The Money and Bond Markets in June

Rates on most money and bond market instruments moved higher during June as pressures intensified further. This tendency was highlighted by the unexpectedly large increase in the prime lending rate posted on June 9 by almost all commercial banks. The 1 percentage point rise brought the prime rate to a record 8½ percent and was followed by sharp increases in rates on many market instruments. While the renewed investor interest that was stimulated by these higher rates resulted in price improvements on some instruments after the initial reaction, rates on commercial paper and bankers' acceptances moved steadily higher in several steps over the month. Prime dealer-placed commercial paper maturing in four to six months was offered at 8⅝ percent on June 30, up 1⅛ percentage points from the close of May, while offering rates on directly placed paper of 60 to 270 days' maturity increased by ⅝ percentage point to 7½ percent over the same period. In the market for bankers' acceptances the bid and offered rates on ninety-day paper rose from 7¾-7½ percent to 8¾-8½ percent during the month.

Prices on both corporate and municipal bonds moved lower during the first week in June and then fell sharply in initial reaction to the prime rate rise. This was followed by an improved tone in the corporate market as investors responded favorably to the higher yield levels, but investor interest in the municipal market remained subdued until the final part of the period. The decline in the stock market and the subsequent switching of funds was an additional factor in the recovery of fixed-income corporate and municipal securities. The market for United States Government securities also was jolted by the prime rate increase, although prices of long-term Treasury bonds quickly recovered and closed higher for the month. In addition, the bill market came under pressure early in the month from heavy sales by foreigners. These sales resulted largely from the reversal of speculative flows into the German mark during May. Bill rates subsequently declined in the face of some reinvestment demand from holders of tax anticipation bills and other maturing Government securities as well as demand associated with midyear publication of financial statements.

In response to the rapid rise in Euro-dollar liabilities of commercial banks in recent months, the Board of Governors of the Federal Reserve System on June 26 proposed to amend its regulations governing member bank reserve requirements and the foreign activities of member banks. In releasing the proposals for comment, the Board stated that the changes are designed to remove a special advantage to member banks of using Euro-dollars for adjustment to domestic credit restraint. The Board stated that the increasing magnitude of this practice has had a distorting influence on credit flows in the United States and abroad. The proposed amendments would impose a 10 percent reserve requirement on certain member bank liabilities which have been free of reserve requirements, and on certain assets of member banks' foreign branches which have likewise been free of reserve requirements. Borrowings by member banks from their foreign branches as well as assets acquired by such branches from their parent banks—above the amount of such borrowings and assets in a base period—would be subject to a 10 percent reserve requirement. The reserve requirement would also be imposed on credit extended to United States residents by a member bank's foreign branch, to the extent that such credit exceeds the amount outstanding in a base period. In addition, a 10 percent reserve requirement would be imposed on member bank borrowings from foreign banks.

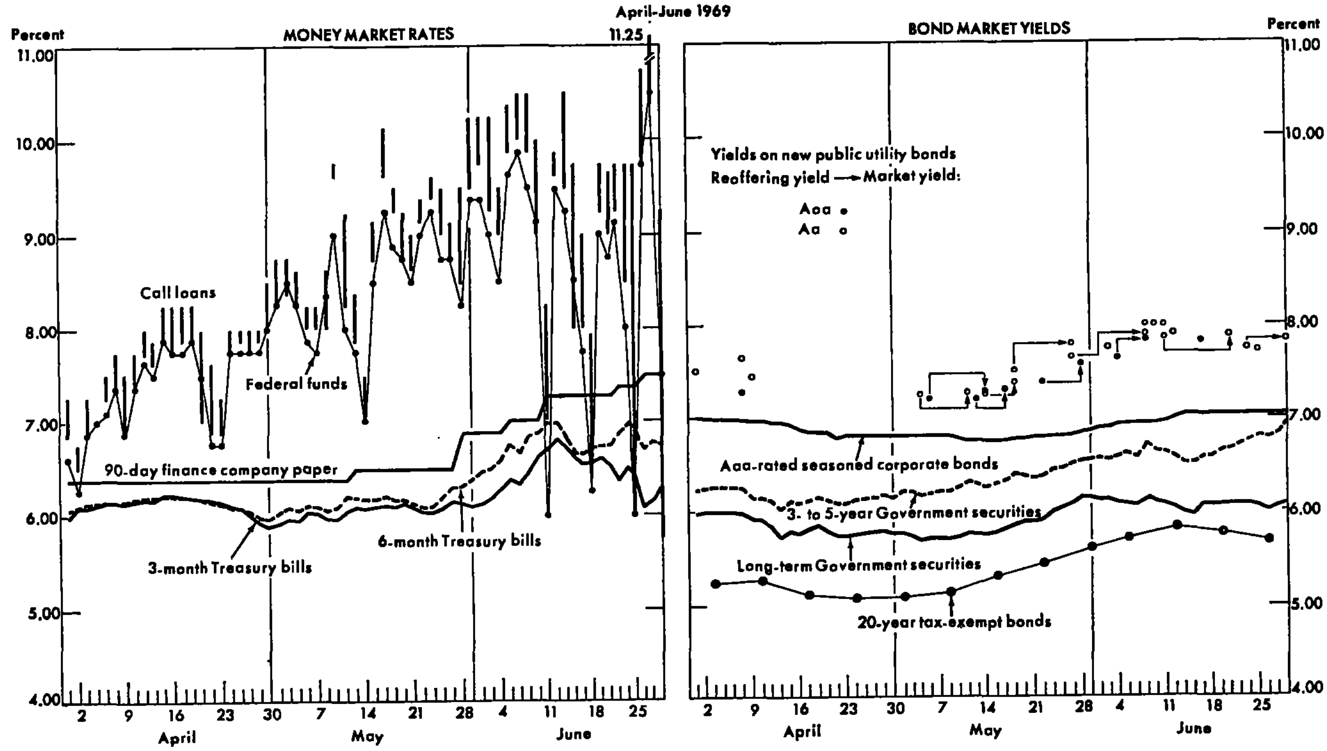
On June 27 the Board of Governors also invited comments on a proposal to bring a member bank's liability on certain so-called Federal funds transactions with customers other than banks within the coverage of the regulations dealing with reserves of member banks and payment of interest on deposits. Recently, some banks have been making the Federal funds market available to their corporate depositors as a means of providing them with interest on short-term funds. In the Board's judgment, there is no justification for a bank's liability on such transactions to be exempt from the rules governing reserve requirements and the legal prohibition against payment of interest on demand deposits.

BANK RESERVES AND THE MONEY MARKET

Pressures on bank reserves continued firm during June, as member bank borrowings at the discount window remained at the high level reached in May and rates on Federal funds averaged about the same as in the last half of May. For the month as a whole, daily borrowings from the Federal Reserve Banks averaged $1.4 billion (see Table I), virtually unchanged from the preceding month. Excess reserves averaged some $20 million higher, however, resulting in a decline of approximately the same size in the average net borrowed reserves of all member banks.

Increased demand for Federal funds in the first business week of June drove the effective rate as high as 9⅞ percent on June 6, a new record (see Chart I), as major money center banks bid aggressively in the market for these funds. The basic reserve deficit of the forty-six major banks rose from an average of $2,840 million in the week ended on May 28 to $4,287 million in the settlement week of June 11 (see Chart II). In contrast to the pattern of other money market instruments, however, the effective rate on Federal funds declined to 9½ percent on the following Monday when the commercial bank lending rate increase was announced. The Federal funds rate moved progressively downward over the remainder of the statement week, reaching 6 percent on June 11 with some trading as low as ½ percent when

Chart I
SELECTED INTEREST RATES
April-June 1969



Note: Data are shown for business days only.

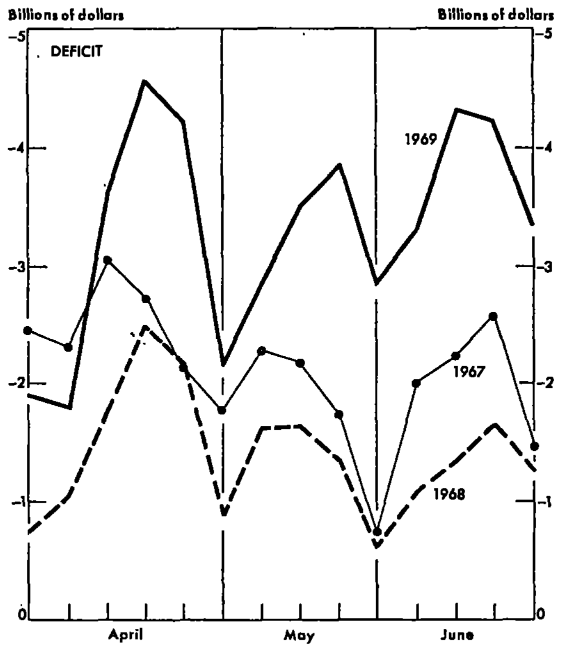
MONEY MARKET RATES QUOTED: Daily range of rates posted by major New York City banks on call loans (in Federal funds) secured by United States Government securities (a point indicates the absence of any range); offering rates for directly placed finance company paper; the effective rate on Federal funds (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.

Chart II

BASIC RESERVE POSITIONS OF MAJOR MONEY MARKET BANKS



Note: Calculation of the basic reserve position is illustrated in Table II.

excess reserves of money center banks were brought to the market. During the period from June 12 to June 30, most Federal funds trading occurred in a 6 to 10½ percent range, somewhat wider than the range prevailing during May. The record 10½ percent effective rate occurred on June 27, the day after the proposed regulations were announced concerning Euro-dollars.

Although there had been apprehension on the part of some market participants concerning the problems which might confront the banking system at the mid-June corporate tax and dividend dates, commercial banks weathered the period with apparently little difficulty. The effective rate on Federal funds fell to 8½ percent on Monday, June 16, and business loans at large weekly reporting commercial banks increased in the week ended on June 18 by some $365 million less than in the 1968 tax payment week. It is probable, however, that some corporations borrowed earlier in the month in anticipation of encountering difficulties during the tax week; the increase in business loans at weekly reporting banks for the first two statement weeks of the month was some $250 million greater than in the same period in 1968. Major money center banks borrowed heavily in the Euro-dollar market in the weeks of June 11 and June 18 in preparation for sizable loan demand, and the rates on these funds rose considerably from their May level. The steepest rise, however, was in conjunction with the prime rate increase, when three-month Euro-dollars reached 12.5 percent. The rate then fell back, closing the month at 10.5 percent.

During the first two statement weeks ended in June, a period of increased tautness in the money market, the System through open market operations injected reserves amounting to $447 million on a daily average basis. This was done primarily through outright purchases of Government securities (see Table I). Over the remainder of the month, however, System operations resulted in a net absorption of funds, effected to a large extent by the use of matched sale-purchase transactions for the temporary withdrawal of excess funds from the market. On balance the System provided reserves of $198 million on a daily average basis during the four statement weeks of June.

Daily average deposits subject to reserve requirements (the bank credit proxy) declined in June at a seasonally adjusted annual rate of about 13 percent, following a decline of 2.5 percent in May. After adjustment to include the changes in liabilities to foreign branches, however, the June decline was only 4 percent, comparing with a 1 percent decline in May. The major factors accounting for the steep drop in June were a sizable runoff in United States Government deposits and a somewhat smaller decline in time deposits. Preliminary data on the seasonally adjusted money supply show a gain of 1.2 percent in June, bringing the rise since March to a 2.9 percent rate.

THE GOVERNMENT SECURITIES MARKET

The prices of Treasury securities moved somewhat irregularly during the month of June, but on balance most issues with maturities of less than seven years provided higher rates of return at the close of the period than at the end of May. Yields on long-term securities, however, generally showed declines of 1 to 19 basis points over the month, reflecting some investor demand after the steady rise in yields during May and very little selling pressure due in part to the fact that dealer inventories were quite light.

The Treasury bill market had not experienced a general deterioration in May similar to that of longer term United States Government securities because of generally thin supply and strong demand, emanating to a large extent from foreign sources. During June, in contrast, these influences were reversed and yields on several bill issues climbed to record levels. Dealer financing costs were high;

Table I

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

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

Factors	Changes in daily averages—week ended on: June 4	June 11	June 18	June 25	Net changes
"Market" factors					
Member bank required reserves	+ 340	+ 259	+ 80	+ 162	+ 841
Operating transactions (subtotal)	— 561	— 133	— 376	+ 87	— 983
Federal Reserve float	+ 182	+ 177	+ 105	+ 153	+ 617
Treasury operations*	— 108	— 217	— 354	— 179	— 858
Gold and foreign account	+ 18	+ 3	—	— 7	+ 14
Currency outside banks	— 344	— 78	— 388	+ 123	— 687
Other Federal Reserve accounts (net)†	— 306	— 20	+ 261	— 1	— 66
Total "market" factors	— 221	+ 126	— 296	+ 249	— 142
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 221	+ 226	— 73	— 176	+ 198
Outright holdings:					
Government securities	+ 424	+ 284	+ 118	— 174	+ 652
Bankers' acceptances	— 1	— 1	+ 1	— 2	— 3
Repurchase agreements:					
Government securities	— 116	— 28	— 151	—	— 295
Bankers' acceptances	— 36	— 9	— 12	—	— 57
Federal agency obligations	— 50	— 20	— 29	—	— 99
Member bank borrowings	+ 219	— 262	+ 56	+ 9	+ 22
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 441	— 36	— 17	— 167	+ 221
Excess reserves	+ 220	+ 90	— 318	+ 82	+ 79
	Daily average levels				
Member bank:					
Total reserves, including vault cash	27,576	27,407	27,014	26,934	27,233‡
Required reserves	27,278	27,019	26,939	26,777	27,003‡
Excess reserves	298	388	75	157	230‡
Borrowings	1,522	1,260	1,316	1,325	1,356‡
Free, or net borrowed (—), reserves	—1,224	— 872	—1,241	—1,168	—1,126‡
Nonborrowed reserves	26,054	26,147	25,698	25,609	25,877‡
Net carry-over, excess or deficit (—)§	51	171	207	127	139
	Changes in Wednesday levels				
System account holdings of Government securities maturing in:					
Less than one year	+ 324	— 35	— 835	+ 243	— 303
More than one year	—	—	—	—	—
Total	+ 324	— 35	— 835	+ 243	— 303

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 June 25.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JUNE 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on: June 4	June 11	June 18	June 25	Averages of four weeks ended on June 25
Eight banks in New York City					
Reserve excess or deficiency(—)*	60	121	— 11	20	48
Less borrowings from Reserve Banks	43	86	—	97	57
Less net interbank Federal funds purchases or sales(—)	1,278	1,806	1,340	775	1,300
Gross purchases	*2,286*	*2,425*	*2,187*	*1,997*	*2,224*
Gross sales	*1,008*	*619*	*846*	*1,222*	*924*
Equals net basic reserve surplus or deficit(—)	—1,261	—1,771	—1,352	— 852	—1,309
Net loans to Government securities dealers	587	391	802	741	630
Net carry-over, excess or deficit(—)†	— 3	29	49	16	23
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	58	100	— 39	— 20	25
Less borrowings from Reserve Banks	552	371	465	460	462
Less net interbank Federal funds purchases or sales(—)	1,558	2,245	2,359	2,026	2,047
Gross purchases	*3,529*	*3,876*	*4,006*	*3,636*	*3,762*
Gross sales	*1,972*	*1,631*	*1,647*	*1,610*	*1,715*
Equals net basic reserve surplus or deficit(—)	—2,052	—2,516	—2,863	—2,506	—2,484
Net loans to Government securities dealers	— 75	— 71	67	90	3
Net carry-over, excess or deficit(—)†	10	47	66	19	36

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—June 1969: June 2	June 9	June 16	June 23	June 30
Three-month	6.191	6.591	6.666	6.524	6.456
Six-month	6.454	6.927	6.654	6.866	6.944

Maturities	Monthly auction dates—April-June 1969: April 24	May 27	June 24
Nine-month	5.977	6.307	7.387
One-year	5.931	6.270	7.342

* 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.

inhibiting inventory accumulation, and retail demand for new issues was less than had been anticipated. Concern about the selling of bills, which usually accompanies June tax and dividend payment dates, and a sizable supply from foreign sources further stimulated dealers to pare their inventories.

In response to the commercial bank prime loan rate increase on Monday, June 9, all segments of the Government securities market underwent upward yield adjustments. Treasury bill rates generally rose by 3 to 52 basis points on Monday, while yields on most notes and bonds registered increases of 4 to 36 basis points. On Tuesday, prices of notes and bonds recouped a healthy amount of the preceding day's losses. Sizable investor selling contributed to further deterioration in the bill market over the remainder of the week, and rates on Treasury bills for the most part ended the statement week of June 11 up 10 to 47 basis points from the preceding Wednesday. Quotations on intermediate-term coupon issues were unchanged to ½ point lower between June 4 and June 11, while long-term bonds recovered enough for the majority to show a gain of 4/32 to 19/32.

A better tone emerged in the market for Government notes and bonds during the following statement week, strengthened to some extent by a continuing decline in the stock market which, for many investors, enhanced the attractiveness of high-yielding fixed-income securities. The improvement extended to bills maturing in two months or longer but not to those of shorter maturity which came under some additional foreign selling pressure early in the week. A major factor contributing to the improved market conditions for most sectors was the lack of any significant selling pressure associated with the June 16 corporation tax date. The possibility of such pressure had been given considerable press coverage as the next test of stringency in the money and capital markets.

Prices of intermediate-term notes and bonds moved steadily lower over the final part of the month in largely professional activity. A cautious tone resulted from official statements concerning the need to continue monetary restraint and from the uncertainty surrounding the fate of the surtax extension in the Congress. In addition, sizable selling emerged in response to a rise in long-term Treasury bill rates. Rates on shorter term bills, which were in thin supply, declined in the wake of reinvestment demand from holders of the maturing tax anticipation bills and some commercial bank buying in connection with midyear financial statements. Some heaviness developed in all segments of the Government securities market following announcement of the proposed changes regulating Euro-dollar and certain nonbank Federal funds borrowing.

At the regular monthly auction on June 24, average issuing rates on the nine- and twelve-month bills were set at record levels of 7.387 and 7.342 percent, respectively, 108 and 107 basis points higher than comparable rates at the auction a month earlier (see Table III). At the final weekly auction on June 30, average issuing rates for the new three- and six-month bills were set at 6.456 and 6.944 percent, respectively, 33 and 73 basis points above the average rates established at the last weekly auction in May.

OTHER SECURITIES MARKETS

During the first week of June, prices drifted somewhat lower in the market for long-term corporate securities while municipal securities showed a more substantial deterioration. *The Weekly Bond Buyer's* index of twenty municipal issues rose 13 points to a historic high of 5.73 percent on Thursday, June 5. Investor response to high-yielding new issues was selective, however: a $100 million offering of five-year Aaa-rated bonds was a quick sellout at 7¾ percent, but a similarly rated thirty-year issue yielding 7⅝ percent met with only moderate success the following day. News of additional industrial price increases and reports of difficulties with Congressional extension of the income tax surcharge contributed to an underlying tone of caution in these markets.

On Monday, June 9, prices of corporate and municipal securities fell sharply in reaction to the surprising rise of 1 percentage point in the commercial bank prime lending rate. Some outstanding corporate bonds were reduced in price by as much as 1½ points on that day. In addition, three recently marketed issues were released from price restrictions, with upward yield adjustments of up to 24 basis points, and announcement was made of the postponement of two previously scheduled issues. Two Aa-rated thirty-year utility issues that were marketed on Monday and Tuesday were priced to yield 8 percent; at this high level they elicited favorable investor response and moved to premiums from their offer prices. In the period after June 10, with bond yields at a level reportedly not matched since Civil War days and with key stock market indexes at their lowest readings since the summer of 1968, a decidedly improved tone developed in the corporate bond market. Reports from several dealers indicated sizable demand from small investors, who were switching funds out of the stock market, as well as increased interest from various pension funds and other institutional investors. Moreover, market participants anticipated additional demand from holders of savings accounts following the dividend-crediting period at the end of June. The rally in the corporate bond market was sustained over the remainder of the month but with a note of caution injected by those who feared that any sizable decline in yields would be short-lived because of the previously postponed new issues waiting in the wings. Despite the market's generally improved tone, moreover, a new record was set on a Aaa-rated $150 million telephone issue offered on June 17 at a net interest cost of 7.91 percent, the highest ever for a top-grade Bell System financing. The issue was an immediate sellout and moved to a premium on the next day.

There was apparently little immediate spillover from the improved corporate market to that for tax exempts, and the already record-high *Bond Buyer* index rose to 5.82 percent on June 12 before moving lower in the final weeks of the month. At the close of June the index stood at 5.68 percent, 8 basis points higher than at the end of May. Despite an unusually light calendar of new issues during June, investor demand for tax exempts was generally unenthusiastic although some new offerings in the final half of the month were priced attractively enough to arouse interest. Dealers' advertised inventories declined by some $200 million over the month to $336 million on June 30, reflecting in part the light pace of new issue activity as market conditions and self-imposed interest rate ceilings led to further deferments of scheduled offerings.