The Money and Bond Markets in June

The nation's financial markets coped successfully with a heavy volume of new private securities flotations in June despite widespread concern about developments in the Middle East and Cambodia and new apprehensions related to the commercial paper market. Although most securities markets had rallied strongly near the end of May, the bond markets during most of June remained under the strong pressure of heavy borrowing demands which pushed yields on new corporate and municipal issues to new highs during the month. Earlier fears of a general shortage of liquidity faded, as the Federal Reserve continued to insure that the money markets would function smoothly with minimal stress during the period of seasonal tax-date pressures. Further indications of a slowing of the economy contributed to strong investor and dealer demand for bonds. As the period drew toward the close, investors were apparently becoming more hopeful that the slowdown would smother the inflationary fires and interest rates would decline.

Against this background the financial markets hardly faltered when the Penn Central Transportation Company, the nation's largest railroad, filed a petition in the third week of the month for reorganization under the Federal Bankruptcy Act. Market participants recognized that this event could lead many investors to reexamine the quality and volume of commercial paper in their investment portfolios, but prompt action by the Federal Reserve Board gave reassurance that the banking system would be in a position to deal with any credit strains that might emerge as this reassessment proceeded. Effective June 24 the Board suspended Regulation Q interest rate ceilings on large certificates of deposit (CD's)—those in denominations of $100,000 or more—for 30- to 89-day maturities. The Board stated that it was taking the action in recognition that unusual demands upon commercial banks for short-term credit could arise as a consequence of current uncertainties in the financial markets. The atmosphere in the bond markets continued to improve in the wake of this action, with yields on most debt securities tending to decline further.

BANK RESERVES AND THE MONEY MARKET

Relatively comfortable conditions prevailed in the money market during June. Cognizant of market concerns, the Federal Reserve System was careful to provide amply for the liquidity of the money market, but System actions did not lead to rapid growth in the monetary aggregates. Lenders in the money market were able to accommodate smoothly the buildup of short-term borrowing pressures around the June corporate tax date. The Federal funds rate declined slightly to about 7¾ percent from 8 percent in late May, and bank reserve positions changed little (see Table I). Average member bank borrowings declined to $907 million from $924 million in May, while the average basic reserve deficit of the forty-six large money center banks rose slightly to a level of $5.3 billion in the four weeks ended on June 24 (see Table II).

The daily average money supply declined in June following a rapid expansion in April and moderate growth in May. The level of the daily average money supply for the four weeks ended on June 24 contracted at a seasonally adjusted annual rate of 5¼ percent from the level recorded in May. On a week-to-week basis, the money supply changed little in June until the week ended on June 24, when there was a marked decline (see Charts I and II). The June performance contrasted with the revised 3½ percent growth rate posted in May, and was largely accounted for by a moderate decline in demand deposits. The currency component, which had experienced an especially large increase in May, continued to expand in June but at a less rapid pace.

The volatile character of the monetary aggregates often makes interpretation of weekly or monthly movements difficult. Because longer term movements are calculated from daily average figures for the first and last months of the period under consideration, these values can also be exaggerated by the choice of particularly high or low months for comparison. If, for instance, the month of February, when the money supply was at a relatively low level, is used as the first month of the comparison, the average rate of growth through June is about 6¼ percent. On the other hand, the growth rate would be about 3¾ percent if the first month were December, when the average money supply level was little affected by a sharp increase at the end of the month.

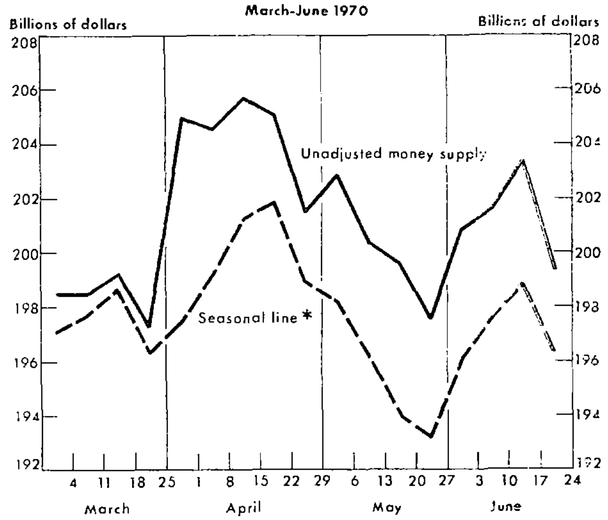
During June, time deposits held at commercial banks expanded at a 7½ percent annual rate, which approximates the average rate of growth achieved on balance thus far in 1970. The change in Regulation Q should lead to further increases in this aggregate, as reintermediation occurs and banks issue a larger volume of the shorter term CD's.

The adjusted bank credit proxy moved upward in June at a 7 percent seasonally adjusted annual rate as contrasted with a 1½ percent rate of decline experienced in May. Most of the strength in this aggregate resulted from continuing rapid time deposit growth and an upsurge of United States Government deposits held at commercial banks. Over the past six months, the adjusted bank credit proxy has grown at an annual rate of 3½ percent, or slightly less than the rate of growth of the money supply during the same period.

Chart II

THE MONEY SUPPLY AND SEASONAL EFFECTS

March-June 1970



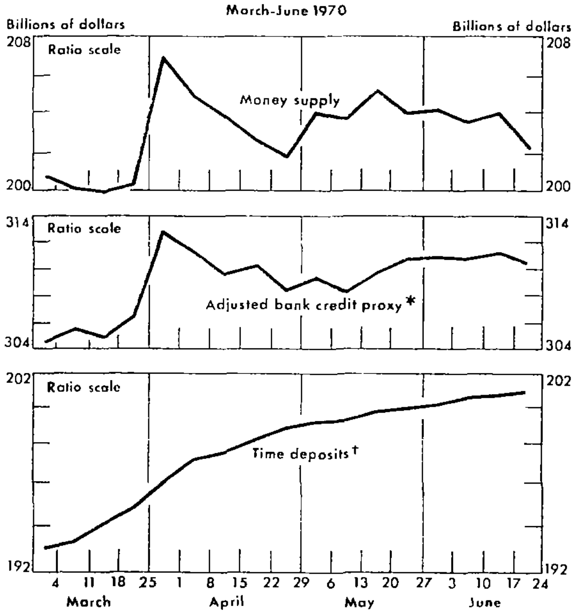
*This line is the average of the seasonally adjusted weekly figures for February multiplied by seasonal factors for March, April, May, and June, beginning with the week of March 4. It indicates what the unadjusted money supply would have been if just the influence of the seasonal factors — which are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

Chart I

CREDIT AND MONETARY AGGREGATES

Seasonally adjusted weekly averages

March-June 1970



Note: Data for June are preliminary.

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

† At all commercial banks.

THE GOVERNMENT SECURITIES MARKET

The market for United States Government securities stabilized in June, although participants remained somewhat uneasy. Market sentiment improved at midmonth, when President Nixon gave a reassuring address on the state of the economy. This improvement continued with the growing belief that the Federal Reserve would not allow a liquidity crisis to develop and impair the functioning of the markets. Yields on Government notes and bonds fluctuated in a narrow range during the early part of the month, but declined after midmonth (see Chart III). The ability of the money and capital markets to withstand heavy corporate demands for funds appears to have had a salutary effect on this market, especially in the longer term area. During the month, most bill rates experienced sizable declines, as heavy demand pressed against a rather thin market supply. Part of the demand for bills was apparently from investors switching from commercial paper.

Yields on coupon securities which had declined in

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JUNE 1970

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

Factors	Changes in daily averages— week ended on June 3	June 10	June 17	June 24	Net changes
"Market" factors					
Member bank required reserves	— 151	+ 97	— 99	+ 250	+ 97
Operating transactions (subtotal)	— 258	+ 25	— 111	— 66	— 410
Federal Reserve float	— 69	— 192	+ 371	+ 200	+ 310
Treasury operations*	+ 54	+ 431	— 169	— 162	+ 154
Gold and foreign account	— 15	— 11	— 12	— 50	— 88
Currency outside banks	— 137	— 135	— 447	— 79	— 798
Other Federal Reserve liabilities and capital	— 90	— 69	+ 147	+ 26	+ 14
Total "market" factors	— 409	+ 122	— 210	+ 184	— 313
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 348	+ 154	+ 423	— 678	+ 247
Outright holdings:					
Government securities	+ 255	+ 143	+ 539	— 678	+ 259
Bankers' acceptances	— 7	— 2	— 3	—	— 12
Repurchase agreements:					
Government securities	+ 71	+ 15	— 86	—	—
Bankers' acceptances	+ 7	+ 4	— 11	—	—
Federal agency obligations	+ 22	— 6	— 16	—	—
Member bank borrowings	+ 294	— 369	— 198	+ 229	— 44
Other Federal Reserve assets†	— 102	+ 36	+ 143	+ 53	+ 130
Total	+ 540	— 179	+ 368	— 396	+ 333
Excess reserves	+ 131	— 57	+ 158	— 212	+ 20

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash	27,613	27,459	27,680	27,254	27,502‡
Required reserves	27,438	27,341	27,440	27,190	27,352‡
Excess reserves	175	118	276	64	158‡
Borrowings	1,225	856	658	887	907‡
Free, or net borrowed (—), reserves	—1,050	— 738	— 382	— 823	— 748‡
Nonborrowed reserves	26,388	26,603	27,022	26,367	26,595‡
Net carry-over, excess or deficit (—)§	82	122	87	175	117‡

	Changes in Wednesday levels				Net changes
System Account holdings of Government securities maturing in:					
Less than one year	+ 501	— 333	+ 271	— 818	— 379
More than one year	+ 82	+ 187	—	—	+ 269
Total	+ 583	— 146	+271	— 818	— 110

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 24.

§ Not reflected in data above.

TABLE II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JUNE 1970

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on June 3	June 10	June 17	June 24	Averages of four weeks ended on June 24
Eight banks in New York City					
Reserve excess or deficiency (—)*	54	— 22	47	58	34
Less borrowings from Reserve Banks	269	195	—	97	140
Less net interbank Federal funds purchases or sales (—)	947	1,770	1,564	1,508	1,447
Gross purchases	2,174	2,818	2,643	2,540	2,544
Gross sales	1,227	1,048	1,078	1,032	1,096
Equals net basic reserve surplus or deficit (—)	—1,163	—1,988	—1,517	—1,547	—1,554
Net loans to Government securities dealers	428	381	321	445	394
Net carry-over, excess or deficit (—)†	— 3	35	5	37	19
Thirty-eight banks outside New York City					
Reserve excess or deficiency (—)*	70	— 3	97	— 13	38
Less borrowings from Reserve Banks	349	237	251	306	286
Less net interbank Federal funds purchases or sales (—)	3,262	3,637	3,849	3,401	3,537
Gross purchases	5,247	5,732	5,845	5,278	5,526
Gross sales	1,985	2,096	1,996	1,877	1,989
Equals net basic reserve surplus or deficit (—)	—3,541	—3,877	—4,004	—3,720	—3,786
Net loans to Government securities dealers	191	109	10	101	103
Net carry-over, excess or deficit (—)†	25	15	13	46	25

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—June 1970: June 1	June 8	June 15	June 22	June 29
Three-month	6.824	6.785	6.733	6.626	6.421
Six-month	6.858	6.895	6.947	6.929	6.603

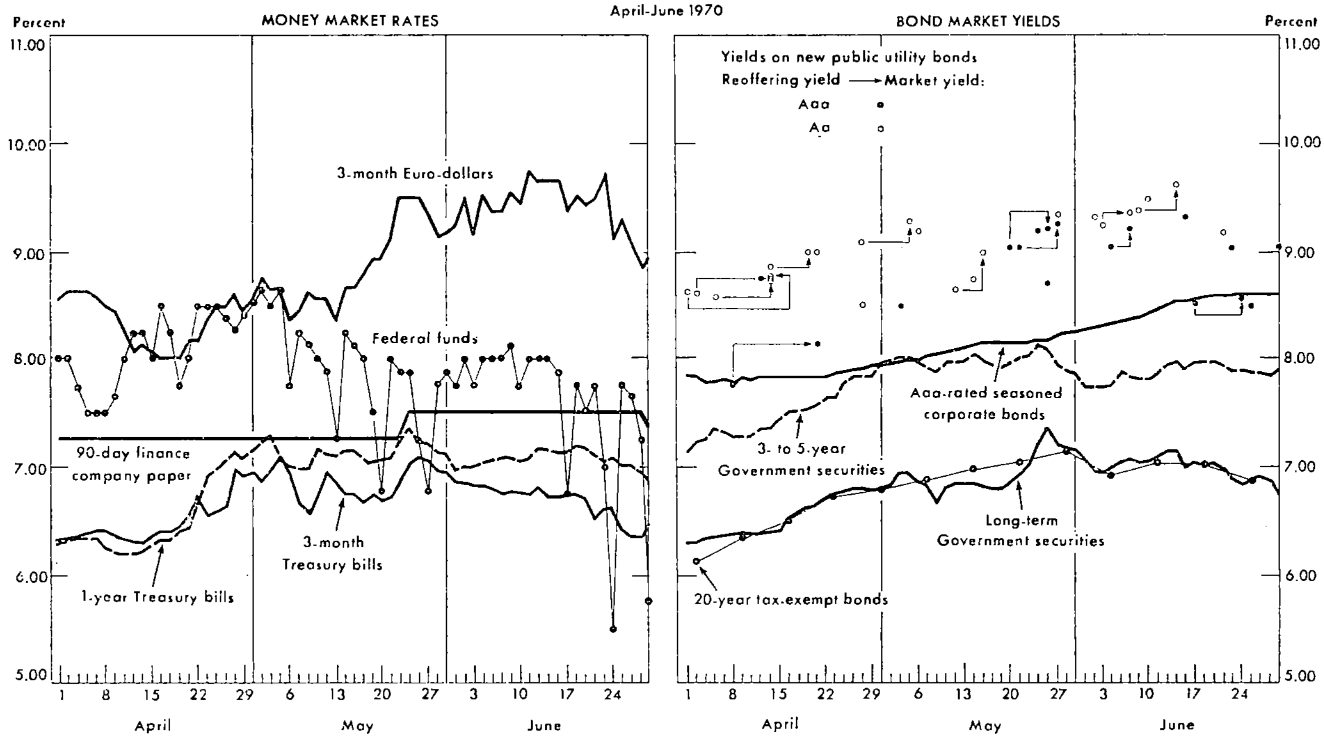
Maturities	Monthly auction dates—April-June 1970: April 23	May 26	June 23
Nine-month	6.844	7.352	7.069
One-year	6.814	7.277	7.079

* 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.

Chart III

SELECTED INTEREST RATES

April-June 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 issee 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.

the late-May rally continued to move to generally lower levels during the first days of June, although yields on a number of intermediate-term securities tended to rise. Subsequently, yields on all coupon securities moved higher, partly reflecting the near-term outlook for interest rates, which was affected by the heavy calendar of long-term corporate offerings and the anticipated shorter term financing needs around the June 15 corporate tax date. By midmonth, yields on most securities were higher than levels set at the end of May, although below the peak values posted in that month. Yields on longer term Government securities began to decline, however, with the midmonth improvement in the capital markets, but yields on intermediate-term issues were less affected. The announcement of Penn Central's plans for reorganization benefited both notes and bonds, as investors sought and acquired higher quality issues. Yields continued to fall for the remainder of the month.

Rates on most Treasury bills moved sharply lower in June. Rates initially declined in a continuation of the late-May rally and then fluctuated at lower levels until after midmonth, with shorter term bills generally registering further improvements and longer term bills experiencing some increases in rates. Later in the month, following the Penn Central petition for reorganization, the shift in investor preference toward higher quality issues and the demand from holders of the $4.5 billion of tax anticipation bills (TAB's) maturing on June 22 moved rates lower on all maturities. Rates continued to fall until the end of the month, and closed the month about 60 to 20 basis points lower than those at the end of May. The average issuing rates set at the weekly and monthly Treasury bill auctions also declined, as indicated in Table III.

On June 26, the Treasury announced plans to auction $2.5 billion of TAB's maturing on March 22, 1971. The bills were to be auctioned on July 2 for payment on July 8 and qualified depositories were permitted to make full payments for subscriptions through credit in their Treasury Tax and Loan Accounts. At the same time, the Treasury also announced plans for an additional cash offering in the neighborhood of $2 billion to be scheduled prior to the refunding of the August 15 maturities.

OTHER SECURITIES MARKETS

The strong pressures that affected the market for corporate and municipal securities in May moderated somewhat in June. Early in the month yields fell on most new issues, but apprehension over the very heavy calendar of corporate offerings scheduled for the latter half of June led to a subsequent deterioration in rates until midmonth. As it became evident that the large volume of new issues would be placed successfully, market conditions improved. The announcement of the Penn Central's financial difficulties did not impair the performance of the markets for high-grade debt issues.

Attention in the corporate market before midmonth continued to be focused on the heavy schedule of new corporate offerings. After a modest improvement early in the month, apprehension of participants over the upcoming flotations was associated with a significant deterioration in market conditions. The turnaround came on the eve of President Nixon's June 17 economic address. On June 16, a $100 million 40-year Aaa-rated telephone company bond issue was offered at a record yield of 9.35 percent, 25 basis points higher than any previous top-rated telephone company offering. At this high yield, the bonds met an excellent reception, as did most of the other issues marketed on the same day. Yields moved lower thereafter in a revival of demand, particularly among institutional investors. At the end of June, another Aaa-rated telephone company flotation consisting of $150 million of 33-year debentures was successfully offered at a yield of 9.05 percent, 30 basis points below the slightly longer term issue marketed on June 16.

In the market for tax-exempt securities, yields fell moderately early in June when new issue activity was light. *The Weekly Bond Buyer's* index of tax-exempt securities, which had hit a record 7.12 percent in the week ended on Thursday, May 28, fell 20 basis points in the week ended on June 4. Subsequently, however, yields again moved upward and remained at higher levels until midmonth. On June 16, the state of California re-entered the market after voters there approved a new 7 percent interest rate ceiling. California had been unable to float new securities for more than a year under the previous 5 percent ceiling. After midmonth, the successful completion of the especially heavy flotations in the corporate market was accompanied by a decline in tax-exempt securities yields as well. At the end of the month, yields on new issues were being set below levels common in May and earlier in June.