The Money and Bond Markets in February

In February, participants in the money and bond markets came increasingly to the view that fiscal and monetary restraint would continue for an extended period, and interest rates rose in the capital markets. The pervasive effects of monetary restraint became more visible, and the new Administration made clear the high priority it accorded to combating inflation. In this context, market participants expected that an extension would be sought in the income tax surcharge currently scheduled to expire on June 30. Also influencing the market were indications that the Treasury would request the Congress to remove the 4¼ percent ceiling on the coupon rates of new Treasury bond offerings.

The banking system remained under considerable pressure during the month as the runoff of large-denomination certificates of deposits (CD's) necessitated continuing adjustments. Bidding for Euro-dollars remained strong, and with the availability of additional funds in this form more limited than in January their rates rose. (The three-month rate on Euro-dollar funds reached 8⁷⁄₁₆ percent bid at the month end.) Banks drew further on their secondary reserves during the month and began selling intermediate- and long-term Government securities as well.

The tone of the money market was quite firm during most of the month. Federal funds transactions were predominantly in a 6¼ to 7 percent range, but some trading occurred at rates exceeding 7 percent. Nationwide reserve availability contracted and member bank borrowings at the Reserve Banks averaged $836 million in February, virtually unchanged from the relatively high January average level.

In the market for Treasury notes and bonds, yields moved higher on balance in February, with most of the upward adjustment recorded in the second half of the month. Elsewhere in the capital market, a somewhat improved tone emerged in the corporate sector early in the month, partly reflecting the favorable technical position of that market. Renewed caution developed as the period progressed, however, and over the month as a whole yields on corporate bonds rose. In the tax-exempt sector, attention continued to focus upon fading commercial bank demand and yields rose further in February.

Rates on Treasury bills moved lower through most of the month. Strong demand for shorter term bills from investors fearful of the interest rate outlook was added to reinvestment demand from holders of the $2 billion of February 15 maturities redeemed during the Treasury's February refunding. Late in the month, however, bill rates moved higher as talk of a possible rise in the commercial bank prime rate increased. Over the month as a whole, most bill rates were little changed on balance.

BANK RESERVES AND THE MONEY MARKET

The tone of the money market was generally firm during the February 5 statement week, and most Federal funds transactions took place in a 6¼ to 6⅜ percent rate range. Nationwide reserve distribution, which had been unusually favorable to the large reserve city banks in the latter part of January,[1] continued to favor banks in the central money market at the beginning of February. Consequently, the large New York City banks as a group accumulated a sizable basic reserve surplus and made large net sales of Federal funds. As the period progressed, however, reserve distribution gradually shifted in favor of banks outside the leading money centers. As a result, the basic reserve position of the major reserve city banks deteriorated sharply and they resumed their more characteristic role of net purchasers of Federal funds.

During the February 12 statement period, the market tone was affected by the weekend snowstorm, which paralyzed much of the Northeast and consequently impeded flows of funds, as well as by the Lincoln's Birthday bank holiday which was observed in many money centers on the final day of the period. Despite an expansion in Federal Reserve float following the snowstorm, average nationwide reserve availability during the period contracted by about $76 million from the preceding week (see Table I), partly as a result of an increase in Treasury deposits at the Federal Reserve Banks. Moreover, reserves con-

[1] For details see this *Review* (February 1969), pages 32 and 34.

Table I

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

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

Factors	Changes in daily averages—week ended on Feb. 5	Feb. 12	Feb. 19	Feb. 26	Net changes
"Market" factors					
Member bank required reserves	+ 202	+ 158	— 184	+ 335	+ 511
Operating transactions (subtotal)	— 90	— 421	— 274	+ 127	— 658
Federal Reserve float	— 33	+ 65	+ 44	+ 22	+ 98
Treasury operations*	+ 223	— 335	+ 161	+ 112	+ 161
Gold and foreign account	+ 3	— 4	—	+ 4	+ 3
Currency outside banks	— 123	— 188	— 461	+ 194	— 578
Other Federal Reserve accounts (net)†	— 161	+ 41	— 18	— 204	— 342
Total "market" factors	+ 112	— 263	— 458	+ 462	— 147
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 69	—	+ 55	+ 16	+ 140
Bankers' acceptances	+ 1	— 1	—	+ 3	+ 3
Repurchase agreements:					
Government securities	+ 8	+ 146	+ 251	— 308	+ 97
Bankers' acceptances	—	+ 20	+ 65	— 42	+ 52
Federal agency obligations	—	+ 18	+ 15	— 20	+ 8
Member bank borrowings	— 145	+ 50	+ 246	— 285	— 134
Other loans, discounts, and advances	—	—	—	—	—
Total	— 67	+ 237	+ 631	— 635	+ 166
Excess reserves	+ 45	— 26	+ 173	— 173	+ 19
	Daily average levels				
Member bank:					
Total reserves, including vault cash	27,409	27,225	27,582	27,074	27,322‡
Required reserves	27,207	27,049	27,233	26,898	27,097‡
Excess reserves	202	176	349	176	226‡
Borrowings	747	797	1,043	758	836‡
Free, or net borrowed (—), reserves	— 545	— 621	— 694	— 582	— 610‡
Nonborrowed reserves	26,662	26,428	26,539	26,316	26,486‡
Net carry-over, excess or deficit (—)§	76	94	92	200	116
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	— 263	—	—8,214	— 442	—8,919
More than one year	—	—	+8,479	+ 62	+8,541
Total	— 263	—	+ 265	— 380	— 378

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 four weeks ended on February 26, 1969.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS FEBRUARY 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on Feb. 5	Feb. 12	Feb. 19	Feb. 26	Averages of four weeks ended on Feb. 26
Eight banks in New York City					
Reserve excess or deficiency(—)*	— 20	— 17	86	43	23
Less borrowings from Reserve Banks	73	91	64	21	62
Less net interbank Federal funds purchases or sales(—)	— 309	514	557	186	237
Gross purchases	*1,172*	*1,633*	*1,756*	*1,648*	*1,552*
Gross sales	*1,482*	*1,119*	*1,199*	*1,462*	*1,316*
Equals net basic reserve surplus or deficit(—)	217	— 622	— 535	— 164	— 276
Net loans to Government securities dealers	885	629	498	379	598
Net carry-over, excess or deficit(—)†	35	— 2	— 3	58	22
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	55	— 1	32	— 4	21
Less borrowings from Reserve Banks	139	249	418	171	244
Less net interbank Federal funds purchases or sales(—)	1,325	1,580	958	849	1,178
Gross purchases	*2,870*	*3,067*	*2,762*	*2,813*	*2,878*
Gross sales	*1,545*	*1,487*	*1,804*	*1,964*	*1,700*
Equals net basic reserve surplus or deficit(—)	—1,409	—1,831	—1,344	—1,024	—1,402
Net loans to Government securities dealers	244	102	65	35	112
Net carry-over, excess or deficit(—)†	— 20	33	16	54	21

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—Feb. 1969: Feb. 3	Feb. 10	Feb. 17	Feb. 24
Three-month	6.251	6.199	6.092	6.080
Six-month	6.359	6.349	6.268	6.258

Maturities	Monthly auction dates—Dec. 1968 to Feb. 1969: Dec. 23	Jan. 28	Feb. 20
Nine-month	6.483	6.195	6.307
One-year	6.412	6.144	6.234

* 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.

tinued to flow away from the major money market banks. Against this background, the tone of the money market was quite firm. As the basic reserve positions of the eight large banks in New York City and the thirty-eight major banks in other money centers deteriorated sharply, these banks collectively made larger net purchases of Federal funds and increased their borrowings from the Federal Reserve Banks (see Table II).

In the February 19 statement period, nationwide reserve availability contracted further, largely as a result of a substantial decline in vault cash and an expansion in required reserves, and the tone of the money market was quite taut. The large commercial banks, accordingly, were strong bidders in the Federal funds market where trading was predominantly in a 6¾ to 7¼ percent range from February 13 through February 18. They also increased their borrowings from the Federal Reserve Banks by $246 million on a daily average basis during the statement period. On the final day of the statement period, the major New York City banks which had overprovided for their reserve needs, supplied a sizable amount of reserves to the Federal funds market. As a result, the effective rate in that market fell to 5 percent and some trading took place at rates as low as 2 percent.

The money market was firm during the final statement week of the month, but the tautness of the preceding week did not persist. Federal funds traded predominantly in a 6½ to 6¾ percent range, the average level of borrowings from the Federal Reserve Banks declined to $758 million, and average net borrowed reserves eased to $582 million. In part, the moderation of pressures in the money market reflected both the sizable amount of excess reserves which member banks carried forward from the preceding week (see Table I) and an improvement in the basic reserve position of the banks in the major money centers (see Table II).

Rates on several types of money market instruments were adjusted higher in February. Rates quoted by dealers in bankers' acceptances on paper maturing in ninety days generally rose by ¼ percent to 6¾ percent bid-6⅝ percent offered. Rates on dealer-placed prime four- to six-month commercial paper moved ¼ percent higher to 6¾ percent offered, and rates on various maturities of directly placed commercial paper increased by ⅛ percent.

With new CD's at a persisting rate disadvantage compared with competing money market instruments (notably Treasury bills), the outstanding volume of CD's continued to contract. At the weekly reporting banks in New York City, the decline amounted to approximately $650 million between January 29 and February 26, while CD's outstanding at all weekly reporting banks declined by $1.1 billion. At the same time, liabilities of United States banks to their foreign branches rose in February by $213 million, far short of the much sharper rise recorded in January.

THE GOVERNMENT SECURITIES MARKET

The subscription period for the Treasury's refunding operation occupied the first three business days of February, and during that time activity was subdued in the market for Treasury notes and bonds.[2] Prices of intermediate-term maturities fluctuated narrowly, as the public accorded the Treasury's offering a lukewarm reception. Prices of longer term issues at first declined rather sharply, when there was some investor switching out of long-term Treasury issues into corporate and Government agency issues, but then quickly rebounded in response to renewed investor demand.

On February 7, the Treasury announced the results of the refunding. Approximately 36 percent of the maturing securities held outside the Federal Reserve Banks and Government accounts was not exchanged for the new notes offered by the Treasury and thus was earmarked for cash redemption. Total subscriptions (including those from both public and official sources) amounted to about $12.5 billion or about 86 percent of the $14.5 billion of notes and bonds maturing on February 15. Subscriptions totaled $8.8 billion for the new 6⅜ percent notes of 1970 and $3.7 billion for the new 6¼ percent notes of 1976, with only $885 million of the latter taken by the public.

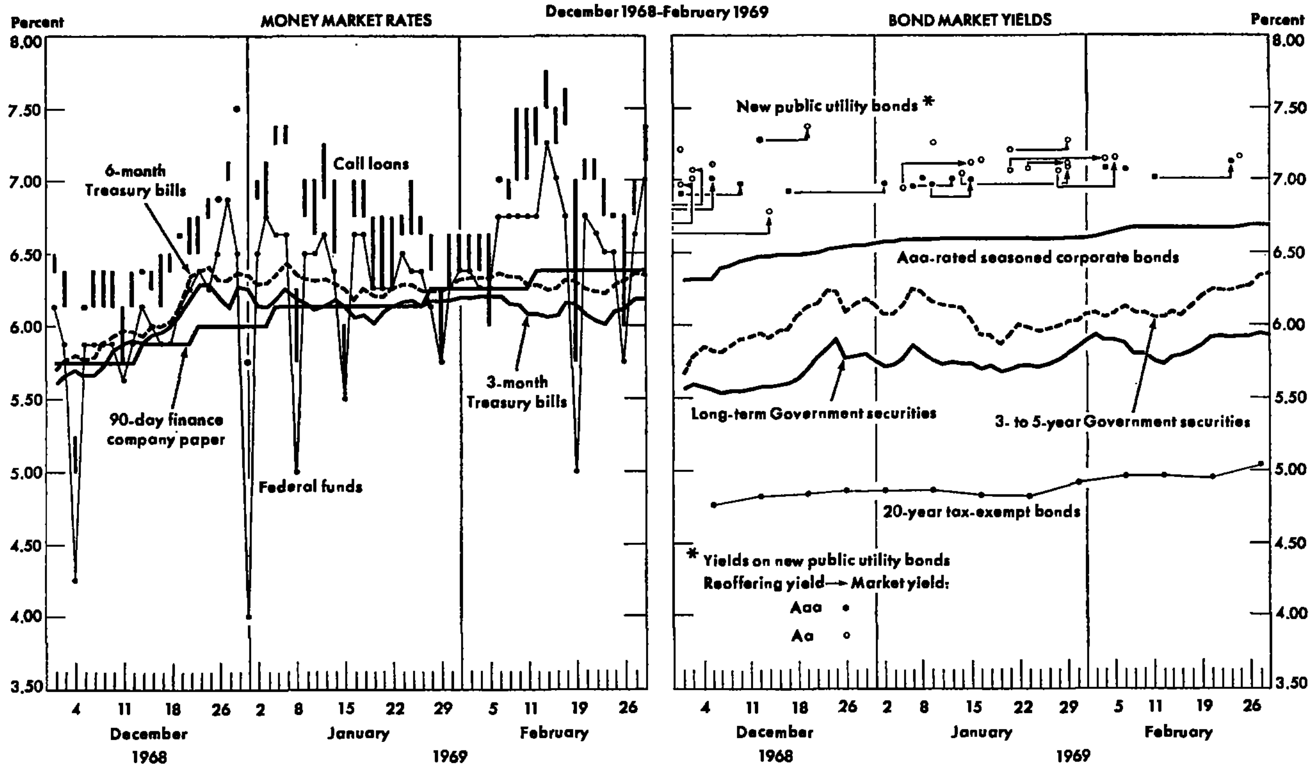
The attrition was considerably larger than had generally been expected by market participants. In particular, the relatively small amount of public subscriptions for the notes of 1976 implied that the issue would be in scarce supply, and this sparked expanded demand for these obligations (trading on a "when-issued" basis) and for outstanding intermediate-term issues as well. Subsequently, a steady investment demand developed for coupon issues of various maturities. From February 6 through February 13, prices of long-term Treasury bonds generally rose, reflecting both investment demand and the improved tone of the corporate bond market, while prices of intermediate-term Government securities also edged higher. (Associated yield declines are illustrated in the right-hand panel of the chart.)

A more cautious atmosphere emerged in the coupon sector around midmonth. Market participants grew more

[2]For details of the refunding offering, see this *Review* (February 1969), page 31.

SELECTED INTEREST RATES

December 1968-February 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.

pessimistic about the interest rate outlook as they weighed the possibility of further increases in the discount rate and the prime rate, while also assessing comments from members of the new Administration which suggested the need for rather prolonged monetary and fiscal restraint. Sentiment in the coupon sector was also affected by indications that the Administration would soon ask the Congress to remove the 4¼ percent ceiling on the coupon rate that the Treasury may offer on new bonds. Moreover, the February 27 increase in the British bank rate from 7 percent to 8 percent drew a cautious reaction in the market. Against this background, prices of coupon issues generally drifted steadily lower from February 14 through the end of the month although the relatively strong technical position of the market somewhat limited the extent of the decline. Overall activity was generally light, but offerings were absorbed by a net investment demand. Prices of longer term bonds suffered relatively large declines, reflecting both some switching out of longer Treasury issues into corporate bonds and outright sales by commercial banks.

Despite the pessimistic climate which generally pervaded most other sectors of the securities market, a relatively strong tone was evident in the Treasury bill sector during most of February as many investors preferred to remain liquid in the face of major market uncertainties. In the first few days of the month, a good investment demand emerged for shorter term bills—which were in scarce supply—and their rates were generally steady to lower. At the same time, however, professional offerings of longer term bills expanded and rates on these obligations tended to edge slightly higher. After the Treasury's refunding results were released on February 7, rates for all bill maturities moved lower as the unexpectedly large attrition led participants to look forward to sizable reinvestment demand for bills from holders of the maturing coupon issues who had decided not to exchange them for new notes. Bill rates continued to decline through midmonth in response to broad investment demand from various sources, especially public funds and other institutional investors. (See the left-hand panel of the chart.) From midmonth through February 25, rates moved irregularly, with declines outnumbering gains.

On February 19, the Treasury announced that it would auction a $1 billion "strip" of bills on February 25 for payment on March 3. The offering represented a $200 million addition to each of five outstanding bill issues maturing from April through August, with subscribers required to take equal amounts of each of the reopened issues. Commercial banks bid aggressively for the strip for which they were permitted to make full payment in the form of credits to Treasury Tax and Loan Accounts. The bill strip was auctioned at an average issuing rate of 5.907 percent. In the closing days of the month, some selling pressures emerged in the bill market and rates edged higher, as banks actively disposed of their awards of the bill strip.

At the regular monthly auction on February 20, average issuing rates on the new nine- and twelve-month bills were set at 6.307 percent and 6.234 percent, respectively, 11 and 9 basis points higher than the average rates at the comparable January auction (see Table III). At the final regular weekly auction of the month, held on February 24, average issuing rates for the new three- and six-month bills were set at 6.080 percent and 6.258 percent, respectively, 9 basis points lower and about unchanged from the average rates established a month earlier.

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, yields on new and recent issues continued to move higher in the opening days of the month amid persisting uncertainty over the future course of interest rates. A new Aaa-rated utility company issue of first mortgage bonds carrying five years of call protection was offered to investors on February 4 at a price to yield 7.07 percent, the highest offering yield ever recorded on a comparable flotation. Nevertheless, investors did not respond enthusiastically to the offering. In both the corporate and tax-exempt sectors, underwriters probed for yield levels which would generate investor interest. Many syndicate price terminations occurred in early February, and the ensuing price reductions boosted yields 5 to 20 basis points. A continuing concern over the dimensions of commercial bank demand for obligations of state and local governments added to the heavy atmosphere in the tax-exempt market.

A more optimistic tone emerged in the corporate sector during the statement period ended on February 12. Market participants were heartened after investors (particularly public pension funds) accorded an enthusiastic reception to an Aaa-rated utility issue which was offered on February 6 to yield 7.06 percent. This excellent response stood in contrast to the initial apathetic reception accorded a somewhat similar flotation just two days earlier and boosted sales of the earlier issue. The corporate bond sector was also encouraged by the relatively moderate February calendar of scheduled new offerings and by the emergence of a steady investment demand. Against this background, three corporate bond issues with small unsold balances that were released from underwriter price restrictions promptly rose in price, in striking contrast to the price cutting which had generally followed syndicate terminations earlier in the month. In the tax-exempt market, however, attention continued to focus on the shallowness of commercial bank demand and a restrained tone persisted during the February 12 week. Despite minimal new issue activity, dealers made little progress in reducing their inventories of tax-exempt bonds during the period.

Subsequently, although the technical position of the corporate bond sector remained strong, market participants reacted with considerable caution to new assessments of the outlook for domestic economic policy and interest rates. In this more bearish setting, corporate bond yields generally adjusted higher in the second half of February. At the same time, sentiment in the tax-exempt sector continued quite restrained and record yield levels predominated. A record 5.135 percent net interest cost was set for a large issue of new Housing Authority bonds.

At the end of February, *The Weekly Bond Buyer's* yield index of twenty seasoned tax-exempt issues rose to a modern high of 5.04 percent, 13 basis points higher than a month earlier and well above the 4.95 to 4.96 percent levels which had prevailed during the first three weeks of the month. Moody's index for seasoned Aaa-rated corporate bonds closed the month at 6.69 percent, 10 basis points higher than a month earlier. The Blue List of advertised dealer inventories of tax-exempt securities totaled $569 million at the end of the month as against its January 31 level of $601 million.