# The Money and Bond Markets in October

The capital markets were under considerable pressure during October, and both short- and long-term interest rates rose. Credit demands remained substantial, as evidenced by an accelerated flow of new corporate and tax-exempt bond offerings. At the same time, mounting indications that the economy was continuing to expand quite vigorously and that inflationary pressures were persisting generated a perceptible shift of sentiment in the money and bond markets. Observers grew increasingly uncertain about the likely course of monetary policy and interest rates in the months ahead. Against this background, the first half of the month saw a fairly steady drop in prices of Treasury notes and bonds, sharp price-cutting in the corporate and tax-exempt bond sectors, where yields approached the historic highs reached last spring, and a general rise in rates on Treasury bills and other short-term money market instruments.

On October 16, however, reports began to circulate that the Paris peace talks had reached a critical stage and that an agreement to de-escalate the Vietnam conflict might soon be forthcoming. These reports sparked a rally in the capital markets. Participants anticipated that any reduction in the United States military involvement in Vietnam would eventually contribute to an easing of pressures in the credit markets as well as in the economy at large. Investment demand for corporate and tax-exempt bonds expanded considerably, and prices rebounded from their depressed levels. Prices of Government securities also rallied in reaction to the Vietnam peace conjectures. Subsequently, peace hopes began to fade and interest rates tended to rise as the Treasury's November refunding approached. Market participants initially responded favorably to the Treasury announcement on October 23 that it would offer a new eighteen-month note, priced to yield 5.73 per cent, and reopen the 5¾ per cent note of November 1974 as alternative replacements for $11.9 billion of outstanding notes and bonds maturing in November and December. In the closing days of the month, market interest in the Treasury refunding ebbed and flowed with changing prospects for a Vietnam agreement. The financing results, summarized below, indicated a satisfactory market response to the offering.

## BANK RESERVES AND THE MONEY MARKET

The tone of the money market was generally firm during October despite intermittent periods of relatively comfortable conditions. Member banks made additional progress toward a more economical management of reserve positions following the inauguration during September of the new reserve-accounting procedure for all member banks.[1] Under these rules, the reserve city banks followed a pattern of building up large excess reserve positions during alternate weeks and carrying the excess over to intervening weeks in which deficiency positions were maintained. Consequently, pressures on the money market tended to increase during settlement periods when excess reserve positions were built up and to diminish when the excess was carried over to the subsequent period. This effect became especially pronounced during the latter half of October.

On a nationwide basis, excess reserves of all member banks averaged only $241 million during the five statement weeks ended on October 30 (see Table I), compared with $332 million during the four weeks in September. Member bank borrowings at the Federal Reserve Banks showed little change, declining by $34 million on average during the five statement weeks to $458 million. Largely in reflection of the decline in average excess reserves, net borrowed reserves averaged $217 million for the five weeks, compared with $160 million during the four weeks ended in September.[2]

Firm conditions prevailed in the money market at the

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[1] Required reserves are now computed on the basis of average deposits held two weeks prior to the current statement week, and the vault cash component of total reserves is calculated with the same two-week lag. Moreover, reserve excesses or deficiencies up to a limit of 2 per cent of average required reserves may be carried over to the next settlement period. For further details of the new reserve-accounting procedures, see this *Review* (October 1968), page 212.

[2] Data cited above for excess reserves and net borrowed reserves do not include the carry-over of excess reserves or deficiencies.

## Table I

### FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, OCTOBER 1968

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

| Factors | Changes in daily averages— week ended on | | | | | Net changes |
|---|---|---|---|---|---|---|
| | Oct. 2 | Oct. 9 | Oct. 16 | Oct. 23 | Oct. 30 | |
| **"Market" factors** | | | | | | |
| Member bank required reserves | — 342 | — 280 | — 328 | + 131 | + 108 | — 711 |
| Operating transactions (subtotal) | — 579 | + 55 | — 98 | — 63 | — 56 | — 720 |
| Federal Reserve float | — 592 | + 126 | + 69 | + 183 | — 496 | — 610 |
| Treasury operations* | — 220 | + 143 | + 103 | — 50 | — 61 | — 185 |
| Gold and foreign account | — 22 | — 11 | + 14 | + 1 | + 4 | — 4 |
| Currency outside banks | + 306 | — 174 | — 272 | — 359 | + 482 | — 117 |
| Other Federal Reserve accounts (net)† | — 40 | — 31 | — 13 | + 162 | + 17 | + 96 |
| Total "market" factors | — 921 | — 225 | — 426 | + 68 | + 73 | —1,431 |
| **Direct Federal Reserve credit transactions** | | | | | | |
| Open market instruments | | | | | | |
| Outright holdings: | | | | | | |
| Government securities | + 985 | + 284 | + 334 | — 165 | + 118 | +1,501 |
| Bankers' acceptances | — | + 4 | + 3 | + 2 | — 1 | + 7 |
| Repurchase agreements: | | | | | | |
| Government securities | + 63 | — 63 | + 96 | — 46 | + 1 | + 51 |
| Bankers' acceptances | + 6 | — 6 | + 51 | — 49 | — 2 | — |
| Federal agency obligations | + 1 | — 1 | + 3 | + 4 | — 7 | — |
| Member bank borrowings | + 65 | — 138 | + 116 | — 183 | + 162 | + 22 |
| Other loans, discounts, and advances | — | — | — | — | — | — |
| Total | +1,119 | + 30 | + 603 | — 438 | + 272 | +1,586 |
| Excess reserves | + 198 | — 195 | + 177 | — 370 | + 346 | + 155 |

| | Daily average levels | | | | | |
|---|---|---|---|---|---|---|
| **Member bank:** | | | | | | |
| Total reserves, including vault cash | 26,270 | 26,455 | 26,960 | 26,462 | 26,696 | 26,588‡ |
| Required reserves | 26,000 | 26,280 | 26,608 | 26,477 | 26,369 | 26,347‡ |
| Excess reserves | 270 | 175 | 352 | — 15 | 327 | 241‡ |
| Borrowings | 540 | 402 | 518 | 335 | 497 | 458‡ |
| Free (+) or net borrowed (—) reserves | — 270 | — 227 | — 166 | — 350 | — 170 | — 217‡ |
| Nonborrowed reserves | 25,730 | 26,053 | 26,442 | 26,127 | 26,199 | 26,130‡ |
| Net carry-over, excess or deficit(—)§ | 61 | 160 | 78 | 172 | 2 | 95‡ |

| | Changes in Wednesday levels | | | | | |
|---|---|---|---|---|---|---|
| **System Account holdings of Government securities maturing in:** | | | | | | |
| Less than one year | + 976 | — 630 | + 808 | + 415 | — 262 | +1,300 |
| More than one year | — 227 | + 83 | — | — | — | — 144 |
| Total | + 748 | — 547 | + 803 | + 415 | — 262 | +1,156 |

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 five weeks ended on October 30, 1968.
§ Not included in average levels of excess or free reserves.

## Table II

### RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS OCTOBER 1968

In millions of dollars

| Factors affecting basic reserve positions | Daily averages—week ended on | | | | | Averages of five weeks ended on Oct. 30 |
|---|---|---|---|---|---|---|
| | Oct. 2 | Oct. 9 | Oct. 16 | Oct. 23 | Oct. 30 | |
| **Eight banks in New York City** | | | | | | |
| Reserve excess or deficiency(—)* | 64 | — 43 | 52 | — 48 | 7 | 6 |
| Less borrowings from Reserve Banks | 150 | 60 | 161 | 21 | 12 | 81 |
| Less net interbank Federal funds purchases or sales(—) | 1,493 | 1,786 | 1,813 | 952 | 609 | 1,331 |
| *Gross purchases* | *1,871* | *2,167* | *2,245* | *1,710* | *1,599* | *1,918* |
| *Gross sales* | *378* | *382* | *432* | *758* | *990* | *588* |
| Equals net basic reserve surplus or deficit(—) | —1,579 | —1,889 | —1,922 | —1,021 | — 614 | —1,405 |
| Net loans to Government securities dealers | 1,189 | 901 | 652 | 642 | 760 | 829 |
| Net carry-over, excess or deficit(—)† | 5 | 53 | 8 | 48 | — 2 | 22 |
| **Thirty-eight banks outside New York City** | | | | | | |
| Reserve excess or deficiency(—)* | 30 | — 14 | 46 | — 75 | 74 | 12 |
| Less borrowings from Reserve Banks | 29 | 117 | 115 | 81 | 100 | 88 |
| Less net interbank Federal funds purchases or sales(—) | 1,071 | 2,043 | 1,883 | 1,724 | 1,426 | 1,629 |
| *Gross purchases* | *2,468* | *3,325* | *3,093* | *2,818* | *2,682* | *2,877* |
| *Gross sales* | *1,397* | *1,282* | *1,210* | *1,094* | *1,256* | *1,248* |
| Equals net basic reserve surplus or deficit(—) | —1,070 | —2,174 | —1,952 | —1,880 | —1,452 | —1,706 |
| Net loans to Government securities dealers | 1,013 | 1,342 | 756 | 624 | 580 | 863 |
| Net carry-over, excess or deficit(—)† | 14 | 20 | 10 | 36 | — 33 | 9 |

Note: Because of rounding, figures do not necessarily add to totals.
* Reserves held after certain adjustments applicable to the reporting period less required reserves.
† Not reflected in data above.

## Table III

### AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In per cent

| Maturities | Weekly auction dates—October 1968 | | | |
|---|---|---|---|---|
| | Oct. 7 | Oct. 14 | Oct. 21 | Oct. 28 |
| Three-month | 5.277 | 5.345 | 5.396 | 5.471 |
| Six-month | 5.362 | 5.428 | 5.457 | 5.473 |

| Maturities | Monthly auction dates—August-October 1968 | | |
|---|---|---|---|
| | Aug. 27 | Sept. 24 | Oct. 24 |
| Nine-month | 5.245 | 5.202 | 5.446 |
| One-year | 5.151 | 5.108 | 5.401 |

* 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.

beginning of the month. In the statement week ended on October 2, Federal funds traded primarily at 6 per cent, while both reserve city and "country" banks accumulated excess reserves. During the next two statement periods, the major New York City banks labored under the pressure of record basic reserve deficits that averaged $1.9 billion, compared with $1.3 billion during the four statement periods in September. Reserves released as a result of a sharp curtailment of lending to securities dealers were more than absorbed by current declines in demand deposits and higher required reserves which, under the new lagged reserve-accounting procedures, reflected a buildup of deposits in the latter half of September. Banks in money centers outside New York City were also under reserve pressure as evidenced by an average basic reserve deficit of $2.1 billion at a group of thirty-eight major banks. All reserve city banks, which had carried over a sizable reserve surplus from the previous week, had a deficit reserve position on average in the week ended on October 9, and the Federal funds rate eased slightly to a 5¾ to 6 per cent range. Money market conditions grew tighter in the following week, when the reserve city banks accumulated excess reserve positions and Federal funds traded predominantly in a 6 to 6⅛ per cent range.

After midmonth, a decline in loans and investments at the major New York City banks, coupled with gains in time deposits and Euro-dollar balances, resulted in a sharp improvement in their basic reserve position. These reserve gains, combined with the carry-over of excess reserves from the preceding week, contributed to reduced pressure in the money market during the October 23 statement period. The predominant rate on Federal funds generally eased to a 5¾ to 5⅞ per cent range, and member banks ended the week with a reserve deficiency averaging $18 million, not including a carry-over excess of $172 million from the preceding week. The basic reserve positions of money market banks eased further in the week ended on October 30 (see Table II), as gains in demand deposits and repurchase agreements against securities exceeded the growth in credit outstanding. Both reserve city and country banks, however, accumulated excess reserves during the week, and money market conditions firmed somewhat, with Federal funds trading generally in a 5⅞ to 6 per cent range.

Commercial paper dealers increased their offering rate for prime four- to six-month paper from 5¾ per cent to 5⅞ per cent on October 18. In the course of the month, direct issuers raised rates for some selected shorter maturities by ¼ percentage point to 5¾ per cent. Rates for bankers' acceptances edged ¼ percentage point higher in two steps during the first half of the month. Most dealers quoted ninety-day unendorsed paper at 6 per cent bid (5⅞ per cent offered) at the month's end. Posted rates for three-month negotiable certificates of deposit (C/D's) rose to 5¾ per cent at most major New York City banks, and a few banks posted 6 per cent by the end of the month. The volume of outstanding C/D's at the weekly reporting banks in New York City expanded to $7.0 billion on October 30, an increase of $513 million from September 25. In contrast, a decline of $81 million had occurred in September. Liabilities of United States banks to their foreign branches declined by $31 million during the five weeks ended on October 30, compared with a rise of $95 million during the previous four weeks.

## THE GOVERNMENT SECURITIES MARKET

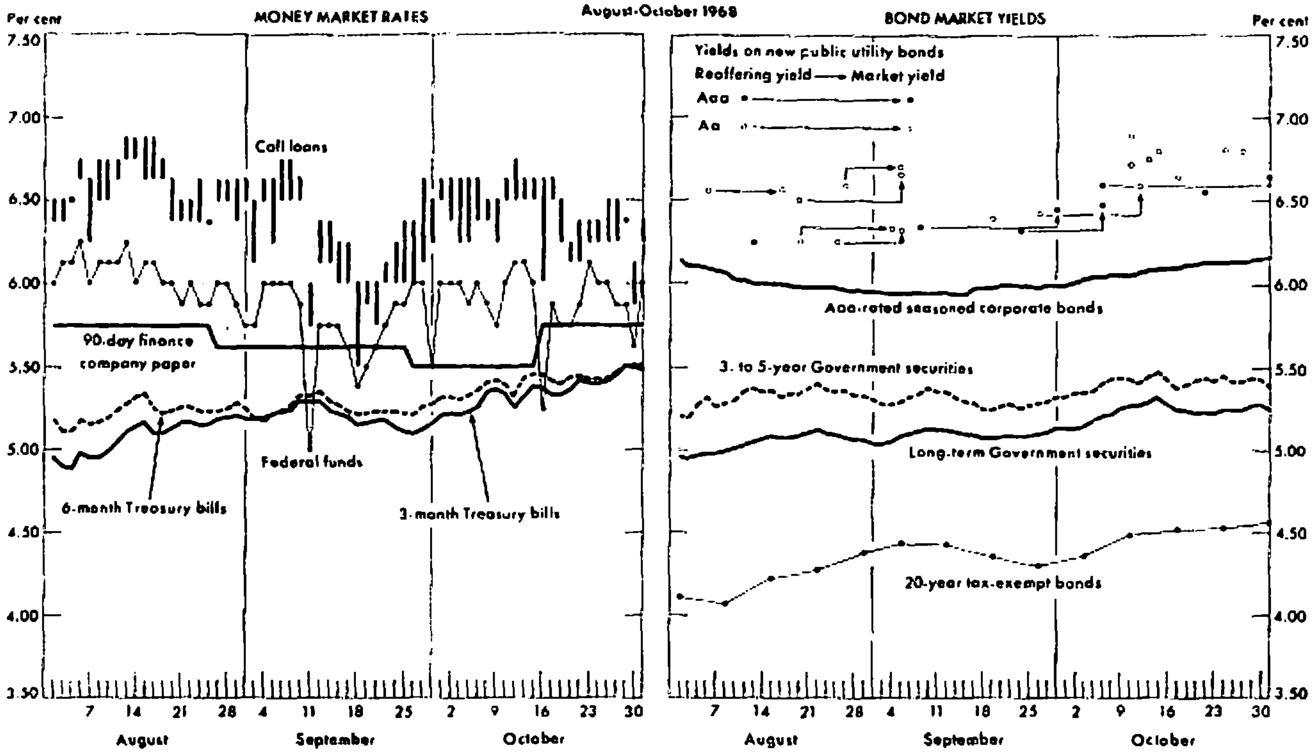
Prices of Treasury notes and bonds generally moved lower in the first half of the month in a climate of increasing caution regarding the outlook for monetary policy and interest rates. The coupon sector was also adversely affected by the firm conditions prevailing in the money market, the heavy tone evident in the markets for corporate and tax-exempt bonds, and the apparent growing investor enchantment with equities. Government securities dealers marked prices progressively lower as they attempted to reduce their sizable inventories prior to the Treasury's November refunding operation. Prices of most coupon issues declined during the first half of the month by from ⁶⁄₃₂ to as much as 2½ points, with the largest losses recorded at the longer end of the maturity spectrum. (Associated yield increases are illustrated in the right-hand panel of the chart.)

A more favorable climate emerged in the Government coupon sector when reports began to circulate that a breakthrough in the Vietnam peace negotiations might be imminent. Prices of Treasury notes and bonds rallied sharply on October 16 and 17, and demand from professional sources expanded substantially. As the month progressed, activity subsided again when the outlook for a quick Vietnam settlement dimmed somewhat. The stronger than expected expansion in GNP during the third quarter, which was reported at midmonth and had temporarily been overlooked by the coupon sector in the flurry of market activity, also influenced market sentiment as participants awaited the terms of the Treasury's November refunding.

The Treasury announced on October 23 that it would offer holders of $11.9 billion of notes and bonds maturing in November and December the opportunity to exchange these securities either for a new issue of the 5⅝ per cent note, maturing in May 1970 and priced at a discount to

SELECTED INTEREST RATES

August-October 1968




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.

yield about 5.73 per cent, or for an additional amount of the outstanding 5¾ per cent note of November 1974 at par. Private investors held approximately $5.6 billion of the eligible maturing issues. Market observers generally considered the Treasury's terms to be relatively attractive, although there was some surprise at the inclusion of an intermediate-term issue in the exchange. The market response was also influenced by the reiteration of official forecasts of an appreciably lower Federal budget deficit for fiscal 1969, as well as by the prediction that the Treasury would not have to raise net new cash over the balance of calendar 1968. Late in the month, a more cautious tone reappeared in the coupon sector, largely in reflection of renewed uncertainty about the Vietnam outlook. The month closed on a stronger note, however, when reports again circulated that a United States bombing halt was imminent. In fact, on the evening of October 31, the President announced that the bombing of North Vietnam would cease on November 1.

On November 1, the Treasury released the preliminary results of its refunding operation. Approximately 84.5 per cent of the $11.9 billion of November and December maturities eligible for exchange was converted into the two note issues offered by the Treasury. Subscriptions totaled $7.8 billion for the new 5⅝ per cent note of 1970 and $2.3 billion for the reopened 5¾ per cent note of 1974. Approximately 66 per cent of the eligible maturing issues held outside the Federal Reserve Banks and Government accounts was exchanged, including $2.9 billion of November maturities and $0.8 billion of December maturities.

In the market for Government agency obligations, prices generally eased in the first half of the month, primarily in reflection of the prevailing weakness in other capital market sectors. Several large agency issues were floated during this period, including offerings amounting to $1.1 billion—of which about $400 million provided new money—from the Federal Home Loan Banks, the Federal land banks, and the Export-Import Bank. These issues were initially accorded mixed receptions by investors. Demand expanded, however, as a better tone emerged in the agency market during the second half of the month in response to the widespread speculation about progress in the Vietnam peace negotiations. In the improved atmosphere, offerings from the Banks for Cooperatives and the Federal intermediate credit banks were well received.

A heavy atmosphere pervaded the Treasury bill market during the early part of October. As in other sectors, widespread uncertainty over the near-term outlook for monetary policy and interest rates set the tone. Moreover, as firm conditions prevailed in the money market and rates posted by the major city banks on call loans to Government securities dealers remained in a high range, dealers became restive and attempted to reduce their inventories. Selling pressure from professional sources was also prompted by expectations that the Treasury would soon announce a special bill offering. Against this background, and in the face of quite limited investment demand and some investor selling, bill rates generally moved higher through October 9 (see chart). Over the next few days, however, demand expanded and the tone of the bill sector improved briefly. A factor in this development was the favorable response of market participants to the Treasury's announcement on October 10 that it would raise only $3 billion of new cash through the sale of June 1969 tax anticipation bills to be auctioned on October 17 and issued on October 24. The size of the offering was smaller than had been anticipated by many observers and, in response to this news as well as to expanded investment demand, bill rates declined on October 10 and 11.

Subsequently, concern over the prospective course of monetary policy once more emerged as a significant restraining factor in the market. Rates again began to edge upward toward midmonth in quiet trading. Then, as the possibility of progress in the Vietnam peace negotiations came increasingly to the forefront, demand for Treasury bills expanded moderately and rates stabilized. At the October 17 auction of the new tax anticipation bills, good interest was evident on the part of commercial banks, which were attracted by the allowance for full payment in the form of credits to Tax and Loan Accounts and the two-week delay in providing required reserves against these deposits. The bills were sold at an average rate of 5.178 per cent, 22 basis points below the average rate on a comparable offering in July.

Rates for outstanding bills rose irregularly during the remainder of the month. At the regular monthly auction of nine- and twelve-month bills held on October 24, average issuing rates were set at 5.446 per cent and 5.401 per cent, respectively, 24 and 29 basis points above average rates established a month earlier (see Table III). At the final regular weekly auction of the month held on October 28, average issuing rates for the new three- and six-month bills were 5.471 per cent and 5.473 per cent, respectively, 29 and 19 basis points above average issuing rates at the comparable auction held in late September.

## OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, prices declined on a broad front during the first half of October. The heavy volume of new flotations in these markets was a major source of pressure. Although new issues were offered at progressively higher yields, considerable investor resistance was encountered. As dealer inventories of unsold offerings expanded and the calendar of scheduled flotations gave no indication of significant respite in the future, syndicate price restrictions were terminated on several slow-moving recent offerings, triggering upward yield adjustments of as much as 70 basis points in the tax-exempt sector and 40 basis points in the corporate bond sector. Concurrently, seasoned bond yields also moved higher. *The Weekly Bond Buyer's* index for twenty-year tax-exempt bonds soared from 4.30 per cent in late September to 4.51 per cent in mid-October, while Moody's index for seasoned Aaa-rated corporate bonds rose during the first half of October by 10 basis points to 6.10 per cent.

As the month progressed and bond yields reached more attractive levels, investor interest gradually revived. Nevertheless, the major forward impetus emerged only when hopes that some progress might have been made in the Vietnam peace negotiations generated a much more optimistic tone throughout the capital markets. Consequently, new offerings marketed around midmonth were for the most part accorded more favorable receptions, dealers were able to make substantial sales out of their inventories, and the technical position of both the corporate and tax-exempt sectors improved considerably. Investor demand contracted, however, when underwriters attempted to lead to lower yield levels. As the month drew to a close, market participants again adopted an attitude of caution and the market tone deteriorated somewhat.

At the end of October, *The Weekly Bond Buyer's* yield index of twenty seasoned tax-exempt issues was quoted at 4.56 per cent, 26 basis points higher than a month earlier, while Moody's index for seasoned Aaa-rated corporate bonds, at 6.16 per cent, was 16 basis points higher than a month earlier. The Blue List of advertised dealer inventories of tax-exempt securities totaled $876 million at the end of the month, a new high for the year and well above the $695 million on the first day of the month.