

FEDERAL RESERVE BANK OF NEW YORK



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Treasury and Federal Reserve Foreign Exchange Operations*

By CHARLES A. COOMBS

During the period September 1966 through early March 1967, all outstanding drawings on the Federal Reserve swap network—both by foreign central banks and by the Federal Reserve—were repaid and the \$4.5 billion of credit lines available under the network have thus been restored to a fully available standby basis (see Table I). Federal Reserve drawings of \$235 million outstanding as of the end of August 1966 were fully liquidated, while subsequent Federal Reserve drawings of \$100 million on the Bank of Italy and \$140 million on the German Federal Bank were also repaid by early 1967.

By early March 1967, the Bank of England had completely liquidated its swap drawings on the Federal Reserve, which had reached a peak of \$450 million last July, while also fully repaying further special credits in sizable amount received during the height of the sterling crisis from both the Federal Reserve and the United States Treasury. Drawings on the Federal Reserve of \$233 million by the Bank for International Settlements (BIS) and a small amount by another central bank during the period have also been paid off.

Since the inception of the Federal Reserve swap network nearly five years ago, total drawings on the network have amounted to \$7.7 billion, of which 91.3 per cent was repaid within six months and 98.5 per cent within nine months, while no drawing has been outstanding for as long as a year. Nor has there been any instance of unduly protracted use of other comparable central bank credit

arrangements. The assurance of such integrity in the use of central bank credit facilities has been the foundation on which the Federal Reserve swap network and related credit arrangements have been built up into a solid defense line against international currency speculation.

Another significant development during the period under review was the joint endeavor of the Federal Reserve and several other central banks, together with the BIS, to minimize a potentially severe strain on the Euro-dollar market toward the close of 1966. The Euro-dollar market, which has become a multibillion dollar operation, functions as a truly international money market and consequently cannot rely, as can a national money market, on the support of any single central bank to relieve temporary stringencies or knots in the market.

There is a great deal which the central banks whose nationals use the Euro-dollar market can do in an ad hoc, informal way, however, to alleviate undesirable strains on the market. Such a seasonal stringency in the Euro-dollar market appeared on November 29, 1966, when year-end window-dressing activities abruptly pushed up the one-month Euro-dollar rate from 6½ per cent to 7¾ per cent, while rates for other maturities reacted sympathetically. On the very same day, concerted action to deal with the situation was taken by several central banks and the BIS.

First, the Swiss National Bank announced that, as in previous years, it would be prepared to enter into swaps over the year-end with Swiss commercial banks. Under these swap contracts, the Swiss National Bank bought spot dollars against a forward resale contract. The dollars so acquired were immediately channeled back into the Euro-dollar market, either directly or via the BIS, thus preventing an abrupt contraction in the supply of Euro-dollars. The volume of such operations by the Swiss National Bank reached the record total of nearly \$400 million during December. In addition, the Swiss National Bank placed

* This is the tenth in a series of reports by the Vice President in charge of the Foreign function of the Federal Reserve Bank of New York and Special Manager, System Open Market Account. The Bank acts as agent for both the Treasury and the Federal Reserve System in the conduct of foreign exchange operations.

Table I
FEDERAL RESERVE RECIPROCAL CURRENCY ARRANGEMENTS
AND COMMITMENTS
 February 28, 1967

Institution	Amount of facility	System drawings outstanding
	In millions of dollars equivalent	
Austrian National Bank.....	100	
National Bank of Belgium.....	150	
Bank of Canada.....	500	
Bank of England.....	1,350	
Bank of France.....	100	
German Federal Bank.....	400	0
Bank of Italy.....	600	
Bank of Japan.....	450	
Netherlands Bank.....	150	
Bank of Sweden.....	100	
Swiss National Bank.....	200	
Bank for International Settlements.....	400*	
Total.....	4,500	0

* Half is available in Swiss francs and half in other European currencies.

in the Euro-dollar market \$75 million which it had purchased outright in November.

Second, the BIS, with the agreement of the Federal Reserve, began drawing upon a \$200 million swap line with the System for the express purpose of channeling these dollars into the Euro-dollar market to counter year-end strains. During December, the BIS employed in such operations the full \$200 million facility while also shifting \$75 million of its own investment funds into the Euro-dollar market. These operations by the BIS supplemented its normal participation in the Euro-dollar market.

Third, the New York Reserve Bank immediately moved into the sterling market, where spot rates were beginning to sag as a result of the competitive pull on British funds by the Euro-dollar market, and executed a total of \$88 million of one-month swap contracts, thereby helping to insulate sterling from the year-end strain.

During the closing weeks of the year, the Netherlands Bank also rechanneled some funds into the Euro-dollar market, while the German Federal Bank and the Bank of Italy took action to reduce the pullback of Euro-dollar placements by their banks. As a result of these coordinated actions, the one-month Euro-dollar rate fell back to 6½ per cent by December 12, 1966, and rates tended to soften further during the remainder of the month as the Euro-

dollar market remained adequately supplied with funds. By thus averting an abrupt rise in Euro-dollar rates toward the end of the year, such central bank operations may also have facilitated to some extent the general easing of credit internationally during recent months.

STERLING

During the past six months, sterling has staged a strong recovery from the severe crisis of last summer. This has reflected a gradual strengthening of confidence in the pound, with consequent short covering. The easing of credit conditions internationally has also contributed to a reversal of earlier drains of short-term funds out of sterling to other markets. More fundamental has been the remarkable achievement of the British Government in securing public acceptance of perhaps the most drastic stabilization program ever to be put forward by a democratic government in peace time.

The wage-price freeze and other measures announced by Prime Minister Wilson on July 20 were so severe, in fact, that the market initially was skeptical of their political feasibility, and selling pressure on the pound continued unabated. In order to demonstrate United States Government support of the British Government's defense of sterling, this Bank for the System and Treasury moved into the market immediately following Prime Minister Wilson's announcement with massive bids for sterling to all major New York dealers and, despite continuing selling pressure, drove the rate up sharply to over \$2.79. These operations were sustained for three days in sizable volume and seemed to exert a useful stabilizing influence in a badly demoralized market. But, as confidence remained at a low ebb and the competitive pull of other markets for short-term funds became even stronger, no significant amount of short covering developed and sterling was subject to pressure through most of August.

More generally, the world economy was confronted in the late summer of 1966 with seriously strained credit conditions in many national money markets. These tensions in domestic markets were naturally aggravated by widespread anxiety as to whether the British Government's battle to defend sterling would succeed. Against this background of dangerous unsettlement in the financial markets, the Federal Reserve announced on September 13 a generalized increase in its swap facilities from \$2.8 billion to \$4.5 billion, including a \$600 million rise to \$1,350 million in the line with the Bank of England. The Bank of England simultaneously announced that it had arranged additional facilities with other central banks. Initial wire-service reports of these large increases in international

credit facilities were necessarily cryptic, and the market—unclear about their implications—responded with some nervous selling. In order to maintain orderly conditions and prevent any slippage in quotations, this Bank again entered the sterling market, making moderate purchases for both Federal Reserve and Treasury account, with the rate at about \$2.7877. As it became clear to the market that the increased central bank credit facilities did not reflect an exhaustion of existing credit lines but were rather designed to provide a broad margin of safety against unforeseeable contingencies, sentiment in the sterling market began to improve.

Moreover, during the course of September, the British trade unions endorsed the Prime Minister's call for wage restraint and there was increasing evidence that the July 20 measures were beginning to take hold. By the end of the month, the spot rate was up to \$2.7910 and sterling was in good demand as the oversold position of the market began to be reflected in a covering of short positions. For the first time in four months, the Bank of England was able to forego net recourse to central bank assistance.

In succeeding weeks, sterling continued to improve as further covering of short positions was encouraged by better trade figures as well as by the November 10 announcement that Britain would initiate top-level discussions aimed at membership in the Common Market. Also, during this period the level of interest rates on dollar investments receded from their August-September highs, and the drain on sterling from this source came to an end. In October and November, the Bank of England added \$120 million to United Kingdom reserves, while making a start on repaying central bank assistance.

This pattern of gradual recovery was interrupted briefly at the end of November and in early December, both because of the mounting tensions surrounding Britain's impasse with Rhodesia and because of the usual year-end window-dressing preparations of commercial banks in several Continental centers. Such year-end window dressing led to large flows of funds across the exchanges, most notably outflows from London on a short-term covered basis—either directly to countries repatriating funds or to an increasingly stringent Euro-dollar market.

These covered outflows from London in turn brought about an appreciable narrowing in the discount for one-month sterling and, with United States money rates continuing to decline, incentives developed to move private funds from the United States into United Kingdom money market instruments. Such flows, while desirable from the point of view of sterling, would have had adverse consequences for the United States balance of payments. In

order to avoid such a development, while at the same time bolstering sagging spot quotations for sterling, this Bank, in consultation with the Bank of England, engaged in market swaps for the Federal Reserve and the Treasury, purchasing \$88 million of spot sterling against sales for delivery in January 1967. These operations complemented the coordinated action being taken by several other central banks and the BIS to relieve potentially disruptive year-end pressures in the Euro-dollar market.

During December, therefore, sterling was well insulated by concerted central bank action designed to cushion year-end short-term capital flows, and occasional Bank of England intervention in defense of the pound was only moderate. The announcement that Britain's seasonally adjusted trade balance had moved into surplus in November for the first time in the postwar period helped generate new demand for sterling and, as the year drew to a close, there was additional buying of sterling when some British corporations repatriated profits for the year-end. On balance, the Bank of England had a small reserve gain from exchange operations in December, even after further repayments of short-term central bank credits.

After the turn of the year, the progressive relaxation of monetary restraint in the United States, Germany, and other countries, combined with reflows of funds from the Continent, resulted in a sharp decline in Euro-dollar rates. Yields on British local-authority deposits also declined, but more slowly, so that for the first time in a year a significant incentive developed to shift funds from Euro-dollars to local-authority sterling deposits. The Bank of England on January 26 reduced its bank rate from the crisis level of 7 per cent to 6½ per cent. Central banks in several other financial centers also cut their discount rates, but the general lowering of interest rates left those in Britain still relatively attractive and short-term investment funds continued to be drawn to London. In addition, demand for sterling reflected the underlying improvement in the United Kingdom payments position and the beginning of the period of seasonal strength, including in particular substantial buying for oil royalty payments. Moreover, as confidence recovered still further, foreigners continued rebuilding their sterling balances. As dollars flowed back to the Bank of England, the bank continued its practice of devoting the bulk of such receipts to repayment of central bank debt while adding only modest amounts to its reserves.

As sterling moved through crisis to convalescence, the Bank of England made extensive use of the network of central bank credit facilities of various types that have been constructed during the past five years. In the case of the Federal Reserve swap line, Bank of England draw-

ings rose to a peak of \$450 million at the end of July, declined to \$400 million by the end of September, to \$350 million at the year-end, and were paid off completely by early March. In addition to drawings on the Federal Reserve swap line, the Bank of England made use of sizable special credits provided by the United States Treasury and, to a lesser extent (i.e., a maximum of \$50 million), by the Federal Reserve. After rising to a peak during the midsummer months, such special credits declined to \$175 million at the end of September, to \$160 million at the year-end, and were fully liquidated during January 1967. During the height of the crisis, the Bank of England also secured credit assistance from other central banks with repayments being subsequently effected.

GERMAN MARK

The German balance of payments swung into sizable surplus in the second half of 1966. Official gold and convertible currency reserves rose by \$578 million in the six-month period, resulting in a net reserve gain of \$419 million for the year as against a loss of \$617 million in 1965. The swing was largely related to cyclical factors. The German economy, which had been overheated through most of 1965 and early 1966, cooled off considerably in the second half of last year. With domestic pressures easing, the growth of German imports slowed and exports began to rise sharply. The resultant improvement on trade account was the major force behind the reemergence of a payments surplus, as other current-account items continued in deficit and the capital accounts were about in balance.

Starting late last year, monetary measures were taken to bring about renewed expansion in the German economy. After reducing reserve requirements in December, the German Federal Bank in January and February cut its discount rate in two steps from 5 per cent to 4 per cent per annum and further lowered commercial bank reserve requirements.

The balance-of-payments surplus was reflected during the period under review not only in rising official reserves but also in a strengthening of the German mark. After fluctuating slightly above par (\$0.2500) in September, the spot rate advanced in October to about \$0.2515 as the trade surplus widened. The tightening domestic money market, coupled with the onset of the usual year-end liquidity pressures, prompted German banks during November and December to repatriate funds normally held abroad in foreign currency assets. Despite the relaxation of reserve requirements in Germany, these demands carried the mark rate even higher and, as it approached its upper

limit of \$0.2518 $\frac{7}{8}$, the German Federal Bank made very large purchases of dollars.

Under the circumstances, the Federal Reserve acted in cooperation with the German authorities in December to alleviate the exchange market pressures resulting from these flows of funds. In order to meet the demand for marks that spilled over into the New York market, the Federal Reserve sold \$28.7 million equivalent of marks from its balances early in December. When the market began bidding strongly for marks on a one-month swap basis shortly before Christmas, the System shifted its intervention and sold \$17.5 million equivalent of marks spot against repurchase one month later. In addition, the System absorbed \$155 million of the dollar gains of the German Federal Bank, using \$15 million of marks previously held outright and \$140 million of marks drawn under the swap arrangement with the German central bank.

After the year-end, there was a substantial reflow of funds out of Germany. In addition to using existing mark balances, the Federal Reserve was able to acquire sufficient marks—from the maturing one-month swaps, from purchases in the New York market, from Spain following its drawing of marks from the International Monetary Fund (IMF), and through the German Federal Bank—to repay by mid-February its \$140 million mark swap drawing. Nevertheless, the mark remained strong in the exchange market, as the German trade account continued in heavy surplus. With the reemergence of a German payments surplus, the United States Treasury was unable to make further progress in reducing its indebtedness in mark-denominated securities issued to the German authorities. The overall amount outstanding remained at \$351 million at the end of February, compared with \$602 million at the beginning of 1966.

SWISS FRANC

In April the Swiss franc began to strengthen after having declined steadily during the first quarter of 1966, and by early May it had reached its effective ceiling of \$0.2317 $\frac{1}{2}$. The franc remained at its ceiling in subsequent weeks as a result of repayments of Swiss franc borrowings by foreigners, attributable to a tightening of the domestic money and capital markets, and later because of capital repatriations in connection with midyear liquidity needs. Consequently, the Swiss National Bank purchased \$200 million outright, and effected an additional \$82 million in short-term swaps with Swiss commercial banks to help provide for their temporary midyear requirements.

In July, tensions associated with the pressures on sterling dominated the foreign exchange markets and the usual

seasonal outflow of funds was converted into an actual inflow of \$69 million. Accordingly, the Federal Reserve drew \$75 million of francs from the Swiss National Bank and another \$75 million of francs from the BIS, using these funds to absorb uncovered dollars from the Swiss central bank. In late July, however, Swiss francs gradually came on offer as the pressures on sterling began to subside and high interest rates abroad gave rise to extensive capital outflows. In early autumn, with funds continuing to move out of Switzerland, the spot rate declined to \$0.2305¼ and the Swiss National Bank began selling dollars to the market. In addition, there were relatively heavy official requirements for dollars between September and November. The consequent reduction in its dollar holdings led the Swiss National Bank to buy \$60 million against Swiss francs from the Federal Reserve during this period. The System used the Swiss francs so acquired to reduce its swap drawings from the Swiss National Bank to \$15 million equivalent.

In November, the Swiss commercial banks began to repatriate large amounts of funds in connection with heavy year-end requirements and, when the spot rate moved to its ceiling, the Swiss National Bank purchased \$75 million in the market. Then, at the end of the month, the Swiss National Bank—as it had done in previous years—announced that it would buy dollars from the Swiss commercial banks on a short-term swap basis and the spot rate immediately receded from the ceiling. The swaps eventually reached a record level of \$398 million. In order to prevent these movements of funds from putting pressure on the Euro-currency markets, the Swiss National Bank, as usual, rechanneled the dollars so acquired into the Euro-dollar market.

After the year-end the Swiss franc eased further, and during January and February the spot rate was generally under \$0.2310. Aside from the unwinding of the December market swaps, however, outflows of funds from Switzerland were smaller than usual because lower interest rates in other countries made short-term investments abroad somewhat less attractive. Consequently, while the Federal Reserve was able to reduce its swap drawing from the Swiss National Bank by \$5 million to \$10 million equivalent with francs purchased in New York, the \$75 million drawn from the BIS in July remained outstanding. The United States authorities therefore decided to use some of their sterling balances to enter into a \$75 million equivalent sterling-Swiss franc swap with the BIS, half each for the System and the Treasury accounts. The Federal Reserve then purchased the Treasury's share of the swap proceeds and thus acquired sufficient Swiss francs to liquidate completely its \$75 million Swiss franc drawing from the

BIS. Finally, at the end of February, the Federal Reserve repaid its remaining \$10 million drawing from the Swiss National Bank with francs purchased from that bank.

ITALIAN LIRA

Italy registered a substantial balance-of-payments surplus during 1966, although on a decidedly smaller scale than in 1965. At first, reserve gains were moderate as Italian commercial banks made large short-term investments in the Euro-dollar market. About midyear, however, Italian payments moved into a period of seasonal strength, and there were short-term capital inflows resulting from growing speculation against sterling. Moreover, by then, most Italian banks had eliminated any net liability position vis-à-vis foreigners and the Bank of Italy was no longer prepared to shift dollars abroad through short-term swaps with those banks at preferential rates. Consequently, there was a marked rise in Italian official reserves, and the Federal Reserve reactivated its swap facility with the Bank of Italy, in July and August drawing lire to absorb a total of \$225 million from the Italian authorities. These drawings were repaid on August 22, when the United States Treasury drew \$250 million of lire from the IMF and sold the lire to the System. Using the remaining \$25 million of lire, plus some balances, the System reduced to \$14 million equivalent a sterling-lira swap with the BIS (originally \$50 million at its inception in February 1966 but reduced to \$40 million equivalent during the spring).

While these operations were under way, large amounts of dollars continued to flow into official Italian reserves during August. Accordingly, in early September the System again used its swap line, drawing lire to absorb \$100 million from the Italian authorities. Shortly thereafter, however, Italian reserves began to decline, as strong seasonal inflows subsided, a tighter Euro-dollar market exerted a renewed pull on Italian bank funds, and the Italian authorities prepaid \$145 million of postwar debt to the United States. Against this background, the System in late September purchased \$13.9 million of lire from the Bank of Italy and, adding some lire on hand, unwound its remaining \$14 million equivalent sterling-lira swap with the BIS.

In succeeding months, dollars were generally in demand in Italy in response to conversion of lira borrowings by foreign firms and outflows to the Euro-dollar market; as a result, lira quotations eased steadily, falling below par by mid-January. Offerings of lire in the market were sizable, and between October and January the Federal Reserve purchased sufficient lire in New York to repay in

Per Jacobsson Foundation Lecture

The Per Jacobsson Foundation in Washington, D. C., will make available to the Federal Reserve Bank of New York a limited number of copies of the text of the 1966 lecture on international monetary affairs. In sponsoring and publishing annual lectures on this topic by recognized authorities, the Foundation continues to honor the late Managing Director of the International Monetary Fund.

The third of the lecture series sponsored by the Foundation was held in Rome, Italy, on November 11, 1966. One lecture was given on that date: "The Role of the Central Banker Today" by Louis Rasminsky, Governor of the Bank of Canada; supplementary comments were made by Marcus Wallenberg of the Stockholms Enskilda Bank and Dr. Franz Aschinger of the *Neue Zürcher Zeitung*.

Because of the interest of many readers of this *Review* in international monetary affairs and in view of this Bank's sympathy with the Foundation's aims, we will distribute copies of the text upon request.

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full its \$100 million equivalent swap drawing from the Bank of Italy. The \$600 million swap facility was thus fully restored to a standby basis.

Although the turn in Italy's balance of payments in late 1966 was sufficient to make possible the liquidation of System lira commitments, Italy's overall reserve position strengthened over the year as a whole. In particular, Italy's creditor position in the IMF increased by some \$336 million. In view of the substantial surplus in their payments position, the Italian authorities at the year-end purchased \$60 million of gold from the United States Treasury in order to replenish their gold holdings. Beginning in January, however, Italy's foreign exchange requirements increased, partly for seasonal reasons. As a result, the Italian lira remained below par and Italian official dollar holdings declined by about \$200 million in January and February.

Federal Reserve and Treasury technical forward commitments in Italian lire, undertaken in 1965, were rolled over periodically during the course of 1966.

DUTCH GUILDER

The Netherlands money market tightened around mid-year and, as mounting tensions in the sterling market led to additional inflows of funds, Dutch official reserves rose

sharply. The Federal Reserve accordingly reactivated its swap facility with the Netherlands Bank—drawing a total of \$65 million of guilders which it used, together with \$2.5 million of guilder balances, to absorb dollars from that bank.

By mid-August, however, the Dutch money market had eased and, as increasingly attractive interest rates on dollar investments were exerting a pull on Dutch funds, the spot guilder rate began to decline, falling below par by mid-September. In order to moderate the decline, the Netherlands Bank sold some dollars to the market and later bought \$10 million from the Federal Reserve against guilders. The System in turn used the guilders to reduce its swap commitment to \$55 million equivalent as of September 16.

During the fall the guilder moved back above par, and subsequently fluctuated within a narrow range during the remaining weeks of 1966 as the Netherlands trade account was seasonally strong and the money market in Amsterdam firmed. During this period, the Netherlands Bank intervened only sporadically and then mainly to relieve money market pressures, which were particularly strong in early November and again in mid-December. In so doing, it used the technique of market swaps, buying dollars spot from Dutch commercial banks and selling them forward (in this instance for 1967 delivery). To help

moderate year-end pressures in the Euro-currency markets, the Netherlands Bank reinvested its December dollar purchases in the Euro-dollar market.

At the end of 1966, foreign currency requirements of the Dutch government led the Netherlands Bank to buy \$20 million against guilders from the Federal Reserve, and the Federal Reserve immediately used the guilders to reduce its swap commitment with that bank to \$35 million equivalent. Then, in January, there was a flow of funds from the Netherlands into sterling (through dollars) and the central bank provided some support for the guilder. These dollar losses, coupled with the conversion into dollars of the guilder portion of Spain's multicurrency drawing from the IMF, reduced the Netherlands Bank's dollar holdings, and the bank purchased \$35 million from the Federal Reserve against guilders. The System in turn repaid the remainder of its outstanding guilder swap drawing, restoring the \$150 million arrangements fully to a standby basis. There were no further Federal Reserve or Treasury operations in guilders during the period covered by this report.

BELGIAN FRANC

During the early summer of 1966, Belgium's trade and service accounts moved into surplus and the Belgian franc began to strengthen. By late July, the Belgian franc had reached its ceiling and the National Bank of Belgium began buying fairly sizable amounts of dollars. In order to absorb some of these gains, the Federal Reserve in early August drew \$30 million of francs under the \$50 million standby portion of the reciprocal swap arrangement with the National Bank.

Belgium's current account swung into deficit later in August, and the National Bank then started supplying foreign exchange to the market, covering these losses by purchasing dollars from the Federal Reserve against Belgian francs. By late September, such purchases totaled \$30 million and the System had fully repaid its swap drawing from the National Bank.

During the early fall the Belgian franc drifted somewhat below par as a result of a continued deterioration on the trade account, and in November the Belgian central bank again began to lose dollars. Because of these market losses, and exchange requirements of the Belgian Treasury, the National Bank again needed dollars in the last few weeks of 1966. The bank bought \$30 million from the United States Treasury against Belgian francs, which the Treasury used to build up a balance for future contingencies. Thus, by the end of 1966 the Treasury had a fully covered position in Belgian francs, since its franc

balances matched its Belgian franc-denominated bond indebtedness.

During the first two months of 1967 there was an improvement in the Belgian current account, and the franc moved somewhat above par after mid-January. Tighter Belgian money market conditions associated with a large Belgian government bond flotation contributed to the rise in the rate, but at no time were there any significant pressures in the market, and at the end of February Belgian official reserves were virtually unchanged.

CANADIAN DOLLAR

Although there were some large capital flows to Canada during the first half of 1966, seasonal weakness in the trade and tourist accounts early in the year and sizable covered conversions of domestic time deposits into United States dollar investments by Canadian banks accounted for net Canadian demand for foreign exchange. During the summer months, the Canadian dollar strengthened, but official gold and exchange reserves continued to decline as Canadian authorities purchased from United States residents nearly \$141 million of Canadian government debt and some \$25 million of IBRD (International Bank for Reconstruction and Development) bonds to adjust their total official reserve holdings to levels mutually agreed upon with the United States. Including those purchases and a \$47 million gold payment to the IMF in connection with Canada's quota increase, Canadian gold and foreign exchange reserves fell \$420 million during the first nine months of 1966.

During the fourth quarter the spot rate for Canadian dollars declined, as there were few new Canadian securities offerings in New York and Canada's balance of payments again entered a period of seasonal weakness. By early November spot quotations had fallen below the \$0.9250 parity, and they remained below par in the remaining weeks of the year when there were large financial outflows associated with dividend payments to non-residents and year-end repatriations of funds by foreigners. There was no significant selling pressure, however, and there was little net change in official Canadian gold and foreign exchange reserves during the final quarter. (Late in the year, the United States Treasury purchased \$17 million of Canadian dollars from the Bank of Canada for resale to IMF members having repurchase obligations to the Fund. Earlier in 1966, the United States Treasury had drawn a total of \$400 million equivalent of Canadian dollars from the IMF for sale to Fund members meeting repayment obligations.)

Seasonal factors continued to run against Canada in

early 1967. With an easing in monetary conditions in the United States, however, there was a revival of Canadian borrowing in New York and some repatriation of Canadian funds from the Euro-dollar market. As a result, the spot Canadian dollar rose sharply during January. Once the borrowings in New York were completed, however, the spot rate tended to ease, and through mid-February it traded just above par in a quiet and balanced market. At the end of the month, there was a flurry of selling when the Royal Commission on Taxation made its report and the spot rate eased just below par.

INTERNATIONAL MONETARY FUND

The United States continued the practice initiated in February 1964 of drawing currencies from the IMF for sale to countries making repayments to the Fund. During the period under review, takedowns were made under the drawing of \$100 million of Canadian dollars arranged on August 18 and the United States arranged an additional "technical" drawing for \$30 million equivalent of German marks.

United States drawings from the Fund—both regular and technical—between February 1964 and February 1967 totaled \$1,640 million. During the same period, other countries drew dollars from the Fund, thereby reducing the Fund's holdings of dollars and reducing this country's repayment obligation. Consequently, at the end of February 1967, net United States indebtedness to the IMF was \$933.5 million.

The general Fund quota increase of 25 per cent adopted in 1964 by the Governors of the Fund was ratified by two more members during the period, bringing the number of ratifications to ninety-two; Fund resources were thereby increased to over \$20.9 billion. As indicated in previous reports, a member must pay its quota increase to the Fund partly in its own currency and partly in gold. The quota increase arrangement provides that the Fund will deposit a total of up to \$350 million of gold with the Federal Reserve Bank of New York and the Bank of England to compensate for any losses arising from other members' gold subscription payments to the Fund. As of February 28, 1967, the Federal Reserve Bank of New York held for United States Treasury account \$213.4 million of gold so deposited by the IMF.

THE GOLD MARKET

Early estimates suggest that official gold reserves of the noncommunist world declined slightly over the course of 1966. Although private hoarding demand evidently de-

clined somewhat, industrial and artistic use again rose and, with new gold supplies off sharply, total demand exceeded the volume of gold coming on to the market. This imbalance was reflected in higher prices on the London gold market and in the activity of the central bank gold pool, which for the first time since its inception closed the year with a net drain on its resources. In the past five months, however, the supply-demand relationship has improved, as South African sales have risen and hoarding demand has declined.

South Africa, the world's leading gold producer, had a payments surplus for the first half of the year and on balance absorbed into its own reserves slightly more than \$200 million of gold from new production in 1966. In addition, the Soviet Union apparently sold no gold in 1966 for the first time in recent years. Commercial and artistic use of gold continued to rise, but private hoarding demand moderated. Tight monetary conditions in many countries increased the yields on alternative investments and undoubtedly cut down on speculative buying. On the other hand, speculative demand was encouraged by several factors during the year—the Vietnam conflict, the Rhodesian situation, and the repeated intimations on the part of French officials that the price of gold should perhaps be raised. In addition, the sterling crisis during the summer led to strong demand and a firm price throughout the third quarter.

During the period under review, the London gold price backed away from the high of \$35.1940 reached in August and September and dipped below \$35.15 on several occa-

Table II
UNITED STATES NET MONETARY GOLD TRANSACTIONS
WITH FOREIGN COUNTRIES AND INTERNATIONAL INSTITUTIONS*
January-December 1966

In millions of dollars at \$35 per fine troy ounce;
United States net sales (—), net purchases (+)

Country	First half	Third quarter	Fourth quarter	Year
Canada.....	+ 150.0	+ 50.0		+ 200.0
France.....	— 323.5	— 277.3		— 600.8
Italy.....			— 60.0	— 60.0
Switzerland.....	+ 18.0	— 20.0		— 2.0
United Kingdom.....	— 26.1	+ 126.0	— 20.1	+ 79.8
All other.....	— 19.6	— 22.2	— 5.7	— 47.5
Net sales.....	— 201.2	— 143.5	— 85.8	— 430.6

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

* Not reflected in this table are United States monetary gold transactions with foreign countries mitigated through special deposits by the IMF.

sions in October and early November. Demand was diminishing as the pressures on sterling eased, and at the same time the volume of South African supplies was picking up rapidly, following an adverse swing in South Africa's payments position. Nevertheless, with the approach of the year-end, demand became very strong once again, influenced partly by heightened tensions in the Middle East and by rumors that economic sanctions might be applied to South Africa in connection with the Rhode-

sian situation. As a result, the price rose to \$35.1971 toward the end of December. Thereafter, the market eased once again in early 1967, although there were brief flurries of demand in response to renewed French official discussion of the role of gold in world monetary arrangements. The lifting of restrictions on French gold trading in Paris was taken in stride both in the London market and elsewhere on the Continent, and at the end of February the London fixing price had fallen to \$35.1486.

The Business Situation

The growth of business activity moderated somewhat further in recent weeks. Severe snowstorms throughout the Midwest and Northeast during late January and early February adversely affected production and sales. These storms, moreover, have greatly complicated the assessment of underlying business trends—a task already made difficult by the many crosscurrents developing in both the financial markets and the markets for goods and services.

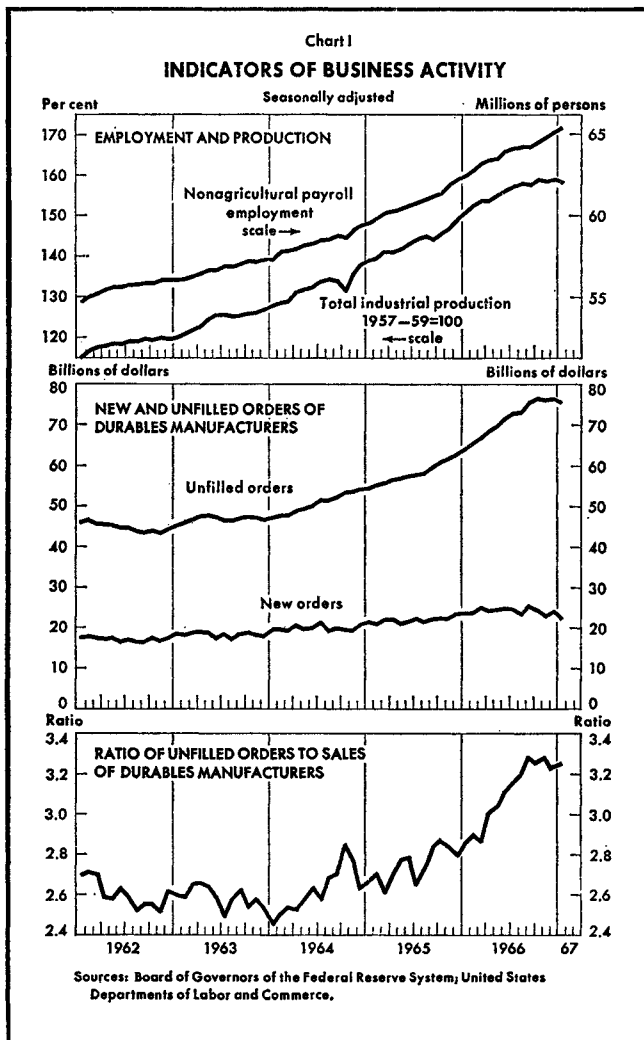
But, taking all factors into consideration, the economy still is moving ahead. Indicators of current strength include the high backlogs of unfilled orders on the books of durables manufacturers, the continuing large gains in employment and personal income, and the steady climb of both defense outlays and spending by state and local governments. While the likelihood of a sizable downward adjustment of inventory spending continues to cloud the outlook for total spending in the coming months, new information indicates more potential strength in some other important areas of private activity than many observers have been anticipating.

RECENT MONTHLY INDICATORS

Due in part to the severe snowstorms that disrupted production in much of the northeastern and midwestern regions of the country late in the month, industrial output in January declined substantially from the December level. The Federal Reserve Board's index of industrial production fell by 1.0 percentage point (or 0.6 per cent), after

having risen by 0.3 percentage point from November to December. At 157.9 per cent of the 1957-59 average, the January production index was back down to the level of last August (see Chart I). The largest January declines occurred in durable consumer goods and durable materials. Automobile assemblies fell by 15 per cent to a seasonally adjusted annual rate of 7¼ million units. Because of production stoppages caused by the heavy snows, this rate of output was lower than had been scheduled. Iron and steel production, also affected by weather conditions, declined by 6 per cent in January, for a total reduction of 14 per cent from last July's high. Business equipment production, which had risen sharply month after month in 1966, leveled off in January, but defense equipment production continued to expand strongly.

The volume of new orders received by durables manufacturers fell by a sizable \$1.6 billion in January, and the seasonally adjusted level of \$22.4 billion was the lowest in more than a year (see Chart I). Contrary to the experience of earlier months, when fluctuations in new orders centered in defense-related businesses, the January decline reflected lower orders in a wide range of industries. Because shipments by durables manufacturers remained strong—the seasonally adjusted volume of \$23.3 billion in January was exceeded only twice—the backlog of unfilled orders was reduced by \$0.9 billion. However, the \$75.5 billion of orders on the books of durables manufacturers at the end of the month was still equivalent to 3¼ months of shipments at current sales rates (see Chart I).



Inventory accumulation is continuing at a rapid pace. While retail and wholesale trade inventories have also increased substantially, it is manufacturing stocks that have provided the main push. Indeed, the increase in manufacturers' stocks in both December and January was at a seasonally adjusted annual rate in excess of \$12 billion. Durables manufacturers' inventories—especially of finished goods—increased in January at a substantially lower pace than in December, and the rise was actually the smallest since last spring, but this was offset by an extremely large inventory accumulation by manufacturers of non-durable goods.

Private nonfarm residential construction outlays (seasonally adjusted) increased in January for the first time

in eight months. This increase had, of course, been foreshadowed by the earlier rises in housing starts from their October lows. Moreover, both housing starts and building permits again climbed sharply in January, thus suggesting further increases in construction outlays in the immediate future. Housing starts increased by 14 per cent, to reach a seasonally adjusted annual rate of 1.2 million units, midway between the 1966 peak rate of 1.6 million units in January and the 1966 low of 0.8 million units in October. Building permits for new private housing units also jumped by 18 per cent in January, thereby recovering almost one third of the reduction that took place between March and October of last year. But, while these developments are certainly most encouraging, it must be recognized that starts and permits are highly volatile series, and assessment of the strength of the housing recovery therefore must await developments in the coming months.

The employment situation continued very strong in January. Nonfarm payrolls again expanded sharply, increasing by 279,000 persons to a seasonally adjusted total of 65.4 million. Almost half of the gain centered in retail trade employment. Manufacturing employment also posted a good advance, but employment by all levels of government increased by less than in preceding months. The overall unemployment rate remained unchanged in January, at 3.7 per cent of the civilian labor force. (This figure was computed by the Bureau of Labor Statistics according to its new and improved definitions which conform more closely to the everyday meaning of "unemployment". The new measurement procedure apparently reduced the reported overall unemployment rate by about 0.2 percentage point.) The key unemployment rate for married men remained in January at its low November and December reading of 1.7 per cent. But, while unemployment rates were unchanged, some easing of the labor shortage is indicated by the recent slight shortening of the manufacturing workweek and by the behavior of various labor turnover rates in manufacturing.

Despite a \$1.1 billion hike in the social insurance contributions of employees, personal income rose by a very large \$5.4 billion in January to a seasonally adjusted annual rate of \$607.2 billion. In comparison, personal income increased by \$3.3 billion in December and averaged a \$4.1 billion monthly gain during the second half of 1966. Wage and salary disbursements were up by \$3.3 billion in January, as against \$2.4 billion in December; dividend receipts rose by \$1.5 billion after falling by an almost equal amount in December, and transfer payments moved up by \$0.7 billion, \$0.4 billion less than in the preceding month.

Despite the continued strong rise in personal income, retail sales remained sluggish in January. According to preliminary data, they were virtually unchanged from their reduced December level. However, part of the poor January performance was undoubtedly the result of heavy snowfalls which blanketed large areas of the country late in the month. There was a significant decline in auto sales during January, but this was offset by increased sales of other consumer goods. With bad weather conditions continuing into February and with new car sales down by as much as 10 per cent, retail sales are unlikely to have shown any improvement during that month.

Recent price movements have reflected the lessened demand pressures in the economy. Consumer prices, which had advanced noticeably more slowly in November and December than in earlier months, were stable in January. Prices of services again increased, but those of foods as well as of other commodities declined about in line with seasonal expectations and presumably in large part as a result of the earlier good performance of wholesale prices. The wholesale price index had declined by 0.8 per cent between August and December, under the impact of falling prices for farm products and processed foods and of only slowly rising prices for industrial commodities. In January, the wholesale index again rose by a substantial 0.3 per cent as the prices of farm products, processed foods, and industrial commodities increased, but preliminary data indicate a 0.2 per cent decline in February. In contrast to recent price developments, unit labor costs in manufacturing (which had temporarily stabilized in December) rose sharply again in January, bringing the increase since July to an annual rate of almost 8 per cent.

INDICATORS OF FUTURE CONSUMER DEMAND AND CAPITAL SPENDING

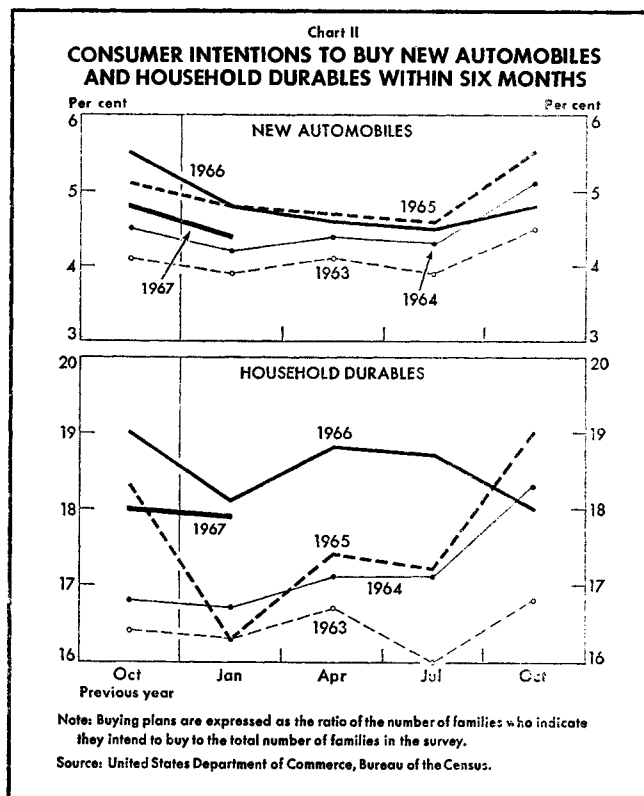
The Commerce Department's January survey of consumer buying intentions reveals little apparent change in consumer sentiment since the previous survey taken in October. In both of these two most recent surveys, the proportion of families intending to purchase a new automobile or one or more of seven big-ticket household durables within six months was lower than in the respective year-earlier survey. While the shortfall from the year-ago percentages was somewhat smaller in the January survey than in the preceding October survey (see Chart II), it should be borne in mind that the October 1966 findings did suffer by comparison with the exceptionally strong buying intentions expressed a year earlier, just prior to a sharp upsurge in auto and durables sales.

The proportion of families intending to buy one or more

household appliances was only 0.2 percentage point lower in January 1967 than in January 1966—considerably smaller than the 1.0 percentage point drop between October 1965 and October 1966. Moreover, the January 1967 reading was among the highest recorded for a January survey. Last fall, the main weakness had been in plans to purchase household durables three to six months in the future or at some indefinite time within six months. This pattern was interpreted as reflecting considerable unease with regard to the economic outlook and the size of a possible tax increase. The latest survey apparently reflects a reduction in this feeling of uneasiness, as it shows a considerable narrowing of the earlier discrepancy between shorter and longer run buying plans.

The survey indicated continued weakness in plans to buy a car within six months, with the proportion of families planning such a purchase smaller than in either of the preceding two years. Here again, however, the decline from the year-earlier reading was less in January than it was last October. This relative improvement centered in the longer term or less definite plans.

The latest Department of Commerce survey also showed



that 27 per cent of the interviewed families expected their incomes to increase in the coming year—a higher proportion than in any of the earlier January surveys. The discrepancy between households' very strong view of their future financial situation and their conservative buying intentions suggests that consumers are presently contemplating a continued high rate of savings.

A special survey of plant and equipment expenditure plans taken in January by McGraw-Hill implies more strength in the capital investment area than was generally thought to exist. To be sure, the \$64.4 billion of outlays planned at this stage for 1967 would amount to a much smaller year-to-year increase than in the preceding three years when the gains ranged between 14.5 per cent and 16.6 per cent. Nevertheless, the planned 6.3 per cent rise indicated by the special McGraw-Hill survey would be quite respectable by historical standards. Another indication that businessmen generally view the economy's future with confidence is their anticipation, indicated by another recent McGraw-Hill survey, that profits before taxes in 1967 will be 4 per cent higher than last year.

The McGraw-Hill survey shows that manufacturing industries are now planning to increase capital spending in 1967 by 8 per cent, with durables manufacturers looking forward to an 11 per cent advance over 1966. Par-

ticularly large increases are being contemplated by the electrical machinery, iron and steel, nonferrous metals, and fabricated metals and instruments industries. Non-durable goods producers, however, intend to up their outlays by a more modest 5 per cent. Outside manufacturing, electric and gas utilities and airlines and mining companies are planning for major increases in plant and equipment expenditures, while railroads anticipate a considerable cut-back. Other transportation and communications industries, as well as commercial enterprises, are projecting little change in capital spending from 1966 levels.

The National Industrial Conference Board's survey of the capital appropriations of the 1,000 largest manufacturers during the fourth quarter of 1966 supports the present indications of strength in business fixed investment plans. Seasonally adjusted, net new appropriations rose by 2 per cent during the fourth quarter and, although still considerably below the levels reached between the fall of 1965 and the summer of 1966, they were well ahead of the figures reported for any but these three quarters. The net new appropriations of these large firms exceeded their capital expenditures during the final quarter of 1966, and closing backlogs rose further. Backlogs at the start of 1967 were equal to almost a full year of capital spending at the fourth-quarter rate.

Fifty-second Annual Report

The Federal Reserve Bank of New York has published its fifty-second *Annual Report*, reviewing the major economic and financial developments of 1966.

The *Report* discusses the difficulties experienced by the United States economy during 1966. Excessive demand pressures resulting from increased defense requirements and rapidly expanding private demands for goods and services gave rise to inflationary forces and a weakening of the nation's foreign trade surplus. Monetary policy, the *Report* notes, became increasingly restrictive in the first part of the year in an effort to restrain the overheated economy, and serious financial stresses became apparent by midsummer. Thereafter, a slower rate of economic expansion and an easing of monetary policy contributed to a lessening of pressures in the financial markets.

Looking ahead, Mr. Hayes, President of the Bank, said in his letter transmitting the *Report* to member banks that the task of returning to a balanced noninflationary growth and of reaching equilibrium in our balance of payments poses a difficult problem for policy makers.

Copies of the *Annual Report* are available from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045.

The Money and Bond Markets in February

Conditions in the money market were quite varied during February, with the underlying tone at times appearing somewhat firmer than might have been expected purely on the basis of current nationwide net reserve availability. Money market conditions were relatively easy at the end of January and in early February, when a severe snowstorm hampered check-clearing operations and caused a sharp bulge in float. A firmer tone prevailed over much of the next three weeks before a more comfortable atmosphere was restored toward the end of the month. As the month progressed, System open market operations provided substantial amounts of reserves on a day-to-day basis—mostly through repurchase agreements—to offset larger than expected absorptions of reserves stemming from movements in other factors. But the excess reserves left in the banking system tended for a time to remain widely dispersed outside the money centers. Money center banks, on the other hand, had sizable reserve deficits. As a consequence, they raised their dealer lending rates from the lower levels prevailing in the second half of January and also for a time bid for Federal funds at somewhat higher rates than had been the case earlier. Conditions became easier again toward the end of the month, when reserve distribution shifted back toward banks in the money centers.

Late on the final day of the month, the Federal Reserve Board announced a reduction in reserve requirements against all savings deposits and Christmas and vacation club accounts and against the first \$5 million of other time deposits at each member bank. The reduction was from 4 per cent to 3 per cent, with half of the cut effective in the statement period beginning March 2 and the remainder becoming effective two weeks later. The Board noted that the action was “intended to assist in meeting developing credit needs throughout the country in a manner consistent with the Federal Reserve’s policy objectives of assuring that the availability of credit is adequate to provide for orderly economic growth”.

Short-term interest rates generally rose through most of February, though in the Treasury bill market sharp declines in rates late in the month erased a good portion of the earlier increases. The rise in bill rates during much of

the month in part reflected the profit taking of dealers and other professionals against the background of the firmer conditions prevailing temporarily in the money market. Dealers became more confident again toward the end of the month, when easier conditions returned to the money market. They were also encouraged by large sales to the Federal Home Loan Banks which bought bills in an operation designed to help the Treasury avoid exceeding the legal debt limit. The reduction in reserve requirements noted above buoyed the bill market further on the final day of the month.

In the longer term markets, the buoyancy that had prevailed during January gave way to a very cautious atmosphere during most of February—though in these markets, too, a sharp rally in prices began late on the final day of the month. The major source of concern during the month was the steady stream of announcements pointing to a very substantial current and prospective demand for capital. These announcements built up the calendar of corporate and tax-exempt bond offerings scheduled for March to more than \$2 billion. The International Bank for Reconstruction and Development scheduled a \$250 million offering—its largest ever—and there were rumors that the Federal National Mortgage Association (FNMA) would be selling another large issue of participation certificates. There was also some uncertainty over the prospective course of monetary policy amid further discussion of possibly greater strength in the economy later in the year.

In this environment, investors responded unenthusiastically to the fairly heavy supply of capital market offerings, despite progressively higher yields. As many of the new issues moved slowly, intensive price cutting occurred and prices of outstanding issues fell. The pressures in the corporate and tax-exempt area carried over into the market for Treasury coupon issues, and prices fell by as much as $3\frac{1}{32}$ points through February 23. Prices of Treasury issues firmed somewhat on the following day, when Treasury trust accounts bought a large amount of coupon issues because of the debt ceiling problem. These purchases of coupon issues, along with some eventual improvement in the distribution of the new issues that were offered in other sectors

Table I
FACTORS TENDING TO INCREASE OR DECREASE
MEMBER BANK RESERVES, FEBRUARY 1967

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

Factors	Changes in daily averages— week ended				Net changes
	Feb. 1	Feb. 8	Feb. 15	Feb. 22	
"Market" factors					
Member bank required reserves*	- 91	+ 19	+ 256	+ 64	+ 248
Operating transactions (subtotal)	+ 522	- 692	- 370	- 56	- 596
Federal Reserve float	+ 241	- 260	- 97	- 65	- 171
Treasury operations†	+ 111	+ 154	- 254	+ 44	+ 55
Gold and foreign account	+ 37	- 7	+ 4	- 2	+ 32
Currency outside banks*	+ 191	- 488	- 38	+ 128	- 207
Other Federal Reserve accounts (net)‡	- 58	- 100	+ 16	- 163	- 305
Total "market" factors	+ 431	- 673	- 114	+ 8	- 348
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	- 208	+ 230	+ 59	- 143	- 62
Bankers' acceptances	- 2	+ 1	+ 1	+ 1	+ 1
Repurchase agreements:					
Government securities	- 34	+ 204	+ 46	+ 212	+ 428
Bankers' acceptances	-	+ 50	-	+ 14	+ 64
Federal agency obligations	-	+ 1	+ 6	+ 24	+ 31
Member bank borrowings	- 362	+ 177	+ 103	+ 21	- 61
Other loans, discounts, and advances	-	+ 1	- 1	-	-
Total	- 606	+ 664	+ 214	+ 129	+ 401
Excess reserves*	- 175	- 9	+ 100	+ 137	+ 53

	Daily average levels				
	Feb. 1	Feb. 8	Feb. 15	Feb. 22	Feb. 29
Member bank:					
Total reserves, including vault cash*	23,905	23,877	23,721	23,794	23,824‡
Required reserves*	23,580	23,561	23,805	23,241	23,422‡
Excess reserves*	325	316	416	553	403‡
Borrowings	176	353	459	477	366‡
Free reserves*	+ 149	- 37	- 40	+ 76	+ 37‡
Nonborrowed reserves*	23,729	23,524	23,265	23,317	23,459‡

	Changes in Wednesday levels				
	Feb. 1	Feb. 8	Feb. 15	Feb. 22	Feb. 29
System Account holdings of Government securities maturing in:					
Less than one year	- 501	+ 852	- 2,220	- 126	- 1,995
More than one year	-	-	+ 2,457	-	+ 2,457
Total	- 501	+ 852	+ 237	- 126	+ 462

Note: Because of rounding, figures do not necessarily add to totals.
* These figures are estimated.
† Includes changes in Treasury currency and cash.
‡ Includes assets denominated in foreign currencies.
§ Average for four weeks ended February 22.

Table II
RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS
FEBRUARY 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended				Averages of four weeks ended Feb. 22
	Feb. 1	Feb. 8	Feb. 15	Feb. 22	
Eight banks in New York City					
Reserve excess or deficiency(-)*	47	8	25	62	36
Less borrowings from Reserve Banks	-	64	136	210	103
Less net interbank Federal funds purchases or sales(-)	353	641	869	529	598
Gross purchases	1,278	1,230	1,326	1,192	1,237
Gross sales	925	589	457	664	639
Equals net basic reserve surplus or deficit(-)	- 306	- 697	- 979	- 676	- 665
Net loans to Government securities dealers	1,093	1,017	774	668	888
Thirty-eight banks outside New York City					
Reserve excess or deficiency(-)*	97	19	42	37	49
Less borrowings from Reserve Banks	91	206	150	127	144
Less net interbank Federal funds purchases or sales(-)	1,429	1,400	1,291	1,321	1,360
Gross purchases	2,223	1,837	1,930	1,877	1,967
Gross sales	794	437	639	556	607
Equals net basic reserve surplus or deficit(-)	- 1,423	- 1,587	- 1,398	- 1,412	- 1,455
Net loans to Government securities dealers	1,020	852	694	706	818

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.

Table III
AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In per cent

Maturities	Weekly auction dates—February 1967			
	Feb. 6	Feb. 10	Feb. 20	Feb. 27
Three-month	4.530	4.577	4.621	4.538
Six-month	4.524	4.581	4.694	4.534
Monthly auction dates—December 1966-February 1967				
	December 27	January 24	February 21	
Nine-month	4.920	4.656	4.718	
One-year	4.820	4.576	4.696	

* 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.

of the capital market during the month, left the market in a reasonably good technical position at the month end.

BANK RESERVES AND THE MONEY MARKET

Conditions in the money market varied over a fairly wide range during February, a period complicated by the holidays on Lincoln's Birthday and Washington's Birthday, by severe weather conditions which affected reserve availability, and by the tendency of reserves frequently to fall short of expectations. Federal funds, after having traded below 5 per cent in late January and the first few days of February, traded in a 5 to 5¼ per cent range during most of the following three weeks despite continued relatively ample levels of nationwide net reserve availability. Most trading was at a 4¾ per cent rate on the final three days of February, however. Rates posted by the large New York City banks on call loans to Government securities dealers were quoted in a 5½ to 6 per cent range over much of February, before falling back to as low as 5 per cent at the end of the month. Dealers in bankers' acceptances boosted their rates on unendorsed acceptances in two steps by a total of ¼ of a per cent during the month.

Continuing the January trend, offering rates on large new time certificates of deposit (C/D's) issued by the major New York City banks declined in early February to a most frequently quoted rate of 5 per cent. The lower rates slowed the expansion in the dollar volume of C/D's outstanding at weekly reporting banks from the rapid pace that occurred in January. The banks continued this somewhat less aggressive policy of attracting C/D money over the remainder of the month, though in the light of the rises in other short-term interest rates they did raise their offering rates somewhat as the month progressed. At the close of the month, some banks were reportedly paying as much as 5¼ per cent to certain customers for some maturities. Over the four weeks ended February 22, reporting banks throughout the nation recorded a \$0.7 billion rise in their outstanding C/D's as against a \$2.2 billion rise during the four weeks ended January 25.

When the month began, nationwide net reserve availability had risen to a relatively high level in the wake of a severe Midwestern snowstorm which gave rise to a sharp bulge in float in the statement week ended February 1 (see Table I). As a result, free reserves averaged \$149 million that week, and member bank borrowings from the Federal Reserve Banks contracted sharply. Nationwide net reserve availability fell back during the next two statement weeks into the range which had prevailed in late January, with member bank borrowings concurrently expanding somewhat.

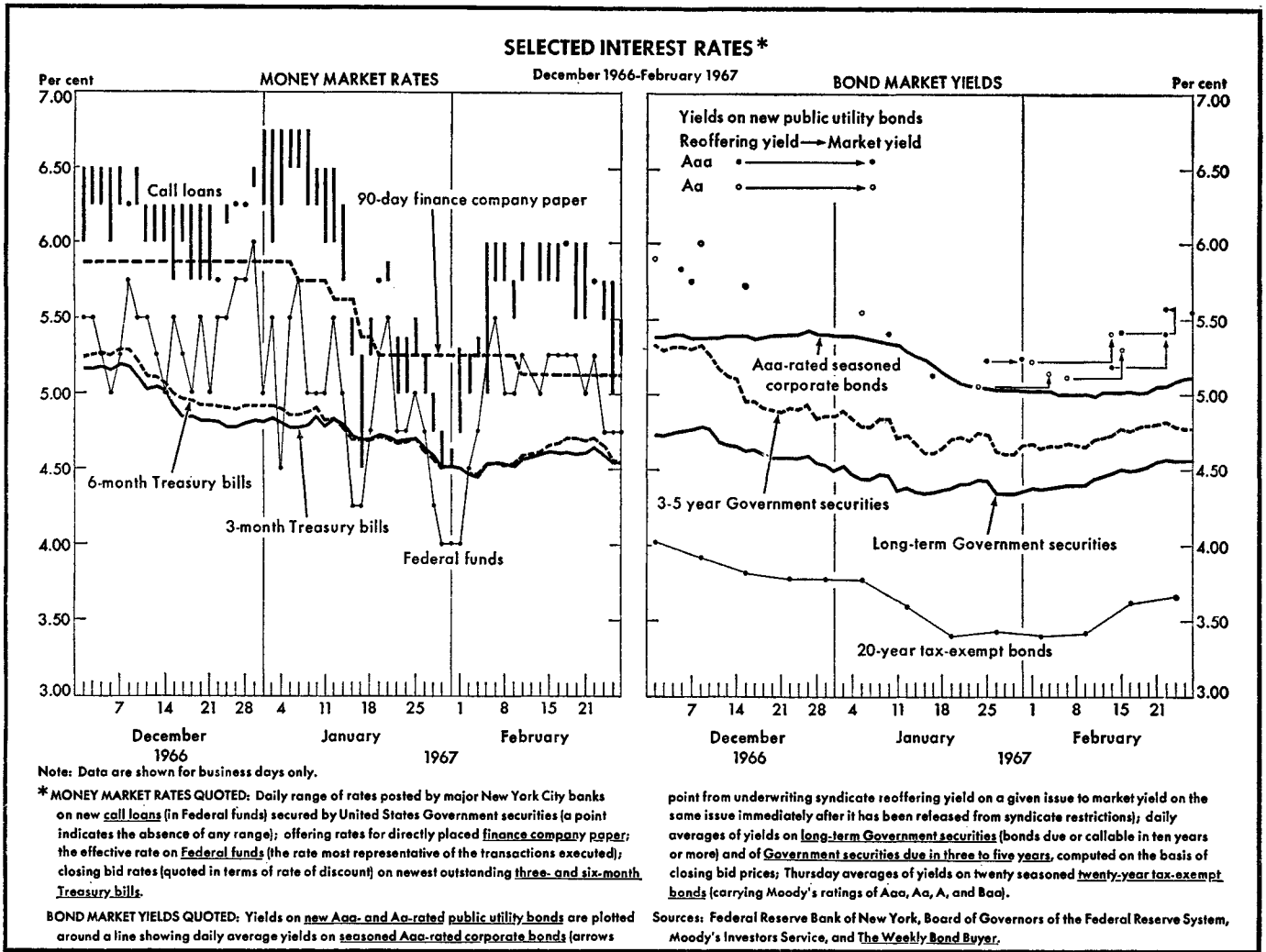
During much of the month, Federal Reserve float persistently averaged lower than anticipated, thus providing less reserves than expected. In part, this reflected a change in the schedule of crediting cash items in the process of collection from banks that are open on Saturdays. Meanwhile, bank credit continued to grow at a rapid pace, with the result that member banks' required reserves persistently averaged higher than expected for the season.

To offset these implicit reserve drains and promote bank credit growth, System open market operations injected reserves rather steadily during most of the period, arranging new repurchase agreements to meet the emerging reserve needs. Much of the reserves remained lodged outside the money centers, however, while heavy lending to dealers and others pushed money center banks into deep basic reserve deficit. To accommodate the very large demand for excess reserves from "country" banks in the week ended February 22, net free reserves were allowed to expand to an average of \$76 million; however, the money market remained firm. As the previously accumulated excess reserves flowed into the money centers in the following week, and as dealers' financing needs weighed less heavily on money market banks, the atmosphere in the money market again became easier.

THE GOVERNMENT SECURITIES MARKET

In the market for Treasury notes and bonds, the optimistic tone which had predominated in December and January continued in evidence at the beginning of February. The disclosure on February 1 of the very successful results of the Treasury's February refinancing operation¹ confirmed earlier market expectations and contributed to the buoyant market sentiment. The exuberance of the coupon sector, however, began to wane shortly thereafter. Observers viewed with increasing caution the mounting additions to the future calendar of corporate and tax-exempt bond offerings and later rumors that the FNMA would soon offer another large volume of participation certificates. With indications that heavy demands for funds would persist in the capital markets for some time to come, and in view of market uncertainty over the future posture of monetary policy, bond market observers began to reassess the sustainability of the higher bond price levels that had emerged during the preceding two months.

¹ For details of the refinancing, see this *Review* (February 1967), pages 37-38.



Against this background, an atmosphere of deepening caution emerged in the market for Treasury notes and bonds during most of February. Although little investment selling developed, investment demand was quite limited and professional offerings depressed prices of coupon securities sharply through February 23. Many issues suffered their largest losses since last summer. Coupon issues maturing within five years recorded price declines ranging as high as $\frac{2}{32}$ of a point during this period, while prices of longer term issues—which were particularly affected by the weakness developing elsewhere in the capital market—declined as much as $3\frac{1}{32}$ points. (The right-hand panel of the chart illustrates the rise in yields which accompanied these price declines.) In the final days of February, a steadier tone developed when Government agencies and

trust funds purchased a sizable volume of marketable outstanding Treasury obligations and redeemed special issues in order to help the Treasury avoid exceeding the legal debt limit. The month closed on a fairly strong note when the market responded quite favorably to news of the reduction in reserve requirements against certain deposits, as noted above. By the end of the month, prices of many coupon issues had recouped a portion of their earlier losses.

A more cautious tone also developed in the market for Treasury bills for a time in February. Although demand remained fairly good, it was less intense than in earlier months. At the same time, increasing dealer financing costs led to an expansion in professional offerings, as dealers attempted to lighten their fairly sizable positions, while

commercial bank offerings also increased. As a result, prices fell and demand did expand somewhat. Meanwhile, rates on bills maturing beyond one month generally rose through February 23. At the regular monthly auction of new nine- and twelve-month bills on February 21, average issuing rates were set at 4.718 per cent and 4.696 per cent, respectively, 6 and 12 basis points above average rates set a month earlier (see Table III).

Subsequently, the tone of the bill market strengthened when the money market became more comfortable, and considerable demand developed on the part of Government agencies. At the final regular weekly auction of the month on February 27, bidding was very aggressive and average issuing rates were set at 4.538 per cent for the new three-month bills and 4.534 per cent for the new six-month bills—8 and 16 basis points, respectively, below average rates at the comparable auction a week earlier but 5 and 7 basis points, respectively, above rates at the last weekly auction in January. At the end of February, the bill sector was encouraged by news of the reserve requirement action earlier discussed.

In the market for Government agency obligations, prices fluctuated irregularly during the month. Prices of short- and intermediate-term maturities were narrowly mixed, while prices of longer term obligations moved sharply lower. Over the month as a whole, new public offerings by agencies totaled approximately \$1.3 billion. Early in the month, the Export-Import Bank offered \$500 million of participation certificates (priced at par), including \$250 million of 5 per cent certificates maturing in 1971 and an equal amount of 5.10 per cent certificates coming due in February 1982. Investor response to these offerings was restrained, and the prices of both issues quickly declined from their initial offering levels. Other new agency issues offered subsequently at lower prices were accorded better investor receptions. However, prices of many agency issues continued to decline, as the market reacted cautiously to talk that additional FNMA participation certificates might soon be sold.

OTHER SECURITIES MARKETS

A heavier tone developed in the markets for corporate and tax-exempt bonds in February. During the early part of the month, underwriters bid fairly aggressively for the large supply of new offerings, and reoffering yields continued to decline. However, as the calendar of scheduled

corporate and tax-exempt flotations steadily expanded during the month, investors became more resistant to the lower yield levels and it became increasingly difficult for dealers to distribute the backlog of recent issues and the heavy supply of new offerings. In the tax-exempt sector, commercial bank demand contracted and the Blue List of dealers' advertised inventories of tax-exempt issues swelled to as much as \$677 million, its highest level in over a year. When syndicate price restrictions were removed on several slow-moving issues, yields were adjusted higher by 30 basis points or more from original reoffering rates, but investment demand remained restrained. In the corporate sector, several underwriting syndicate pricing agreements were terminated during the month and the price declines that followed boosted yields by 20 basis points or more (see the right-hand panel of the chart). At the lower price levels, demand for corporate bonds did expand somewhat. Both sectors were encouraged at the end of the period by the announcement of a reduction in reserve requirements against savings and certain time deposits.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds rose by 9 basis points to 5.11 per cent. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying rates ranging from Aaa to Baa, increased by 23 basis points to 3.66 per cent (see the right-hand panel of the chart). These indexes are, however, based on only a limited number of seasoned issues and do not necessarily reflect market movements fully, particularly in the case of new and recent issues.

THE STORY OF CHECKS

The Federal Reserve Bank of New York has available for distribution a new edition of an illustrated booklet entitled *The Story of Checks*. Prepared as a teaching aid, it describes the origin and development of checks, the growth and automation of check-clearing operations, and discusses the checkless society envisioned for the future. Requests for copies should be directed to the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045.