The Money and Bond Markets in April

During April the money market was subjected to pressure from greater monetary restraint and from unusually large reserve drains around midmonth. The Federal funds rate and other short-term interest rates advanced in the wake of the April 3 announcement of increases in the Federal Reserve discount rate and reserve requirements on demand deposits at member banks. (For details, see the statement of the Board of Governors reproduced in full on page 75 of the April issue of this *Review.*) Accompanying the firmer money market conditions that emerged during the month were variations in day-to-day rates which reflected some fairly abrupt shifts in the distribution of reserves between money center and other banks. In large part, these fluctuations were due to wide swings in the size and distribution of Treasury cash balances around the midmonth tax date. After mid-April, however, short-term Treasury bill rates began to reverse the upward movement which had occurred earlier, and by the month end rates were below March 31 levels.

Sentiment in the bond markets, particularly in the corporate sector, continued to improve, and some feeling developed that yields had already hit their peaks for the year. New issues were aggressively sought for a time at declining yields, prices of outstanding bonds rose sharply, and the market resisted such potentially bearish price influences as a rebound in the volume of new offerings, the report of a strong first-quarter advance in gross national product, and new trouble with North Korea. The marked revival of expectations that lower interest rates lay ahead stemmed from a growing belief that the anti-inflation programs of the Federal Reserve and the Administration, including the proposed repeal of the investment tax credit, would prove effective. Renewed optimism over progress toward a settlement in Vietnam worked in the same direction. By the month end, however, the rally began to lose steam as money market rates remained high and signs of a slowing of price inflation remained sparse.

BANK RESERVES AND THE MONEY MARKET

Increased pressure on bank reserves during April was apparent in some increase in member bank borrowings from the Federal Reserve Banks and a marked rise in the prevailing range of Federal funds rates. For April as a whole, borrowings at the discount window averaged approximately $1 billion, a rise of close to $80 million from March. Since excess reserves declined on balance, net borrowed reserves in April advanced $160 million to $860 million.

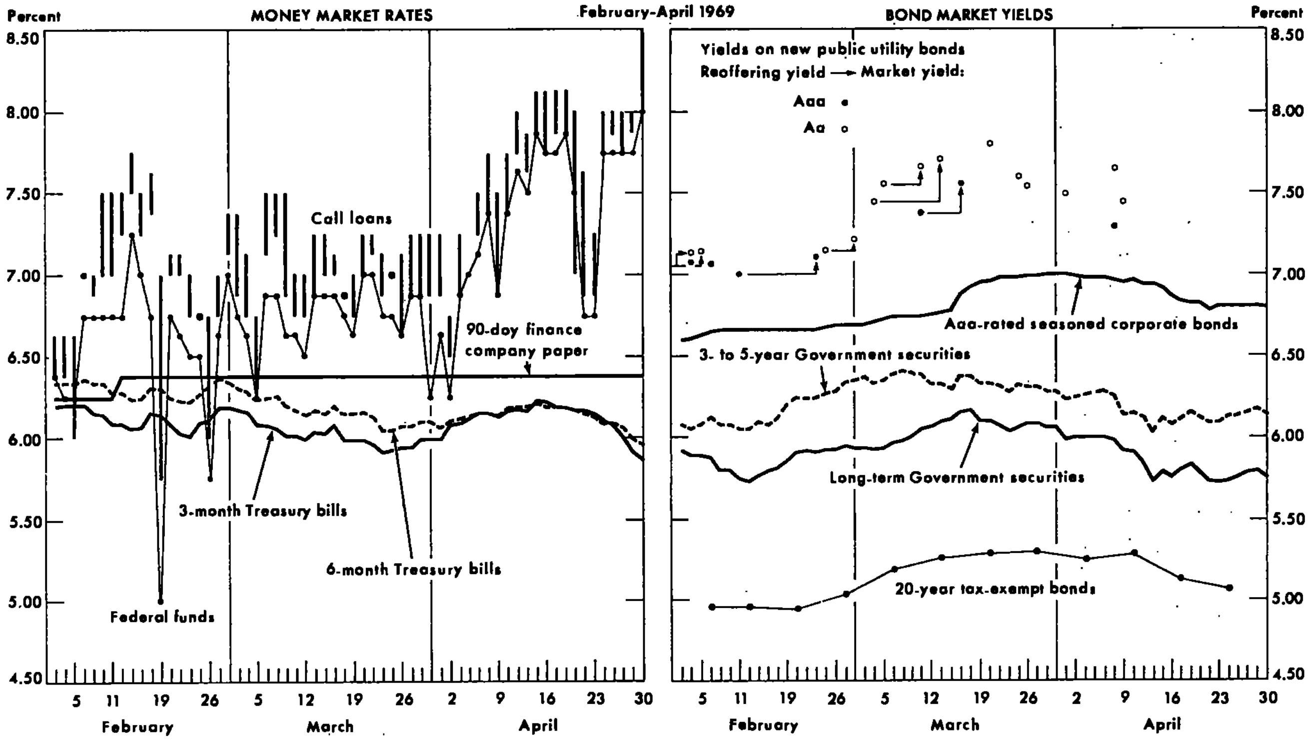
The Federal funds rate, after having remained mostly in a 6⅝ to 6⅞ percent range in March, moved up to a 7 to 7½ percent range following the announcement of the discount rate and reserve requirement increases in early April (see Chart I). About midmonth the rate rose further to around 7¾ percent. The distributional effects of the Treasury operations on the major money market banks were quite pronounced during April. Chart II records the pattern of basic reserve deficits during the February-April period for the past three years. The early- to mid-April jump was far more than seasonal in 1969 and, indeed, the $2¾ billion rise during the two-week period was one of the sharpest on record. The major money market banks, in seeking to cover their combined deficit of over $4½ billion, were instrumental in bidding up the Federal funds rate. While a subsequent reversal of the skewed distribution of reserves brought a temporary respite, Federal funds continued to trade at 7¾ percent or above for most of the last half of the month. Indeed, on April 30, the final day of a statement week, some transactions at rates as high as 9½ percent were reported.

Reserve management in April had to deal with the effects of the increase in reserve requirements and with recourse to temporary Federal Reserve credit by the Treasury to bridge the gap between receipts and expenditures. At the beginning of April, Treasury balances were inadequate to cover net outlays until the inflow of tax receipts after midmonth. As a consequence, funds flowing into large banks for the account of the Treasury were withdrawn daily, and remaining cash shortfalls were financed by the sale of special certificates to the Federal Reserve. Thus, reserves were redistributed from money center banks to others, and at the same time credit extended to the Treasury by the System was creating new reserves which had to be offset by open market operations. As corporate

Chart I

SELECTED INTEREST RATES

February-April 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 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).

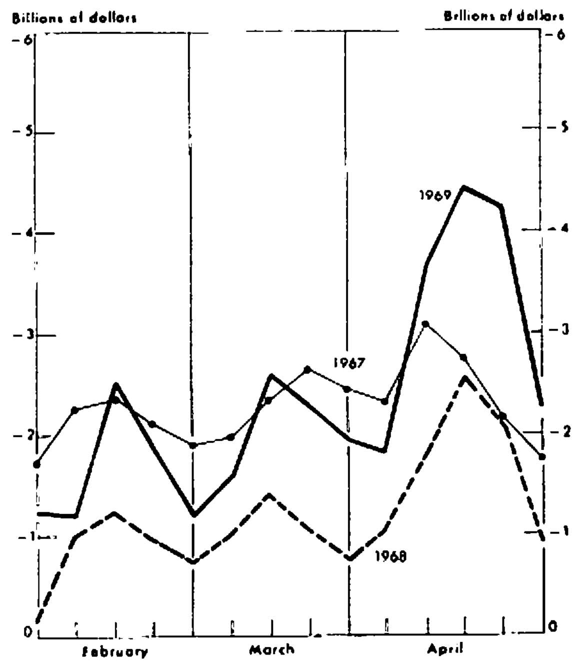
Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, and The Weekly Bond Buyer.

tax payments began to flow in at midmonth, balances in Tax and Loan Accounts at commercial banks were restored and indebtedness to the Federal Reserve was repaid. In sum, Treasury cash management operations provided about $1 billion in reserves in the week ended on April 16 and then withdrew around $1.2 billion during the succeeding week as operations were reversed (see Table I).

Confronted with the need to absorb a substantial volume of reserves in the week ended on April 16, and to reverse direction in the following week, the System resorted extensively in the earlier week to matched sale and purchase transactions. These operations involved sales of Treasury bills by the System to dealers under agreements to repurchase during the next week. Initially, then, these transactions absorbed reserves, and the impact tended to fall on money market banks, where reserve pressures were already great. The ½ percentage point boost in reserves required against member bank demand deposits applied to deposits in the week that began April 3. Because of the two-week lag in reserve settlement, however, the full impact was delayed until the week beginning April 17, when this action accounted for about $650 million of the total rise of $940 million in required reserves for that week.

In spite of these reserve pressures, monetary aggregates were buoyant. Total deposits subject to reserve requirements (the bank credit proxy) rose about 6 percent (seasonally adjusted annual rate) in April after a 5 percent drop in the first quarter. Adjustment to include liabilities to foreign branches would have more than halved the first-quarter decline, but would not have altered the April results much (although sales of assets by domestic banks to their foreign branches introduced some distortion). Liabilities to foreign branches, which had advanced about $3.9 billion in the first three months of 1969, registered a drop of $200 million in April. This reversal coincided with a slowdown in the rate of decline in time deposits at commercial banks. While large certificates of deposit continued the slide that has taken place throughout 1969, liquidations in April were little more than seasonal. Indeed, total time deposits on a seasonally adjusted basis were about unchanged in April after a drop of 6½ percent in the first quarter. Following a 2 percent rise in the first quarter, the money supply registered a surprising 13 percent annual-rate gain in April. Part of this upsurge was related to a sharp, temporary fall in the amount of cash items in process of collection. In turn, this drop was associated with a lull in transactions involving foreign banks, which were closed for holidays both before and after the Easter weekend. This kind of aberration also occurred in 1968, but on a somewhat smaller scale.

Chart II
BASIC RESERVE POSITIONS OF MAJOR MONEY MARKET BANKS



Note: All figures shown represent deficit positions. Calculation of the basic reserve position is illustrated in Table II.

THE GOVERNMENT SECURITIES MARKET

In the market for Government securities most yields declined on balance during April, although some bill rates were higher during the first half of the month. The upturn was attributable in part to bank sales of issues acquired in late-March Treasury offerings and to money market pressures which increased dealer financing costs. Many bill rates initially jumped from 5 to 9 basis points in reaction to the April 3 announcement of monetary policy actions, although bills due after six months soon retraced most of the rise.

After midmonth, upward impulses subsided and rates worked lower. The Treasury announcement that $200 million of the maturing April 30 bill would not be refunded, public fund demand, and reinvestment of the proceeds of maturing tax anticipation bills contributed to the improved performance. Long bills tended to benefit somewhat from the increased confidence that monetary and fiscal measures attacking inflationary pressures would be effective in the long run. Participants also anticipated that the Treasury's May refinancing operation would generate strong demand for bills. As a consequence, the yield curve in the bill market was flat during much of the latter half of the month, and the six-month bill sometimes traded slightly below the rate level of the three-month bill. At the regular monthly auction on April 24, average issuing rates on the nine- and twelve-month bills were set at 5.98 and 5.93 percent, respectively, 8 and 20 basis points lower than comparable rates at the auction a month earlier (see Table III). At the close of the month, the quoted rates on three- and six-month maturities were 5.87 and 5.96 percent bid, respectively, down 12 and 14 basis points from March 31. Rates for most other bills registered net declines of from 2 to 17 basis points in April.

Long-term markets were bolstered by the prospect of intensified monetary and fiscal attacks on inflation and by optimism about a resolution of the struggle in Vietnam. Participants focused on the positive aspects of changes in the discount rate and reserve requirements, expecting that such actions would contribute to price stability and, in time, to lower interest rates. Later in the month further improvement was generated in the capital markets by the President's recommendations for tax action. The view emerged that the elimination of the 7 percent investment tax credit might inhibit corporate capital expenditures and thereby contribute to a reduction of inflationary pressures and a contraction in the volume of corporate borrowing in the capital markets. The strong performance of the corporate bond market during the month gave a boost

Table I

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

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

Factors	Changes in daily averages—week ended on					Net changes
	April 2	April 9	April 16	April 23	April 30	
"Market" factors						
Member bank required reserves	— 79	+ 57	— 89	— 940	— 169	—1,220
Operating transactions (subtotal)	— 259	— 7	+ 390	+ 221	— 310	+ 35
Federal Reserve float	— 291	+ 249	+ 41	+ 688	— 770	— 88
Treasury operations*	+ 50	+ 119	+ 380	— 427	— 194	— 72
Gold and foreign account	+ 25	— 15	+ 29	+ 5	+ 2	+ 46
Currency outside banks	+ 55	— 90	— 189	— 160	+ 591	+ 207
Other Federal Reserve accounts (net)†	— 97	— 270	+ 130	+ 119	+ 61	— 57
Total "market" factors	— 338	+ 50	+ 301	— 719	— 479	—1,185
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 126	+ 185	— 192	+ 397	+ 364	+ 880
Outright holdings:						
Government securities	+ 51	+ 57	— 559	+ 819	+ 280	+ 648
Bankers' acceptances	+ 2	+ 3	— 1	+ 2	— 2	+ 4
Special certificates	—	+ 96	+ 627	— 723	—	—
Repurchase agreements:						
Government securities	+ 52	— 7	— 211	+ 223	+ 4	+ 61
Bankers' acceptances	+ 11	— 5	— 33	+ 56	+ 26	+ 55
Federal agency obligations	+ 10	— 9	— 15	+ 29	+ 56	+ 62
Member bank borrowings	+ 232	— 248	— 187	+ 374	— 17	+ 154
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+ 361	— 116	— 378	+ 770	+ 347	+ 984
Excess reserves	+ 23	— 66	— 77	+ 51	— 132	— 201

	Daily average levels					
Member bank:						
Total reserves, *including* vault cash	26,695	26,572	26,584	27,575	27,612	27,008‡
Required reserves	26,438	26,381	26,470	27,410	27,579	26,856‡
Excess reserves	257	191	114	165	33	152‡
Borrowings	1,195	947	760	1,134	1,117	1,031‡
Free, or net borrowed (—), reserves	— 938	— 756	— 646	— 969	—1,084	— 879‡
Nonborrowed reserves	25,500	25,625	25,824	26,441	26,495	25,977‡
Net carry-over, excess or deficit (—)§	136	130	125	41	85	103‡

	Changes in Wednesday levels					
System account holdings of Government securities maturing in:						
Less than one year	+ 326	+ 144	— 578	+ 409	+ 876	+1,177
More than one year	—	—	—	—	—	—
Total	+ 326	+ 144	— 578	+ 409	+ 876	+1,177

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 on April 30.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS APRIL 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Averages of five weeks ended on April 30
	April 2	April 9	April 16	April 23	April 30	
Eight banks in New York City						
Reserve excess or deficiency(—)*	18	— 7	— 35	41	— 32	— 3
Less borrowings from Reserve Banks	—	75	84	201	63	85
Less net interbank Federal funds purchases or sales(—)	— 159	888	1,807	1,435	293	853
Gross purchases	*1,332*	*1,833*	*2,382*	*2,202*	*1,558*	*1,861*
Gross sales	*1,491*	*946*	*575*	*767*	*1,265*	*1,009*
Equals net basic reserve surplus or deficit(—)	177	— 970	—1,926	—1,595	— 388	— 940
Net loans to Government securities dealers	440	948	1,010	780	645	765
Net carry-over, excess or deficit(—)†	38	35	11	— 24	14	15
Thirty-eight banks outside New York City						
Reserve excess or deficiency(—)†	3	23	— 149	— 1	— 23	— 29
Less borrowings from Reserve Banks	489	486	367	429	288	412
Less net interbank Federal funds purchases or sales(—)	1,452	2,202	2,136	2,201	1,521	1,902
Gross purchases	*3,293*	*3,607*	*3,630*	*3,430*	*3,047*	*3,401*
Gross sales	*1,841*	*1,405*	*1,494*	*1,229*	*1,526*	*1,499*
Equals net basic reserve surplus or deficit(—)	—1,939	—2,666	—2,652	—2,631	—1,832	—2,344
Net loans to Government securities dealers	— 95	80	218	124	— 5	64
Net carry-over, excess or deficit(—)†	31	29	43	14	17	27

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—April 1969				
	April 1	April 7	April 14	April 21	April 28
Three-month	6.065	6.167	6.195	6.175	6.053
Six-month	6.136	6.185	6.191	6.164	6.043

Maturities	Monthly auction dates—February-April 1969		
	February 20	March 26	April 24
Nine-month	6.307	6.058	5.977
One-year	6.234	6.132	5.931

* 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.

to prices of Treasury coupon issues. Momentum tapered off toward the end of the month, however, prompted by some profit taking and hesitation in the face of the upcoming announcement of the Treasury refinancing operation. On April 30 the Treasury announced that it would offer holders of issues maturing May 15 and June 15 a choice of a 6⅜ percent note, due in fifteen months and priced to yield 6.42 percent, or a seven-year 6½ percent note, priced at par. For the month as a whole, yields on three- to five-year issues were down 14 basis points, and long-term yields fell 29 basis points.

OTHER SECURITIES MARKETS

In the corporate bond sector new issue yields, which had begun to slide in mid-March, continued to decline throughout most of April. Although sporadic price corrections provided temporary interruptions, the underlying condition of the market was improved. After facing considerable resistance to new offerings in March, underwriters encountered renewed investment demand in April. As a consequence, inventories were considerably lightened, and, with a lower prospective supply of new offerings, aggressive bidding for new issues developed. At the same time that technical conditions improved, investors also appeared to be heartened by the new round of anti-inflation measures, and once again optimism over Vietnam peace spread through the market. Buoyancy was somewhat deflated late in the month, however, by the enlargement of dealer positions and by the announcement of very strong consumer price advances in March.

The revival in the corporate bond market appears to have commenced with the very strong reception of an $80 million Consolidated Edison issue, offered on March 19 to yield 7.90 percent. Subsequent financings, most of which carried some form of call protection, were offered at successively lower yields, and many traded at premiums after initial distribution. Some of the flotations had been postponed from the congested period of early March. One of the highlights in April was the excellent reception of a $75 million noncallable mortgage bond issue offered by Commonwealth Edison at 7.30 percent for three- and five-year maturities. This response prompted other borrowers to shorten maturities of their offerings. The short term to maturity was an innovative feature, attractive to investors and less costly to borrowers than comparable financing at commercial banks. However, investor enthusiasm ebbed at the month end, when more inflationary evidence came to light, and new bond offerings in both short and long maturities began to encounter resistance.

The tax-exempt sector also rallied, but the recovery was generally more limited than that in the corporate sector. The ability of commercial banks, facing severe reserve pressures, to add materially to tax-exempt holdings was thought questionable—particularly in light of strong business loan demand. Furthermore, investors expressed uncertainty about the tax status of these securities in view of the tax-reform measures now under consideration by the Congress. Finally, the numerous postponements recorded in March were still overhanging the market, and it was considered likely that a large volume would be offered if new issue rates edged much below 5 percent. The breach of that level in the earlier upsurge had prompted changes in financing plans, in many cases because borrowers were subject to 5 percent interest-rate ceilings. At the end of April, *The Weekly Bond Buyer's* index of twenty municipal bond yields was 5.09 percent, a drop of 21 basis points over the month.