The Money and Bond Markets in September

The capital markets functioned effectively in September, distributing to investors a substantial share of the overhang of unsold securities on hand when the month opened and a sizable volume of new issues. Interest rates in the several sectors of the bond market continued to rise in the first part of the month, but then moved lower or stabilized over the remainder of the period. Market participants, like most other observers of the economy, found the economic indicators suggesting greater strength than they had expected, but most continued to believe that fiscal restraint would slow the pace of activity in the months ahead. Moreover, at midmonth, Government securities dealers tended to take heart from the decline in day-to-day money rates. Also at work was widespread expectation that major commercial banks would reduce their prime lending rate once mid-September seasonal borrowing needs had been met. On September 24, after action earlier by a few smaller banks, a large New York City bank lowered its prime rate by ½ percentage point to 6 per cent. Other major banks across the country subsequently took action, but limited their reduction to ¼ percentage point. Reflecting some disappointment in the market over the size of the prime rate reduction and the strengthened business outlook, bond prices declined during the last few days of the month.

Money market rates edged higher early in September but moved irregularly lower thereafter. The Federal funds rate fluctuated widely around 5¾ per cent during the month. In contrast, this rate had held generally within a narrow range of 5¾ to 6 per cent in the latter half of August after the reduction in Federal Reserve discount rates to 5¼ per cent began. New York City bank lending rates on new overnight loans against Government securities collateral rose briefly in early September to a 6½ to 6¾ per cent range, but then declined to about 6¼ per cent. Treasury bill rates rose during the first third of the month and declined irregularly thereafter. The bid rate on three-month bills attained a high of 5.30 per cent around September 10 but fell back to close the month at 5.16 per cent. During the latter half of September, rates on prime commercial paper and directly placed finance company paper were lowered by ⅛ percentage point.

BANK RESERVES AND THE MONEY MARKET

The money market operated smoothly during September, despite extraordinary pressures on the major banks, uncertainties resulting from a shift to new reserve accounting procedures, and the usual seasonal churning of funds in connection with quarterly corporate dividend and tax payments. Net reserve availability at member banks expanded during the month, both in reflection of the difficulties of reserve management in the face of abnormally large swings in reserve factors and in accommodation of the period's special strains. Member bank borrowings from the Reserve Banks were little changed, averaging $492 million (see Table I) as compared with $577 million in August. Heavy flows of Federal funds occurred on most days as major day-to-day reserve swings were accommodated.

System open market operations were presented with unusual problems during September because of large swings in member bank reserve positions imposed by operating factors. After the usual decline in reserves brought about by the outflow of cash to the public over the Labor Day holiday, reserves mounted sharply as a result of an $800 million decline in average Treasury balances at the Reserve Banks in the week ended on September 11 and a strong increase in float and gains from other factors in the week ended on September 18. Subsequently, reserves were heavily drained by a rebuilding of Treasury balances in the last statement week of the month. In view of the short-lived nature of the reserve bulge, System open market operations made extensive use of matched sale-purchase transactions to absorb reserves temporarily. A maximum of $1.8 billion of these transactions, whereby securities are sold and simultaneously repurchased for delivery one or more days later, was outstanding on September 18.

The forty-six banks in the major money centers came under very heavy reserve pressures during the month. In the first statement week, these banks had a relatively high average basic reserve deficit of $2.5 billion (see Table II), reflecting in part substantial loans to Gov-

Table I

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

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

Factors	Changes in daily averages—week ended on				Net changes
	Sept. 4	Sept. 11	Sept. 18	Sept. 25	
"Market" factors					
Member bank required reserves	+ 16	— 59	+ 59	— 59	— 43
Operating transactions (subtotal)	— 303	+ 780	+ 691	— 400	+ 768
Federal Reserve float	— 28	+ 205	+ 270	+ 17	+ 470
Treasury operations*	+ 150	+ 891	— 62	— 659	+ 230
Gold and foreign account	— 15	+ 6	+ 6	+ 5	+ 2
Currency outside banks	— 350	— 288	+ 143	+ 217	— 275
Other Federal Reserve accounts (net)†	— 63	+ 52	+ 333	+ 21	+ 343
Total "market" factors	— 287	+ 721	+ 750	— 459	+ 725
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 312	— 647	— 698	+ 214	— 810
Bankers' acceptances	— 2	—	— 1	— 1	— 4
Special certificates	—	+ 13	— 13	—	—
Repurchase agreements:					
Government securities	—	—	—	—	—
Bankers' acceptances	—	—	—	—	—
Federal agency obligations	—	—	—	—	—
Member bank borrowings	+ 80	+ 180	— 220	+ 70	+ 101
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 392	— 455	— 941	+ 284	— 720
Excess reserves	+ 105	+ 266	— 191	— 175	+ 5

	Daily average levels				
Member bank:					
Total reserves, including vault cash	25,871	26,106	25,946	25,830	25,961‡
Required reserves	25,599	25,568	25,599	25,658	25,629‡
Excess reserves	272	538	347	172	332‡
Borrowings	454	634	405	475	492‡
Free (+) or net borrowed (—) reserves	— 182	— 96	— 58	— 303	— 160‡
Nonborrowed reserves	25,417	25,562	25,541	25,355	25,469‡
Net carry-over, excess or deficit (—)§	—	—	—	115	—

	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+ 110	—1,844	— 557	+2,010	— 281
More than one year	+ 68	—	—	—	+ 68
Total	+ 178	—1,844	— 557	+2,010	— 213

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ Average of four weeks ended on September 25, 1968.
§ Not included in average levels of excess or free reserves.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS SEPTEMBER 1968

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Averages of four weeks ended on Sept. 25
	Sept. 4	Sept. 11	Sept. 18	Sept. 25	
Eight banks in New York City					
Reserve excess or deficiency(—)*	— 25	129	19	— 14	27
Less borrowings from Reserve Banks	104	225	86	84	125
Less net interbank Federal funds purchases or sales(—)	976	1,478	1,416	1,123	1,248
Gross purchases	*1,495*	*1,781*	*1,905*	*1,635*	*1,704*
Gross sales	*519*	*302*	*490*	*512*	*456*
Equals net basic reserve surplus or deficit(—)	—1,105	—1,575	—1,483	—1,221	—1,346
Net loans to Government securities dealers	1,094	1,104	1,340	1,303	1,210
Net carry-over, excess or deficit(—)†	—	—	—	22	—
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	38	84	— 1	5	32
Less borrowings from Reserve Banks	90	201	128	213	158
Less net interbank Federal funds purchases or sales(—)	1,322	2,095	2,533	2,235	2,046
Gross purchases	*2,636*	*3,117*	*3,562*	*3,165*	*3,120*
Gross sales	*1,314*	*1,022*	*1,029*	*931*	*1,074*
Equals net basic reserve surplus or deficit(—)	—1,374	—2,211	—2,661	—2,442	—2,172
Net loans to Government securities dealers	929	1,092	1,215	1,006	1,061
Net carry-over, excess or deficit(—)†	—	—	—	4	—

Note: Because of rounding, figures do not necessarily add to totals.
* For statement weeks prior to the week ended on September 25, reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.
† Not reflected in data above.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In per cent

Maturities	Weekly auction dates—September 1968			
	Sept. 9	Sept. 16	Sept. 23	Sept. 30
Three-month	5.246	5.218	5.151	5.182
Six-month	5.277	5.248	5.230	5.283

	Monthly auction dates—July-September 1968		
	July 24	Aug. 27	Sept. 24
Nine-month	5.342	5.245	5.202
One-year	5.309	5.151	5.108

* 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.

ernment securities dealers and continued acquisitions of investments apparently in the expectation of lower interest rates during the month ahead. Seasonal credit demands and a rapid rundown of Treasury Tax and Loan Account balances before the September 16 tax date led to an increase in the basic deficit to $4.1 billion in the week ended on September 18. This was a considerably larger deterioration in position than normal for the season. Subsequently, the rebuilding of Government deposits at the major banks, a decline in loans, and other seasonal factors led to a marked relaxation of pressure. By the end of the month, the daily basic reserve deficit of the forty-six banks had fallen sharply.

The major money market banks managed their reserve positions cautiously during the September 11 statement week. Confronted with a sharp increase in their basic reserve deficit to an average of $3.8 billion for the week, they bid heavily in the Federal funds market and borrowed in volume at the "discount window". Federal funds traded predominantly at 6 per cent during the early part of the week, but transactions took place at rates as low as 2 per cent on Wednesday when cumulative excesses flooded into the market at the close of the last biweekly period for "country" banks.

The initiation of new reserve accounting procedures by the Federal Reserve System in the week ended on September 18 exerted a significant influence on the reserves and behavior of banks during the month. Under the new procedures, all member banks are required to meet their daily average reserve requirements on a weekly basis, whereas country banks had previously had a biweekly statement period. In addition, beginning in that week the reserve requirements of all banks are based on average deposits two weeks earlier rather than on current deposits. The vault cash component of the banks' total reserves is recorded with the same two-week lag. An additional element of the new system permits member banks to carry forward into the following reserve week excesses or deficits up to a limit of 2 per cent of average required reserves.

The transition to the new accounting procedures in the September 18 statement week compounded the uncertainties normally present in the banking system around the corporate tax date. As the average basic deficit of the forty-six banks mounted to a record high, the major banks bid heavily for funds and also borrowed from the Reserve Banks. Nevertheless, the money market remained relatively steady, with Federal funds trading primarily at 5¾ per cent.

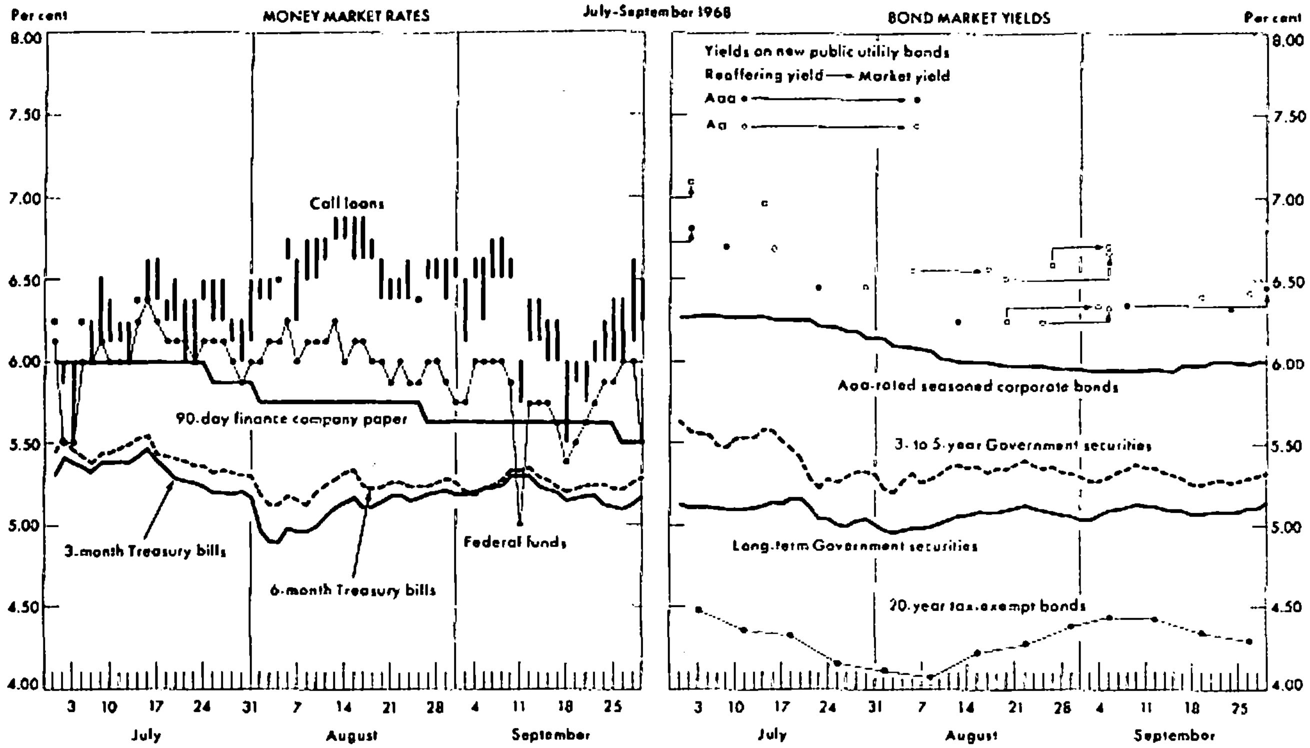
In the final statement week of the month, the money market banks experienced a moderate improvement in their basic reserve positions. At the same time, they were able to carry over about $25 million of average excess reserves from the preceding week under the new reserve accounting rules. In consequence, the banks appeared willing to accumulate sizable reserve deficiencies through much of the week, contributing to a somewhat more comfortable tone in the Federal funds market. However, when these banks scrambled to cover their deficiencies on the final day, the Federal funds rate rose as high as 6¼ per cent, and member bank borrowings from the Federal Reserve bulged to $1.6 billion. The experience of the first two weeks under the new procedures suggests that reserve city banks were able to economize considerably on excess reserves, but that country banks were less quick in adapting to obtain the full benefits of the new system.

The reductions in rates on commercial and finance company paper, which occurred on September 18 and 26, respectively, brought the rate on prime four- to six-month commercial paper to 5¾ per cent and that on directly placed finance company paper maturing in sixty days or more to 5½ per cent. Offering rates posted by the New York City banks on new large-denomination negotiable certificates of deposit (C/D's) were largely unchanged during September at levels well below Regulation Q ceilings. At these rates, the weekly reporting banks experienced a mild net erosion of their C/D liabilities, amounting to $81 million for the four statement weeks ended on September 25. This loss of funds was more than compensated for by an increase in liabilities to the banks' own foreign branches. The apparent preference of the banks for Euro-dollars was related in part to the easing in rates on these funds during most of September.

THE GOVERNMENT SECURITIES MARKET

Prices of Treasury coupon securities drifted lower during the first part of September, but recovered before the middle of the month when the prevailing mood over the future trend of interest rates shifted from pessimism to optimism. Nevertheless, caution again emerged near the end of the period, as it became evident that the economy remained more robust than had been expected by many observers. At the beginning of the month, market opinion seemed inclined to the view that further declines in yields would be dependent upon definite signs of slackening in business activity. With a majority of economic indicators pointing to a continued strong upward movement of the economy, prices of coupon securities came under downward pressure. Additional price depressants in the Treasury market came from the unrelieved congestion in the markets for corporate and tax-exempt debt issues and from an announcement at the start of the month of a sizable financing by the International Bank for Recon-

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.

struction and Development (IBRD) scheduled for later in September. Isolated instances of reductions in prime lending rates of commercial banks outside New York City had no market effect, since these moves were widely regarded as premature. In the climate that prevailed, investors generally preferred to sit on the sidelines awaiting further interest rate developments, and trading was largely professional.

Toward midmonth, market sentiment was buoyed by the publication of weekly reserve statistics, revealing a substantial reduction in the level of net borrowed reserves during the September 11 statement week. This event sparked a technical price rally which generated a revival of investment demand, mainly for intermediate-term coupon securities. Encouraged by this demand, and also by some temporary easing of the money market and a reduction in their financing costs, dealers were reluctant to reduce their own holdings of coupon issues. Subsequently, the upward price movement was given further impetus by the bullish content of market advisory letters and by a marked improvement in the condition of the corporate and tax-exempt bond markets. Added factors in the market strength were the successful distribution of the new IBRD issue, the lowering of the British bank rate, and the report of an August decline in industrial production, all of which occurred soon after midmonth. Announcements of a reduction in the prime rate at major New York City banks on September 24 and 25 had little net impact on the market, since rumors concerning this move had circulated widely after midmonth and the emergence of a split rate proved a disappointment to market participants. As the month drew to a close, market enthusiasm tended to be dampened by fresh evidence of continuing strong inflationary pressures in the economy. Prices of intermediate coupon maturities, in strong demand around midmonth, closed ⅛ point lower to ¼ point higher for the month, while long-term issues closed about 1¼ points lower.

Market rates on Treasury bills moved in a pattern similar to that of yields on coupon securities during September, rising early in the month and declining thereafter. Throughout the period, there was a strong demand for issues maturing in the tax months of December 1968 and March 1969. The relative scarcity of these maturities was gradually relieved over the month, as the supply increased with each regular weekly auction of three- and six-month bills. Bidding in these auctions was generally quite aggressive. In the first auction of the month, the three- and six-month bills were awarded at average issuing rates of 5.25 and 5.28 per cent, respectively, 5 and 3 basis points higher than rates established in the preceding auction (advanced to Friday, August 30, because of the Labor Day holiday). In two subsequent auctions, average issuing rates also moved lower, but in the final weekly auction rates rose slightly (see Table III).

Around midmonth, as a better atmosphere began to emerge in the Government coupon market, the Treasury bill sector was given an added lift by a sharp easing of money market conditions, which spurred professional buying, and by a contraseasonal tax-period investment demand. Toward the latter part of the month, commercial banks made purchases prior to the September 30 statement publishing date. On balance for the month, market rates on outstanding Treasury bills changed only slightly, declining to 5.16 per cent for the three-month issue and rising to 5.28 per cent for the six-month issue.

OTHER SECURITIES MARKETS

During the first half of September, the corporate and tax-exempt bond markets labored under heavy pressure, reflecting the carry-over of large unsold balances of August debt offerings and a continuing heavy volume of new financing. The tax-exempt market was in a particularly poor technical position as the month opened, with the Blue List of dealers' advertised inventories at a near-record high of $794 million. Despite the rapid flow of new offerings and the release of a substantial volume of recently floated securities through syndicate terminations, dealers succeeded in reducing inventories steadily over the first half of the month. Price concessions on older issues were deep, however, and new issues were marketed at a higher pattern of reoffering yields. The relatively large number of syndicate terminations during the period resulted in upward yield adjustments of as much as 30 basis points on tax-exempt securities and 16 basis points on corporates. One corporate termination occurred on September 17, when the market felt the impact of the highly successful sale of long-term bonds by the IBRD. The $250 million issue, carrying 12½-year call protection, sold out rapidly at a yield of 6.435 per cent, 11 basis points lower than that on the last previous offering by the same borrower in late March but somewhat higher than many observers had expected.

At mid-September, the six-week decline in prices of tax-exempt securities came to a halt, and pressures on the corporate market also lifted, though less dramatically. Rumors of an impending decline in the prime lending rate in New York City, which began to circulate around midmonth, had a relatively greater effect on tax-exempt securities, generating an active demand from commercial banks and dealers alike. Trading in tax exempts remained brisk over much of the month, and the larger part of the month's heavy new offerings was distributed without difficulty at a moderately reduced level of reoffering yields. After declining to a September low of $584 million, the Blue List rose to close the month at $663 million, still well below its starting level. *The Weekly Bond Buyer's* average yield on twenty seasoned tax-exempt issues (carrying ratings from Aaa to Baa) declined from a monthly high of 4.44 per cent in early September to 4.30 per cent near the month end (see chart on page 213). In contrast, yields on seasoned corporate issues registered an increase for the month, the average yield on Moody's Aaa-rated bonds closing at 6.00 per cent as compared with 5.96 per cent at the end of August.