## The Money and Bond Markets in May

A deepening gloom settled over financial markets during most of May, but the darkest clouds appeared to be lifting as the month closed. Corporate stock prices first sagged and then tumbled, setting off shock waves that were felt in all sectors of the bond market. The malaise affecting the markets appeared to reflect the concern of market participants about Cambodian developments and their implications for peace, the Federal budget, and domestic tranquility. There was also anxiety about continued inflation and strong wage demands even while the economy was slowing down and corporate profits were falling.

Against this background of uncertainty, the Dow-Jones industrial index of stock prices fell by almost 105 points during the month to 631.16 on May 26, the lowest level since late 1962, before rebounding to 700.44 at the close of the month. New issues of corporate and municipal securities were floated at ever-increasing yields throughout most of May. Corporate bond yields rose above the record levels set last December, even though the successful completion of the mammoth \$1.6 billion American Telephone and Telegraph Company financing lessened the pressure. At midmonth, *The Weekly Bond Buyer's* index of tax-exempt securities reached a record level and continued to climb.

Effective May 6, the Board of Governors of the Federal Reserve System reduced the margin requirements on purchasing or carrying stocks from 80 percent to 65 percent and on purchasing or carrying convertible bonds from 60 percent to 50 percent. The Board cited the sharp reduction in the use of credit for stock purchases. This was the first change in these requirements since June 1968, when they were raised from 70 percent to 80 percent for stocks and from 50 percent to 60 percent for convertible bonds.

In the Treasury securities market, attention focused on the Treasury's \$3.5 billion offering of 7¾ percent eighteen-month notes to the public for cash and the offering of the reopened 7¾'s of 1973 and 8's of 1977 in exchange for the issues maturing May 15, of which \$4.9 billion was in the hands of the public. In the great uncertainty engendered by events in Cambodia the cash offering was successfully completed, but with 100 percent allotments to all subscribers—well above the expectations of some observers. The exchange offering was quite well received, involving public exchanges of \$2.1 billion into the 7¾'s and \$1.2 billion into the 8's. The combined operation raised \$2 billion for the Treasury. Prices rallied for a time after the offering, but later wilted in the general market atmosphere. Many intermediate- and long-term issues fell to new record lows before rebounding near the month's end. Treasury bill rates fluctuated during the month in the nervous market.

### BANK RESERVES AND THE MONEY MARKET

The money market was comparatively steady during May in contrast to the turbulence in the securities market. Federal Reserve open market operations allowed the Federal funds rate to recede to around 8 percent from the 8 to 8½ percent range that had prevailed in the second half of April. Member banks as a whole remained under pressure, with their borrowings from the Federal Reserve Banks averaging \$925 million (see Table I) as compared with \$866 million in April.

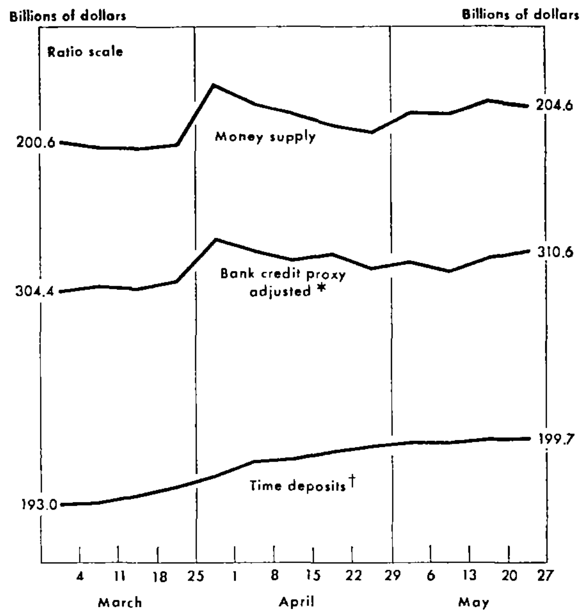
The slightly less firm money market conditions in May reflected in part some ebbing of the unusual reserve pressure that had weighed on the major money market banks in April. The average basic deficit of the forty-six large reserve city banks declined by \$1,105 million to a level of \$5,183 million in the four weeks ended on May 27 (see Table II), compared with the average of the preceding five weeks. In April the large financing demands of Government securities dealers had contributed to the record basic deficit of \$8.0 billion at these banks after the mid-April tax date. In May, a major factor in the improved position of these banks was a sharp decline in bank lending to Government securities dealers resulting from the reduction in dealer portfolios.

The seasonally adjusted money supply on a daily average basis was higher in May than in April, although the adjusted bank credit proxy was slightly lower. Ac-

Chart I

CREDIT AND MONETARY AGGREGATES

Seasonally adjusted weekly averages




Note: Data for May are preliminary.

* Total member bank deposits subject to reserve requirements plus nondeposit liabilities, such as Euro-dollar borrowings and commercial paper issued by bank holding companies or other affiliates.

† At all commercial banks.

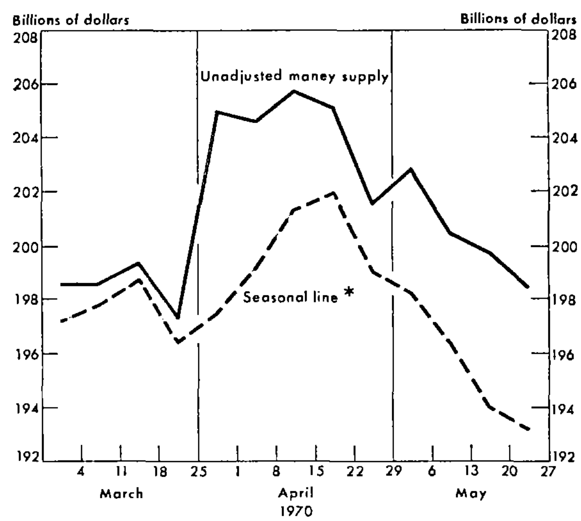
cording to preliminary data, over the month the money supply grew at a 6½ percent annual rate. To some extent, market uncertainties may have augmented demands for cash in May. The growth rate in May represented a tapering-off from the 10¾ percent rate of the preceding month, which had been influenced by an unusual increase in the first week of April (see Chart I).[1] So far this year the money supply has grown at a 5½ percent annual rate. The adjusted bank credit proxy, on the other hand, experienced over a 1 percent annual rate of decline in May, according to preliminary figures. This compares with the 13¾ percent rate of gain posted in April and brings the five-month growth rate for this aggregate to 2¾ percent.

Much of the divergent movement in the money supply and the adjusted bank credit proxy during May is explained by the sharp drop in United States Government demand deposits. Movements in Government demand deposits are often inversely related to movements in private demand deposits, as changes in Government deposits frequently reflect the flow of funds between the public and private sectors. The decline of Government deposits in May was associated with a strengthening in private demand deposits during the month, which raised the growth of the money supply. The bank credit proxy, on the other hand, includes both Government and private demand deposits, and thus turned in a much weaker performance.

The money supply spurted unseasonably in the first week of May (see Chart II). While this event coincided with large System purchases of Treasury bills, which were undertaken in part to relieve unusual market pressures during the period the books were open for the Treasury's financing, the bulge in the money supply probably bore little relation to the System's action at that time. Erratic moves in the weekly data for seasonally adjusted money supply are not at all uncommon. Not only is there some question about whether the seasonal factors now in use accurately reflect current patterns of deposit flows, but also even with all seasonality removed there would apparently remain a considerable amount of unexplained week-to-week variation.

Chart II

THE MONEY SUPPLY AND SEASONAL EFFECTS




*This line is the average of the seasonally adjusted weekly figures for February multiplied by seasonal factors for March, April, and May, beginning with the week of March 4. It indicates what the unadjusted money supply would have been if just the influence of the seasonal factors — which are drawn from the behavior of the money supply during comparable weeks of previous years — had been operative.

1 For a discussion, see this *Review* (May 1970), pages 98-99 and 104-5.

## Table I

### FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MAY 1970

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

| Factors | Changes in daily averages—week ended on | | | | Net changes |
|---|---|---|---|---|---|
| | May 6 | May 13 | May 20 | May 27 | |
| **"Market" factors** | | | | | |
| Member bank required reserves | — 222 | + 508 | — 181 | + 634 | + 739 |
| Operating transactions (subtotal) | — 552 | — 834 | + 330 | + 180 | — 876 |
| Federal Reserve float | — 83 | — 142 | + 237 | — 346 | — 334 |
| Treasury operations* | — 109 | — 191 | + 307 | + 176 | + 183 |
| Gold and foreign account | — 34 | — 55 | + 44 | + 84 | + 39 |
| Currency outside banks | — 202 | — 403 | — 413 | + 289 | — 729 |
| Other Federal Reserve liabilities and capital | — 124 | — 44 | + 155 | — 17 | — 30 |
| Total "market" factors | — 774 | — 326 | + 149 | + 814 | — 138 |
| **Direct Federal Reserve credit transactions** | | | | | |
| Open market operations (subtotal) | +1,167 | + 95 | + 143 | — 418 | + 987 |
| Outright holdings: | | | | | |
| Government securities | +1,154 | + 397 | — 50 | — 221 | +1,280 |
| Bankers' acceptances | — 2 | — 3 | — 1 | — 3 | — 9 |
| Repurchase agreements: | | | | | |
| Government securities | — 36 | — 202 | + 138 | — 138 | — 238 |
| Bankers' acceptances | + 8 | — 35 | + 20 | — 20 | — 27 |
| Federal agency obligations | + 43 | — 62 | + 36 | — 36 | — 19 |
| Member bank borrowings | — 120 | + 40 | + 369 | — 251 | + 38 |
| Other Federal Reserve assets† | — 39 | — 130 | — 509 | — 295 | — 973 |
| Total | +1,008 | + 4 | + 3 | — 963 | + 52 |
| **Excess reserves** | + 234 | — 322 | + 152 | — 143 | — 79 |

| | Daily average levels | | | | Monthly averages |
|---|---|---|---|---|---|
| **Member bank:** | | | | | |
| Total reserves, including vault cash | 28,582 | 27,752 | 28,084 | 27,300 | 27,930‡ |
| Required reserves | 28,237 | 27,729 | 27,910 | 27,276 | 27,788‡ |
| Excess reserves | 345 | 23 | 175 | 32 | 144‡ |
| Borrowings | 773 | 813 | 1,182 | 931 | 925‡ |
| Free, or net borrowed (—), reserves | — 428 | — 790 | —1,007 | — 899 | — 781‡ |
| Nonborrowed reserves | 27,809 | 26,939 | 26,902 | 26,369 | 27,005‡ |
| Net carry-over, excess or deficit (—)§ | 75 | 209 | 78 | 154 | 129‡ |

| | Changes in Wednesday levels | | | | Net changes |
|---|---|---|---|---|---|
| **System Account holdings of Government securities maturing in:** | | | | | |
| Less than one year | +1,772 | — 672 | —9,338 | — 255 | —8,493 |
| More than one year | — | — | +9,523 | — | +9,523 |
| Total | +1,772 | — 672 | + 185 | — 255 | +1,030 |

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 May 27.

§ Not reflected in data above.

## TABLE II

### RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MAY 1970

In millions of dollars

| Factors affecting basic reserve positions | Daily averages—week ended on | | | | Averages of four weeks ended on May 27 |
|---|---|---|---|---|---|
| | May 6 | May 13 | May 20 | May 27 | |
| **Eight banks in New York City** | | | | | |
| Reserve excess or deficiency (—)* | 105 | — 79 | 73 | — 51 | 12 |
| Less borrowings from Reserve Banks | 93 | 150 | 332 | 86 | 165 |
| Less net interbank Federal funds purchases or sales (—) | 1,253 | 1,858 | 1,654 | 1,158 | 1,481 |
| Gross purchases | 2,308 | 2,727 | 2,789 | 2,134 | 2,490 |
| Gross sales | 1,055 | 869 | 1,136 | 976 | 1,009 |
| Equals net basic reserve surplus or deficit (—) | —1,241 | —2,088 | —1,913 | —1,295 | —1,634 |
| Net loans to Government securities dealers | 563 | 339 | 336 | 417 | 414 |
| Net carry-over, excess or deficit (—)† | 7 | 71 | — 15 | 53 | 29 |
| **Thirty-eight banks outside New York City** | | | | | |
| Reserve excess or deficiency (—)* | 75 | — 20 | 3 | 28 | 22 |
| Less borrowings from Reserve Banks | 248 | 254 | 310 | 148 | 240 |
| Less net interbank Federal funds purchases or sales (—) | 3,403 | 3,729 | 3,238 | 2,952 | 3,331 |
| Gross purchases | 5,319 | 5,918 | 5,486 | 5,091 | 5,454 |
| Gross sales | 1,916 | 2,188 | 2,248 | 2,138 | 2,123 |
| Equals net basic reserve surplus or deficit (—) | —3,576 | —4,004 | —3,545 | —3,072 | —3,549 |
| Net loans to Government securities dealers | 333 | 219 | 186 | 219 | 239 |
| Net carry-over, excess or deficit (—)† | 12 | 51 | 24 | 30 | 29 |

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

* Reserves held after all 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 percent

| Maturities | Weekly auction dates—May 1970 | | | |
|---|---|---|---|---|
| | May 4 | May 11 | May 18 | May 25 |
| Three-month | 7.184 | 6.994 | 6.828 | 7.133 |
| Six-month | 7.493 | 7.202 | 6.996 | 7.355 |

| Maturities | Monthly auction dates—March-May 1970 | | |
|---|---|---|---|
| | March 24 | April 23 | May 26 |
| Nine-month | 6.100 | 6.844 | 7.352 |
| One-year | 6.132 | 6.814 | 7.277 |

* 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.

## THE GOVERNMENT SECURITIES MARKET

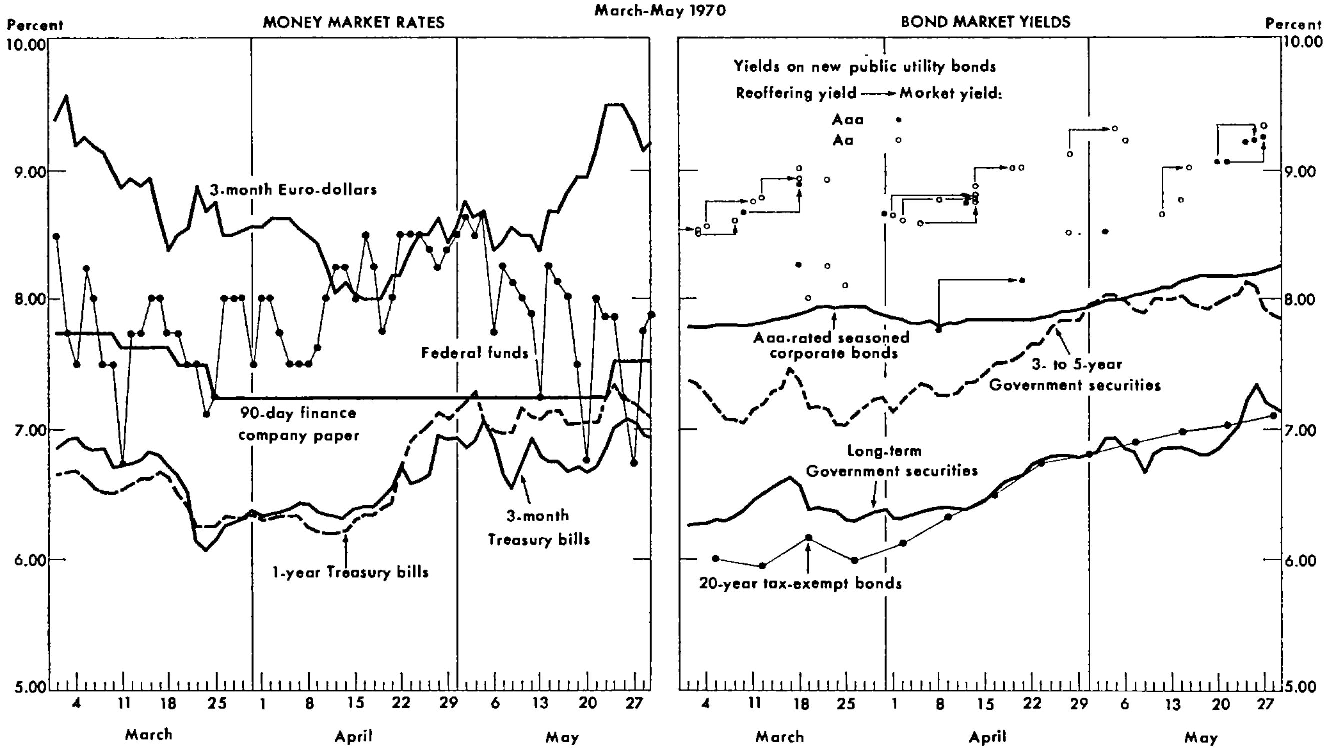
During much of May the Government securities market remained under strong pressures, and yields on many Government issues rose (see Chart III). In large part, these pressures reflected market reaction to President Nixon's decision to send United States troops into Cambodia, and its diplomatic, economic, and social ramifications. Toward the end of the period, however, investor demand and confidence appeared to strengthen somewhat and technical conditions improved, following the completion of the Treasury and AT&T financings. Over the period as a whole, yields on Treasury bills and short- and intermediate-term coupon issues showed little net change but considerable fluctuation, while yields on longer term Government securities rose sharply.

There were some anxious moments for the Treasury in the wake of the President's announcement of the Cambodia action, after the terms of the May financing had been set. In a rather strained atmosphere, the public's subscriptions for the new 7¾ percent eighteen-month note totaled about $3.6 billion, only $100 million more than the amount originally offered by the Treasury, and they were allotted in full for the first time in such an offering in recent years. Normally, such offerings are heavily oversubscribed and allotments are only a fraction of the amounts subscribed for. On this occasion, a relatively high allotment was anticipated, but many investors looked for perhaps 50-60 percent rather than the 100 percent that developed. The exchange offering, on the other hand,

Chart III

SELECTED INTEREST RATES

March-May 1970




Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; 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-month and one-year 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.

was quite well received. Of the approximately $4.9 billion of maturing notes held by the public, about $3.3 billion was exchanged during the subscription period for the reopened 7¾ percent notes due in May 1973 and the 8 percent notes due in February 1977. The proportion of maturing notes redeemed for cash was surprisingly low in view of the simultaneous $3.6 billion cash financing which in effect took the place of an "anchor issue" in the exchange offering.

At the beginning of the month, prices of intermediate-term Treasury securities showed some weakness, but they rose somewhat during the middle of the subscription week. Selling again drove prices lower in the early part of the following week, as dealers attempted to unload excess holdings of the when-issued notes. Prices then fluctuated narrowly until the last day of the week, when a stock market rally and news of a decline in the Federal Reserve Board's index of industrial production led to an improvement in market sentiment. During the third week of the month, prices again fell sharply in response to another major stock market decline, to announcements of projected Federal budget deficits for the current and following fiscal years, and to a substantial increase in the consumer price index during April. Prices continued to decline until the final days of the month, when improved market sentiment led to some gains.

Due in part to large System purchases and reduced dealer inventories, rates on Treasury bills declined during the subscription period and continued to move lower for a short time thereafter. However, persisting domestic and international tensions as well as market concern over possible resale of securities by the System tended to push rates somewhat higher during the second week in May. After midmonth, rates stayed within a narrow range in quiet trading, while activity picked up in the market for intermediate-term securities. Over the month as a whole, bill rates were generally 18 basis points lower to 8 basis points higher than those at the end of April. (For issuing rates on newly auctioned Treasury bills, see Table III).

Activity in the market for Federal agency securities was highlighted by the initial offerings of bonds backed by the Government National Mortgage Association. These securities, which were issued by the Federal National Mortgage Association, consisted of a two-part offering of $150 million of 8⅛ percent issues due in one year and $250 million of 8⅜ percent issues due in five years. The bonds met an excellent reception and quickly rose to a premium on a when-issued basis.

## OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt securities moved lower in May under the impact of many of the same developments which influenced the markets for United States Government securities. As a result, yields on some new issues were pushed to record levels, and by the end of May *The Weekly Bond Buyer's* index of yields on twenty municipal bonds rose to 7.12 percent, the highest level in the history of the index. AT&T successfully completed its massive financing by midmonth and announced on May 18 that subscriptions for the new debentures had amounted to an estimated 98 percent of the $1.57 billion offered.

Deteriorating market conditions early in the month led to the postponement of a number of new debt flotations in both the corporate and municipal sectors, and several recent issues were released from price restrictions with subsequent upward yield adjustments of as much as 75 basis points. In the weak market atmosphere, record yields were required on new issues to attract favorable receptions.

Prices of outstanding corporate and tax-exempt securities showed narrow price declines over the last two weeks of May. Although the volume of new securities remaining in underwriters' syndicates had been substantially reduced by midmonth, the market tone remained fundamentally weak. New-issue yields on corporate securities continued to rise, reflecting a heavy schedule of financing activity. For example, $30 million of Aaa-rated electric utility bonds was offered late in the month at a record yield of 9.20 percent, or 15 basis points higher than a comparable issue marketed only four days earlier. Developments in the tax-exempt sector were similar, although new-issue activity was moderate. Yields on securities in this sector also moved near, or above, previous records, as evidenced by a $20 million Aa-rated offering by the state of Delaware. Included in this offering were eighteen- to twenty-year bonds which, when reoffered to investors, were priced to yield a record 7.10 percent when held to maturity. In the final week of the month, the prolonged decline in the stock market was reversed, and conditions in the bond market showed some improvement.