The Money and Bond Markets in January

In the first month of the new year, following the sharp upward adjustments in interest rates that had occurred in December, market psychology improved considerably for a time and the money and bond markets showed increased rate stability. Late in the month, however, a cautious atmosphere reappeared as the cumulative effects of increased monetary restraint became more visible.

After a brief reaction to the rise in the prime lending rate of commercial banks on January 7, prices of Government coupon issues were steady to higher over a large portion of the month. Contributing to the better tone were forecasts of Federal budget surpluses for fiscal 1969 and 1970, progress in procedural matters at the Vietnam meetings in Paris, and the absence of large-scale liquidation of securities by commercial banks.

Late in the month, caution revived as monetary indicators pointed to sustained monetary restraint. In addition, nervousness grew in the corporate and tax-exempt bond markets when investors exhibited lackluster interest in new offerings. At the same time, market activity contracted in the Government coupon sector and prices moved irregularly as participants awaited an announcement from the Treasury concerning its February refunding. The market reacted with some restraint when the Treasury offered either a fifteen-month note (priced to yield about 6.42 percent) or a seven-year note (priced to yield about 6.29 percent) as alternative replacements for the $14.5 billion of outstanding coupon issues maturing in mid-February. As the month drew to a close, prices of Treasury notes and bonds declined in quiet trading.

The money market displayed a firm tone through the major part of January, and most trading in Federal funds occurred in a 6¼ to 6⅝ percent range. Large commercial banks continued to experience sizable runoffs of certificates of deposit (CD's) during the month, as rates on Treasury bills and other competing short-term money market instruments remained more attractive. The major banks adjusted, in part, to the CD drain by increasing their borrowings in the Euro-dollar market.

THE GOVERNMENT SECURITIES MARKET

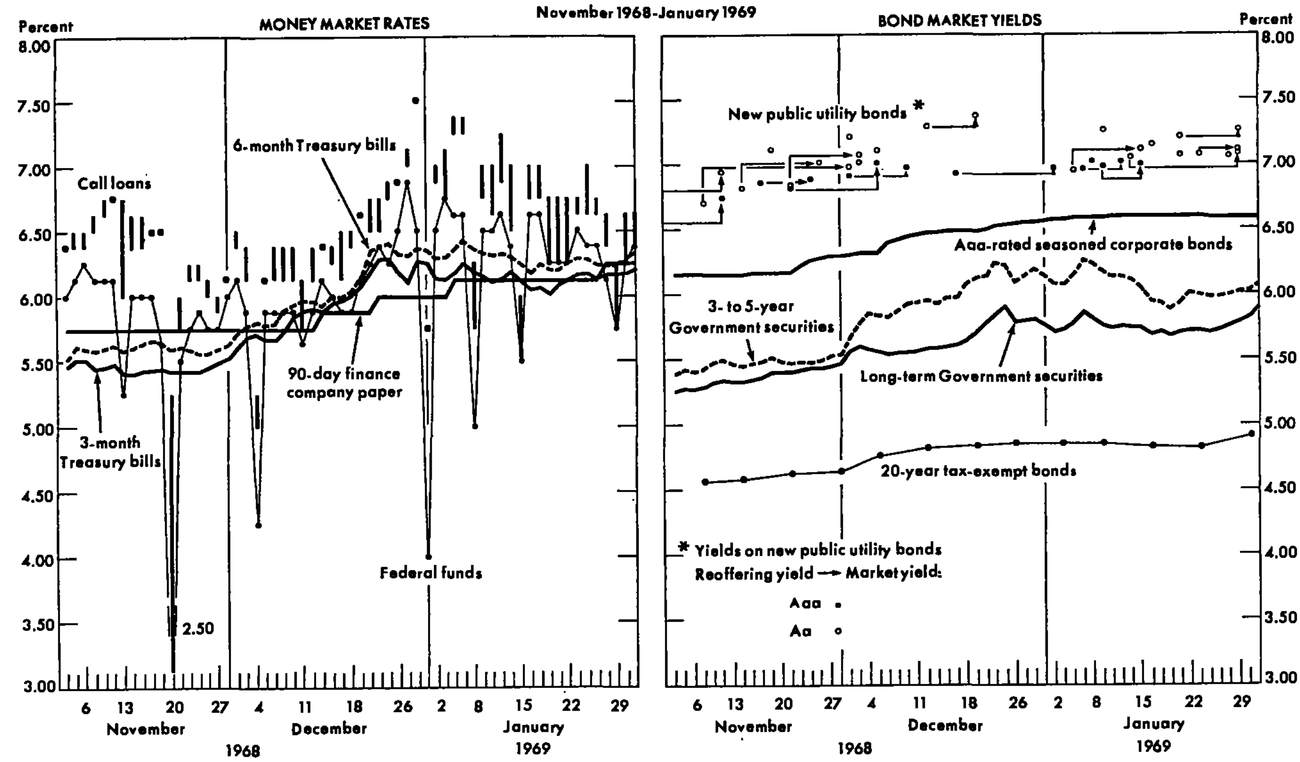
An atmosphere of caution persisted in the market for Treasury notes and bonds in early January. There was concern on the part of market participants over the possible severity and duration of monetary restraint. The January 7 increase in the prime rate briefly generated some nervousness over the interest rate outlook. Prices of Treasury notes and bonds consequently fluctuated in the first few days of January and then declined sharply in initial response to the prime rate action.

Subsequently, a continuing strong demand for short-term securities contributed to the view that near-term interest rate pressures might prove less severe than some observers had forecast. In addition, market sentiment was encouraged by an improvement in the technical position of the coupon sector, by the absence of any alarming amount of investment selling, particularly by banks, and by a steady demand—especially for intermediate-term issues—from a variety of investor sources. The market was also buoyed by the predictions of a Federal budget surplus and by the announcement that there had been a surplus in this nation's balance of payments in 1968. As a result, prices throughout the maturity range generally moved higher from January 8 through midmonth. (Associated yield declines are illustrated in the right-hand panel of the chart.)

On January 16 it was announced that negotiators in Paris had reached an agreement on certain procedural matters that had delayed the start of expanded Vietnam peace discussions. This news strengthened market hopes that interest rates might already have reached their peaks, and triggered a fairly sharp rise in prices of coupon issues. Subsequently, the market tone became less buoyant when commercial bank selling of intermediate-term issues developed, accompanied by some investor switching out of long-term Treasury securities into corporate and Federal agency issues. Moreover, overall activity contracted as attention began to focus on the Treasury's approaching

SELECTED INTEREST RATES

November 1968-January 1969



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 (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 seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on 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.

refunding. Thus, from January 21 onward, prices of intermediate- and long-term coupon issues generally edged irregularly lower.

On January 29, the Treasury announced that holders of the 5⅝ percent notes and 4 percent bonds maturing on February 15 could, if they wished, convert their holdings into new 6⅜ percent notes of May 1970 which were priced to yield about 6.42 percent and/or into new 6¼ percent notes of February 1976 which were priced to yield about 6.29 percent. The public holds approximately $5.4 billion of the maturing securities, while an additional $9.1 billion is held by the Federal Reserve and Government accounts. (Subscription books for the exchange offerings were open from February 3 through February 5.) In the closing days of the month, activity was fairly light in the coupon sector. Prices of outstanding issues of short- and intermediate-term maturity receded slightly in adjustment to the refunding offerings. At the same time, longer term issues, which were affected by the heavier tone of the corporate and tax-exempt bond sectors, declined fairly sharply.

A good tone prevailed in the Treasury bill sector as the new year commenced. A broadly based demand for bills was evident from both professional and investor sources, while offerings were moderate and readily absorbed. News of the prime rate increase triggered a sharp but brief upward adjustment in bill rates on January 7. Subsequently, however, a steady investment demand for bills and some professional short covering spurred a rapid market recovery, and bill rates generally declined (as illustrated in the left-hand panel of the chart). Good commercial bank interest emerged at the January 14 auction of $1¾ billion of additional June tax anticipation bills for which commercial banks were permitted to pay through credits to Treasury Tax and Loan Accounts. The tax bills were sold at an average issuing rate of 5.940 percent.

More optimistic reports concerning the Paris peace talks generated lively professional demand and produced a relatively sharp drop in bill rates on January 16. Over the next few days, rates continued to move lower in response to persisting investment and professional demand. From January 22 through the end of the month, however, a more cautious tone emerged in the bill sector. Investment activity in outstanding bills contracted somewhat, and concern over monetary restraint began to revive. Market participants appeared hopeful, however, that the Treasury's approaching refunding would generate demand for bills from holders of the maturing coupon issues who chose not to take on the Treasury's exchange offerings. Nevertheless, in the closing days of January, the refunding operation appeared to be producing little demand for bills. Moreover, bank offerings of the June tax anticipation bills expanded.

At the final regular weekly auction of the month, held on January 27, average issuing rates for the new three- and six-month bills were set at 6.167 percent and 6.255 percent, respectively, 3 and 8 basis points below the average rates established a month earlier. At the first monthly auction of the new year, on January 28, average issuing rates on the new nine- and twelve-month bills were set at 6.195 percent and 6.144 percent, respectively, 29 and 27 basis points lower than the record average rates at the comparable December auction (see Table III).

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, yields continued to rise during the first few days of January, in some cases to record highs. Nonetheless, some new flotations encountered investor resistance. The undertone of caution was reinforced by the prime rate increase announced early in the month. Subsequently, however, a steadier tone emerged in both sectors. A fairly good investor interest in new and recently issued tax-exempt securities developed before midmonth. At the same time, underwriters in the corporate sector probed for new trading levels. While some corporate offerings were marketed at slightly lower yields, they often drew mixed receptions from investors.

In the final third of the month, prices of corporate and tax-exempt bonds moved lower on balance in relatively light trading. A more cautious undertone again emerged in both sectors during this period, reflecting some concern about the lack of investment interest in these securities as well as uncertainty over the outcome of the Treasury's refunding operation.

At the end of January, *The Weekly Bond Buyer's* yield index of twenty seasoned tax-exempt issues was quoted at 4.91 percent, 6 basis points higher than a month earlier. Moody's index for seasoned Aaa-rated corporate bonds closed the month at 6.59 percent, 4 basis points higher than a month earlier. The Blue List of advertised dealer inventories of tax-exempt securities totaled $601 million at the end of the month as against the December 31 level of $547 million.

BANK RESERVES AND THE MONEY MARKET

The tone of the money market was generally quite firm during January. In the January 8 statement period, reserve distribution favored banks outside the major money centers. As banks in the central money market came under heightened reserve pressures, largely because of a sizable contraction in demand and time deposits, the average basic reserve deficit of the eight major New York City banks deepened to $1.4 billion (see Table II). Most Federal funds transactions during the week were effected in a 6½ percent to 6¾ percent rate range.

A firm tone persisted in the January 15 statement period. The average basic reserve deficit at the eight major New York City banks grew by $130 million to almost $1.6 billion, while the deficit of the thirty-eight major banks in the money centers outside New York City rose by $206 million to almost $2.1 billion. This deterioration resulted primarily from a further contraction in deposits coupled with an increase in required reserves—an increase which, because of the two-week lag under the new reserve-accounting method, reflected earlier deposit growth. On a nationwide basis, average member bank borrowings from the Federal Reserve Banks rose during the January 15 week by $189 million and net borrowed reserves increased fairly sharply (Table I). The large money market banks also continued to purchase a substantial volume of Federal funds (see Table II), at rates which were predominantly in a 6⅜ to 6⅝ percent range during the statement period.

A steadily firm tone was evident in the money market during the January 22 statement week. A pronounced shift in reserve distribution in favor of the major money market banks occurred, as evidenced by a sharp improvement in the basic reserve positions of the eight major New York City banks and a slight improvement in the reserve positions of the thirty-eight money market banks

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1969

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

Factors	Changes in daily averages— week ended on Jan. 1	Jan. 8	Jan. 15	Jan. 22	Jan. 29	Net changes
"Market" factors						
Member bank required reserves	— 625	— 328	— 573	+ 257	+ 668	— 601
Operating transactions (subtotal)	— 128	+ 135	+ 782	+ 169	— 358	+ 600
Federal Reserve float	+ 24	— 331	— 332	+ 43	— 558	—1,154
Treasury operations*	— 119	— 19	+ 16	+ 18	— 166	— 270
Gold and foreign account	+ 2	— 2	+ 1	+ 15	+ 69	+ 85
Currency outside banks	+ 84	+ 365	+1,188	+ 15	+ 393	+1,995
Other Federal Reserve accounts (net)†	— 120	+ 128	— 42	+ 78	— 95	— 56
Total "market" factors	— 753	— 193	+ 209	+ 426	+ 310	— 1
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 576	+ 398	— 175	— 480	— 503	— 184
Bankers' acceptances	— 1	+ 2	— 2	— 4	— 2	— 7
Repurchase agreements:						
Government securities	+ 166	— 54	— 172	—	—	— 60
Bankers' acceptances	+ 21	+ 1	— 29	—	—	— 7
Federal agency obligations	+ 7	+ 5	— 16	—	—	— 4
Member bank borrowings	+ 459	— 819	+ 189	+ 92	+ 112	+ 33
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+1,228	— 467	— 205	— 392	— 393	— 229
Excess reserves	+ 475	— 660	+ 4	+ 34	— 83	— 230
	Daily average levels					
Member bank:						
Total reserves, including vault cash	28,295	27,963	28,540	28,317	27,566	28,136‡
Required reserves	27,433	27,761	28,334	28,077	27,409	27,803‡
Excess reserves	862	202	206	240	157	333‡
Borrowings	1,318	499	688	780	892	835‡
Free, or net borrowed (—) reserves	— 456	— 297	— 482	— 540	— 735	— 502‡
Nonborrowed reserves	26,977	27,464	27,852	27,537	26,674	27,301‡
Net carry-over, excess or deficit (—)§	191	298	117	69	115	158‡
	Changes in Wednesday levels					
System account holdings of Government securities maturing in:						
Less than one year	+ 331	— 215	— 535	+ 297	— 159	— 281
More than one year	—	—	—	—	—	—
Total	+ 331	— 215	— 535	+ 297	— 159	— 281

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 for five weeks ended January 29, 1969.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JANUARY 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended Jan. 1	Jan. 8	Jan. 15	Jan. 22	Jan. 29	Averages of five weeks ended on Jan. 29
Eight banks in New York City						
Reserve excess or deficiency(—)*	291	— 29	— 16	36	18	60
Less borrowings from Reserve Banks	434	—	136	86	—	131
Less net interbank Federal funds purchases or sales(—)	1,090	1,403	1,410	635	— 128	882
Gross purchases	*1,634*	*2,166*	*2,333*	*1,735*	*1,353*	*1,844*
Gross sales	*544*	*764*	*923*	*1,100*	*1,481*	*962*
Equals net basic reserve surplus or deficit(—)	—1,232	—1,432	—1,562	— 685	146	— 953
Net loans to Government securities dealers	837	828	732	706	838	788
Net carry-over, excess or deficit(—)†	67	94	12	— 8	29	39
Thirty-eight banks outside New York City						
Reserve excess or deficiency(—)*	205	— 48	— 21	— 8	— 41	17
Less borrowings from Reserve Banks	483	186	237	346	260	302
Less net interbank Federal funds purchases or sales(—)	1,518	1,626	1,807	1,625	1,083	1,532
Gross purchases	*2,792*	*3,141*	*3,235*	*2,872*	*2,554*	*2,919*
Gross sales	*1,274*	*1,515*	*1,428*	*1,247*	*1,471*	*1,387*
Equals net basic reserve surplus or deficit(—)	—1,796	—1,859	—2,065	—1,979	—1,384	—1,817
Net loans to Government securities dealers	360	383	172	280	396	318
Net carry-over, excess or deficit(—)†	21	97	22	3	22	33

Note: Because of rounding, figures do not necessarily add to totals.
* 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 percent

Maturities	Weekly auction dates—January 1969 Jan. 6	Jan. 13	Jan. 20	Jan. 27
Three-month	6.227	6.215	6.076	6.167
Six-month	6.365	6.375	6.233	6.255

Maturities	Monthly auction dates—November 1968-January 1969 Nov. 22	Dec. 23	Jan. 28
Nine-month	5.693	6.483	6.195
One-year	5.568	6.412	6.144

* 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.

outside New York City (see Table II). At the same time, however, nationwide reserve availability contracted somewhat, largely as a result of System open market operations which more than absorbed the reserves released by market factors. Against this background, Federal funds traded predominantly in a 6¼ to 6⅝ percent range, while average member bank borrowings from the Federal Reserve Banks rose by an additional $92 million to $780 million.

In the final statement period of the month, the reserve positions of the forty-six major reserve city banks improved dramatically, partly as a result of a sharp contraction in required reserves and expanded borrowings from foreign branches. The large New York City banks actually accumulated an average basic reserve surplus (see Table II) for the first time in almost a year, and their net sales of Federal funds averaged $128 million. Accordingly, most Federal funds transactions took place in a 6⅛ to 6½ percent rate range. At the same time, nationwide reserve availability contracted by $195 million as average net borrowed reserves rose to $735 million. With reserve distribution sharply favoring money market banks, pressure on the reserve positions of banks outside the money centers intensified. As a consequence of heightened reserve pressures at the relatively smaller banks, member bank borrowings from the Federal Reserve Banks rose by $112 million to $892 million.

Offering rates posted by the major New York City banks on the various maturities of CD's generally remained at the Regulation Q ceiling levels in January, while the outstanding volume of CD's continued to fall. CD's outstanding at the weekly reporting banks in New York City declined by $810 million between December 31 and January 29, compared with a $1 billion contraction in December. At the same time, however, liabilities of United States banks to their foreign branches rose by $2.6 billion, more than offsetting the $1.2 billion contraction in December.