted beyond midmonth. The rates posted by the New York City banks on new loans to Government securities dealers were as high as 6½ to 6⅞ per cent in the first half of the month, well above July levels, placing strong pressure on dealers to reduce their positions especially in Treasury bills. As a result, Treasury bill rates rose, and the three-month bill rate fluctuated approximately in a 5.10 to 5.20 per cent range in the last two thirds of the month. Following the reduction in the Federal Reserve discount rate, the Federal funds rate eased somewhat in the second half of the month to a 5¾ to 6 per cent range and bank lending rates on new call loans to securities dealers declined late in the period to a 6⅜ to 6⅝ per cent range.

BANK RESERVES AND THE MONEY MARKET

The tone of the money market was generally quite firm during the first half of August. The basic reserve deficit of the major money market banks increased sharply, primarily as a result of continued heavy borrowing by securities dealers (partly in connection with the Treasury's August financing), large Treasury calls on Tax and Loan Accounts, and an increase in bank investments. In the face of substantial demands for securities loans and considerable reserve pressures, the major New York City banks during this period posted rates on new call loans to Government securities dealers generally in a high 6½ to 6⅞ per cent range. The average basic reserve deficit of the New York City banks in the two statement periods ended on August 14 was almost $1.5 billion, substantially above the $547 million average level recorded over the five statement periods in July. At the thirty-eight major reserve city banks outside New York, the basic reserve deficit averaged $1.2 billion during the interval (see Table II), little changed from the high July average. In order to fill their large reserve needs, the money market banks borrowed heavily in the Federal funds market (where the effective rate ranged from 6 to 6¼ per cent) and satisfied their residual reserve needs in part through expanded borrowing from the Federal Reserve Banks. Nationwide net borrowed reserves during the first half of the month averaged about $315 million (see Table I), compared with an average of approximately $190 million in the five statement periods ended on July 31. Aggregate member bank borrowings from the Federal Reserve Banks averaged $657 million during the first half of August, as against a $523 million average level in July.

The tone of the money market remained relatively firm, following the ¼ percentage point decrease (from 5½ per cent to 5¼ per cent) in the discount rates of the Federal Reserve Banks of Minneapolis (effective August 16) and Richmond (effective August 19)[1] and the similar reduction on August 16 in the rate charged by the Federal Reserve on repurchase agreements with nonbank dealers in Government securities. The major money market banks continued to report large basic reserve deficits, reflecting not only the persisting impact of dealer borrowing, but also bank acquisitions of securities. Market pressures diminished somewhat after midmonth when the distribution of reserves gradually became more favorable to the money market banks. The effective rate on Federal funds eased to a 5¾ to 6 per cent range, and bank rates on dealer call loans were quoted in a 6⅜ to 6⅝ per cent range for new loans.

Several adjustments were made during August in the rates on various money market instruments. By the end of the month, bankers' acceptance rates were generally ⅛ percentage point below their July 31 levels, and rates on directly placed and dealer-placed commercial paper were approximately ¼ per cent and ⅛ per cent lower, respectively.

The large weekly reporting banks continued in August to realize a net inflow of funds in the form of large-denomination negotiable certificates of deposit (C/D's); the volume of outstanding C/D's rose over the month by an estimated $833 million. Rates on C/D's coming due within two months generally remained at the 5½ per cent Regulation Q ceiling applicable to this maturity area. However, most of the large New York City banks offered new C/D's of longer maturity at posted rates from ¼ percentage point to ¾ percentage point below the ceiling rates (which are 5¾ per cent for 60- to 89-day C/D's, 6 per cent for 90- to 179-day C/D's, and 6¼ per cent for longer term C/D's). In their efforts to fill substantial reserve needs, the large reporting banks supplemented the inflow of C/D funds with a substantial volume of borrowings from overseas branches. Their liabilities to foreign branches rose by approximately $880 million during August.

[1]Actions by the other districts between August 23 and August 30 made the new 5¼ per cent discount rate uniform throughout the Federal Reserve System. The New York Federal Reserve Bank lowered its rate on August 30.

THE GOVERNMENT SECURITIES MARKET

Activity in the market for Government notes and bonds was dominated early in the month by the Treasury's large August financing operation, the terms of which were disclosed at the end of July. The Treasury offered a 5⅝ per cent six-year note (priced at 99.62 to yield about 5.70 per cent) to replace $8.6 billion of outstanding securities maturing on August 15 and to raise an estimated $1.5 billion of new cash. Approximately $5.1 billion of the note was offered to the public (which held $3.6 billion of the maturing securities), while an additional portion of the offering was earmarked for Government investment accounts and the Federal Reserve Banks. The announcement of the financing operation was received with enthusiasm in the market. Many observers considered the 5.70 per cent offering yield generous, especially in light of their anticipations of a near-term decline in interest rates. In initial trading following the announcement, only a minor and brief downward adjustment in prices of outstanding coupon issues occurred. Prices rapidly recovered, and during the first two trading days of August rose throughout the maturity spectrum in response to broad professional and investment demand. The underlying tone of the coupon sector was quite strong during this period, amid further discussion in the market of the prospects for a decline in interest rates, including the Federal Reserve discount rate and the prime lending rate of commercial banks. It was generally believed, moreover, that the Treasury's offering would be substantially oversubscribed.

A less buoyant tone emerged in the coupon sector from August 5 through about midmonth, as diverse market influences came into play. Early in this period, activity in outstanding issues slackened and some profit taking—primarily from professional sources—occurred as the market awaited the outcome of the Treasury's financing. The Treasury announced the financing results on August

Table I

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

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

Factors	Changes in daily averages—week ended on August 7	August 14	August 21	August 28	Net changes
"Market" factors					
Member bank required reserves*	— 50	+ 309	— 153	+ 107	+ 213
Operating transactions (subtotal)	— 427	— 219	+ 49	— 57	— 654
Federal Reserve float	+ 18	— 9	+ 346	— 261	+ 94
Treasury operations†	+ 198	— 65	— 64	— 80	— 11
Gold and foreign account	— 49	+ 15	+ 16	+ 48	+ 30
Currency outside banks*	— 518	— 225	+ 126	+ 218	— 399
Other Federal Reserve accounts (net)‡	— 76	+ 65	— 373	+ 14	— 370
Total "market" factors	— 477	+ 90	— 104	+ 50	— 441
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 76	+ 52	+ 392	+ 59	+ 579
Bankers' acceptances	— 2	— 1	— 1	—	— 5
Repurchase agreements:					
Government securities	+ 276	— 17	— 112	— 181	— 34
Bankers' acceptances	— 7	— 8	— 18	— 15	— 48
Federal agency obligations	+ 12	—	— 10	— 2	—
Member bank borrowings	+ 135	— 161	+ 43	— 245	— 228
Other loans, discounts, and advances	— 2	— 7	— 4	—	— 13
Total	+ 487	— 142	+ 291	— 386	+ 250
Excess reserves*	+ 10	— 52	+ 187	— 336	— 191
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	26,246	25,879	26,225	25,782	26,036‖
Required reserves*	25,878	25,569	25,722	25,615	25,696‖
Excess reserves*	368	310	503	167	339‖
Borrowings	737	576	619	374	577‖
Free (+) or net borrowed (—) reserves*	— 369	— 266	— 116	— 207	— 238‖
Nonborrowed reserves*	25,509	25,303	25,606	25,408	25,459‖
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 401	— 277	—4,406	— 276	—4,558
More than one year	—	—	+4,779	—	+4,779
Total	+ 401	— 277	+ 373	— 276	+ 221

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 August 28, 1968.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS AUGUST 1968

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on August 7	August 14	August 21	August 28*	Averages of four weeks ended on August 28*
Eight banks in New York City					
Reserve excess or deficiency(—)†	5	24	12	30	18
Less borrowings from Reserve Banks	337	170	274	—	195
Less net interbank Federal funds purchases or sales(—)	1,110	1,373	1,006	1,152	1,160
Gross purchases	*1,591*	*1,824*	*1,509*	*1,600*	*1,631*
Gross sales	*480*	*452*	*503*	*448*	*471*
Equals net basic reserve surplus or deficit(—)	—1,442	—1,518	—1,267	—1,122	—1,337
Net loans to Government securities dealers	1,431	1,051	1,114	1,094	1,173
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)†	14	38	20	— 1	18
Less borrowings from Reserve Banks	44	55	90	70	65
Less net interbank Federal funds purchases or sales(—)	1,022	1,335	1,425	1,344	1,282
Gross purchases	*2,218*	*2,632*	*2,665*	*2,628*	*2,536*
Gross sales	*1,196*	*1,297*	*1,240*	*1,284*	*1,254*
Equals net basic reserve surplus or deficit(—)	—1,052	—1,353	—1,494	—1,415	—1,329
Net loans to Government securities dealers	715	885	835	749	796

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—August 1968: August 5	August 12	August 19	August 26	August 30
Three-month	4.905	5.084	5.123	5.173	5.194
Six-month	5.099	5.273	5.220	5.242	5.250

Maturities	Monthly auction dates—June-August 1968: June 25	July 24	August 27
Nine-month	5.745	5.342	5.245
One-year	5.731	5.309	5.151

* 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.

7, reporting that the six-year note offering was heavily oversubscribed. Subscriptions from the public totaled \$23.6 billion, including \$11 billion from commercial banks for their own accounts. (Banks were permitted to pay for 50 per cent of their awards by crediting Treasury Tax and Loan Accounts.) The Treasury accepted approximately \$5.5 billion of public subscriptions (exceeding the \$5.1 billion originally offered), and an additional \$4.8 billion was allotted to Government investment accounts and the Federal Reserve Banks; thus approximately \$1.7 billion of new cash was raised in the operation. The Treasury allotted in full subscriptions for \$250,000 or less and all subscriptions from local governments, public funds, and foreign official sources, while all other subscriptions from the public were subject to an 18 per cent allotment although assured of a minimum award of \$250,000.

The 18 per cent allotment on large subscriptions, although relatively low, nevertheless exceeded the estimate which predominated in the market just prior to the release of the financing results. Consequently, the news precipitated some selling pressures in the coupon sector, while at the same time market anticipations of a near-term easing in monetary policy began to wane. Commentary in the press and in market advisory letters cast doubts on the outlook for a relaxation in monetary policy in view of the persistence of domestic inflationary pressures. Furthermore, news of a deterioration in the British trade balance in July diminished expectations of a cut in the British bank rate, which bond market participants had hoped would augur a lowering of the Federal Reserve discount rate. As midmonth approached, considerable uncertainty pervaded the market, while the relatively wide gap between high dealer-financing costs and prevailing yields on coupon issues put an appreciable damper on market sentiment. Against this background, prices of most Treasury notes and bonds declined steadily from August 5 through August 15, with the largest price declines occurring in the longer term maturity area where demand was modest and an expansion in offerings from institutional investors developed. However, as market yields moved higher (see chart on page 202), investment demand from commercial banks and other sources tended to revive, particularly for the new 5⅝ per cent six-year note.

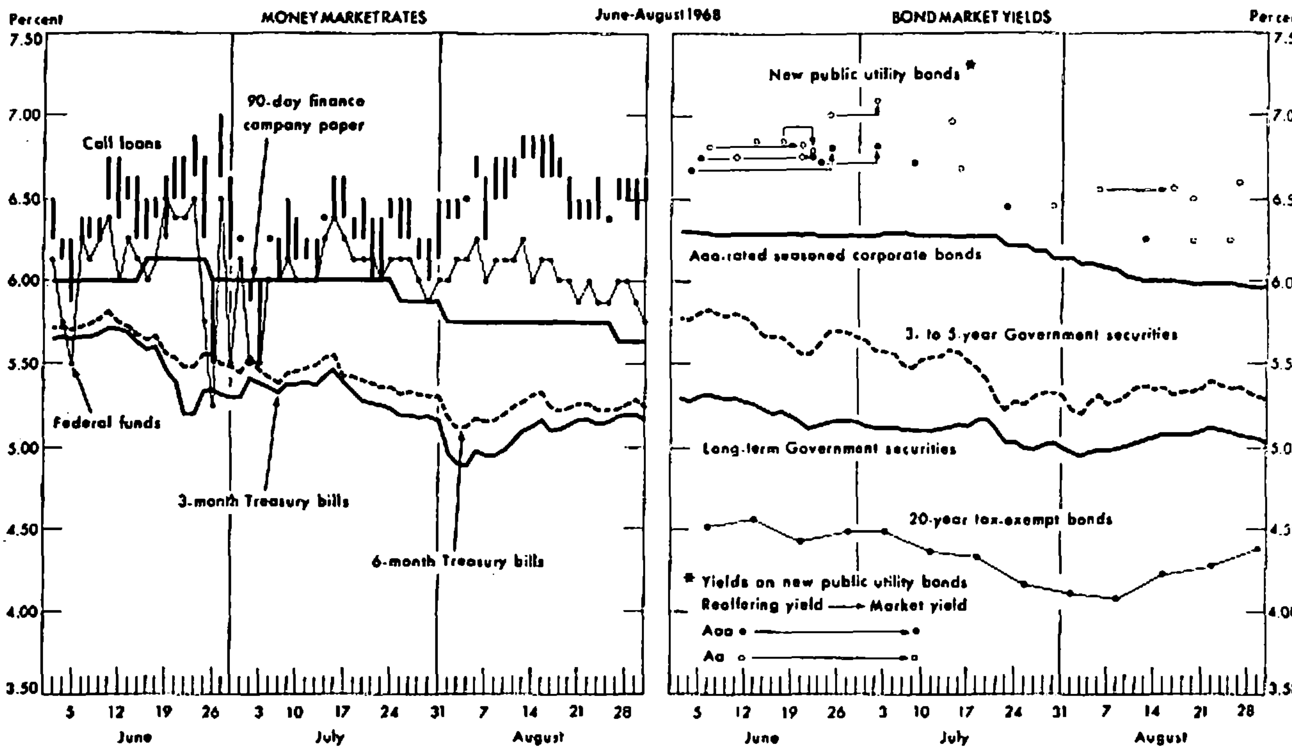
Prices of Treasury notes and bonds initially advanced in response to the ¼ percentage point reduction on August 16 in the discount rate of the Federal Reserve Bank of Minneapolis. However, the apparent reluctance of some Reserve Banks to join promptly in the discount rate reduction appeared to temper its impact upon the market. Activity contracted, and prices subsequently drifted irregularly lower. Some professional selling pressure developed in reaction to President Johnson's statement on August 19 that the current policy on the prosecution of the Vietnam war would be continued for the balance of his Administration. Soon thereafter, the invasion of Czechoslovakia by the Soviet Union and several other Warsaw Pact nations generated a very cautious tone in the coupon sector. Thus, from August 19 through August 22, prices of Treasury notes and bonds generally receded. However, as prices edged downward, demand emerged repeatedly, thereby limiting the extent of the decline. Subsequently, demand expanded somewhat, and during the remainder of the month prices edged higher in relatively quiet trading. Over the month as a whole, prices of most issues maturing within four years were unchanged to $^{19}/_{32}$ higher while issues of longer maturity were mostly unchanged to $^{19}/_{32}$ lower.

Treasury bill rates moved sharply lower in the opening days of August in response to strong investor demand —particularly for 1968 maturities—augmented by professional purchases of longer term issues. The bill market was buoyed during this period by the absence of a short-maturity coupon offering in the Treasury's August financing, as well as by expectations of considerable reinvestment demand for bills from holders of maturing notes and bonds who preferred not to convert into the six-year note being offered by the Treasury. As a result, acute scarcities developed in the bill market, especially in the short-maturity area. Consequently, rates for bills maturing in less than five months dropped as much as 28 basis points in the first two trading days of August, while rates on longer bills fell by as much as 19 basis points.

As the month progressed, a fairly good investment demand persisted, but firm conditions in the money market, highlighted by rising dealer-financing costs, made market inventories more burdensome to carry and generated selling pressures from professional sources. In this setting, and amid mounting uncertainty over the future course of monetary policy, bill rates increased fairly sharply over the August 6 through August 15 interval.

Subsequently, demand for bills expanded somewhat and rates moved lower in reaction to the August 16 reduction in the discount rate of the Federal Reserve Bank of Minneapolis, followed by the ¼ percentage point decrease in the rate charged by the Federal Reserve System on repurchase agreements with nonbank dealers in Government securities. A hesitant atmosphere soon reappeared in the bill sector, however, when demand contracted and offerings increased; uncertainty concerning the implications of the invasion of Czechoslovakia also had a restraining impact. Against this background, bill rates fluctuated from

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.

August 20 through the end of the month.

At the regular monthly auction of nine- and twelve-month bills held on August 27, bidding was aggressive and average issuing rates were set at 5.245 per cent and 5.151 per cent, respectively, 10 and 16 basis points below average rates established a month earlier (see Table III). At the final regular weekly auction of the month held on August 30, average issuing rates for the new three- and six-month bills were 5.194 per cent and 5.250 per cent, respectively, virtually unchanged and 4 basis points below auction rates at the comparable auction held in late July.

Prices of Government agency securities rose in early August and then moved irregularly over the remainder of the month. A very good reception was accorded an August 7 offering by the Federal land banks of $230 million of a 5.70 per cent bond maturing in 1972 (including $70 million of new cash). Other new financing activity included the offering on August 14 by the Federal Home Loan Banks of $300 million of a 5.65 per cent six-month debenture at par. The issue, which partially replaced a $500 million maturity, was accorded an excellent investor reception. A week later, the Federal intermediate credit banks offered $337 million of a 5.65 per cent nine-month debenture which partly replaced $375 million of maturing obligations. The new debenture was priced at par and was very well received. On August 28, the Federal National Mortgage Association offered $350 million of a 5¾ per cent three-year debenture priced at par. The offering, which replaced a maturing issue of equal amount, was fairly well received.

OTHER SECURITIES MARKETS

A fairly strong tone prevailed in the corporate bond sector during the first half of August, and prices generally moved higher. The sector was in an excellent technical position. The volume of new offerings and scheduled flotations was relatively light, and unsold balances of recent issues were small. Underwriters competed aggressively for the limited amount of new corporate bonds made available by borrowers at competitive bidding during this period. Just before midmonth, investors accorded a good reception to a $50 million Aaa-rated utility company debenture issue (with five years of call protection) which was reoffered to yield 6.25 per cent, 20 basis points below the yield on a comparable issue which had been marketed on July 23. The midmonth news of a reduction in the Federal Reserve discount rate in two districts also buoyed market sentiment. At the higher price levels, however, investors became more selective, new issues encountered mixed receptions, and scattered price declines occurred. Over the month as a whole, the average yield on Moody's Aaa-rated seasoned corporate issues declined by 18 basis points to close the month at 5.96 per cent (see chart).

In the tax-exempt sector, a heavy volume of new issues flowed into the market and the calendar of scheduled flotations steadily expanded in August. Underwriters bid fairly aggressively for new tax-exempt offerings during the early days of the month but, as yields edged slightly lower and the volume of new issues grew, investor receptions became quite restrained. The Blue List of dealers' advertised inventories increased sharply, the technical position of the market deteriorated, and yields rose steadily over the remainder of the month. Even at the emerging higher yield levels, considerable investor indifference to new and recent flotations persisted. As underwriters terminated price restrictions on several recent issues, yields were adjusted still higher, and a very heavy atmosphere prevailed when the month ended. The Blue List of dealers' advertised inventories amounted to $794 million on August 30, compared with $482 million on July 31. *The Weekly Bond Buyer's* average yield for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) rose by 24 basis points over the month to 4.38 per cent (see chart).