

FEDERAL RESERVE BANK OF NEW YORK



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Recent Developments in the Capital Markets

Pressures have mounted again in the nation's capital markets after having eased in late 1966. Corporations and state and local governments have borrowed record amounts in the capital markets so far this year, and in recent weeks yields on long-term obligations have approached—and in some cases exceeded—last summer's peaks. The prospect of very substantial Treasury financing in the second half of the year and a growing belief that the rate of economic advance will accelerate sharply have weighed more and more heavily on the markets and have led to some anticipatory borrowing.

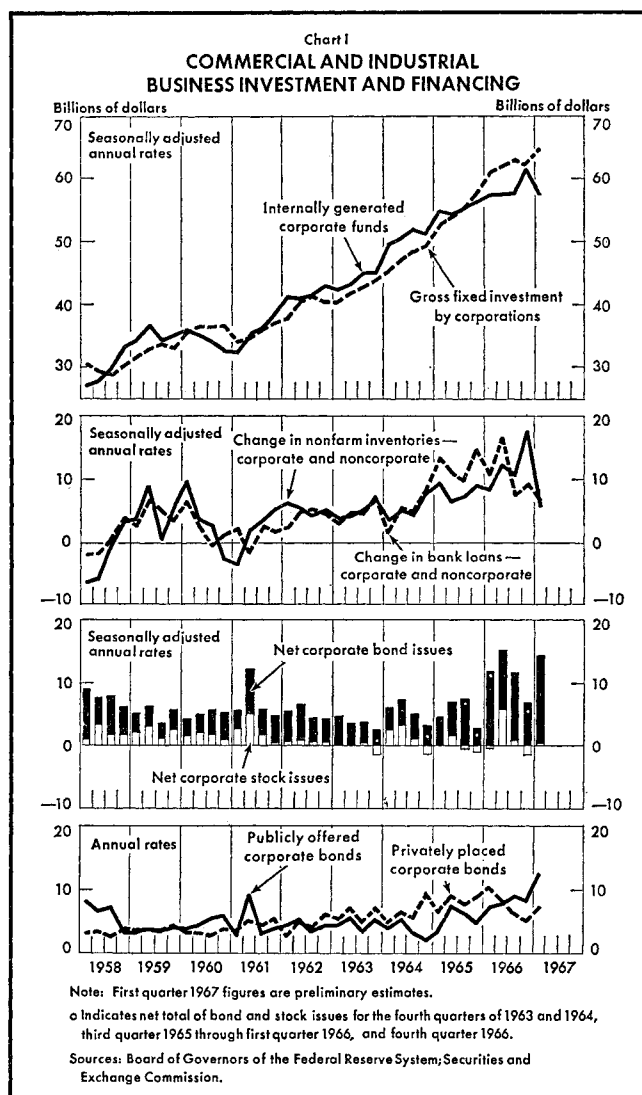
These developments emphasize the need for prompt action to reduce the Federal budget deficit significantly. A substantial tax increase would go far to relieve the tensions that have been building up in the capital markets. At the same time, a tax increase would help assure that the renewed growth of the economy is held to a sustainable pace.

BUSINESS FINANCE

Despite the general slowdown in the economy, business firms have had to raise a substantial volume of funds during the first half of 1967. While the need for funds for inventory investment and for new plant and equipment declined since the beginning of the year, internally generated funds (retained earnings plus capital consumption allowances) also fell, with the result that corporations have had to continue to rely heavily on outside sources of financing (see Chart I). In addition, corporate needs for funds were augmented during the first half of the year by acceleration of tax remittances to the Treasury. The speedup in collections of social security contributions, withheld income taxes, and excise taxes in the first quarter drew off an estimated \$650 million of business working capital, and the continued acceleration of the corporate income tax payment schedule added an estimated \$4.3 billion to business tax remittances in April and June.

So far in 1967, businesses have exhibited a preference for obtaining funds through the capital markets rather than from the banking system. Through the first half of 1967, bank loans to business have grown at a slower rate than the 14.3 per cent gain recorded in 1966. The reduced rate

of business loan growth this year in part reflects corporate restructuring of debt in the wake of very heavy borrowing from banks in 1966. According to data from registration statements filed with the Securities and Exchange Commis-

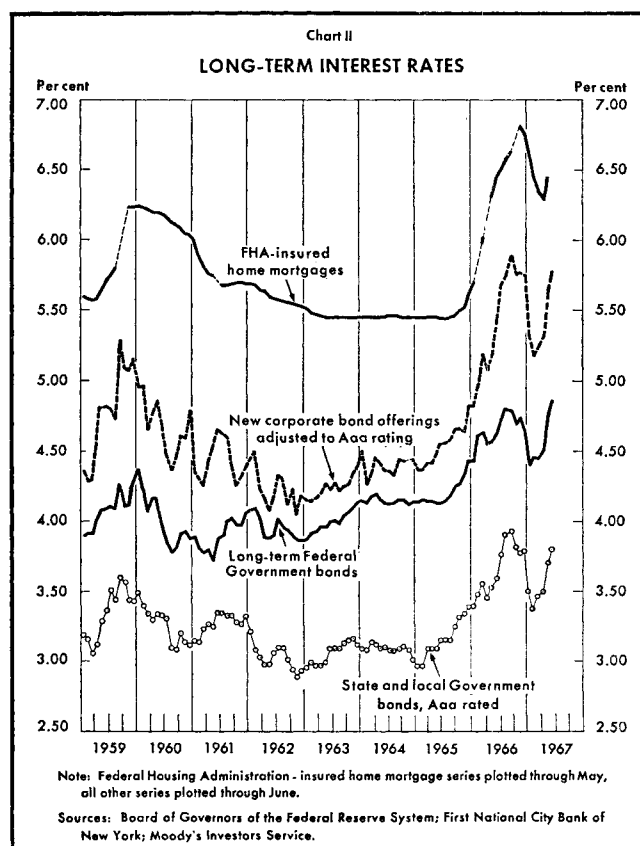


sion, market borrowing for repayment of bank debt rose to 28.6 per cent of new bond financing in the first quarter of 1967 from 21.6 per cent for the same period of 1966, and preliminary data indicate a further increase in the proportion during the second quarter of 1967. The shift to capital market financing was facilitated in the early part of the year by the decline in market rates that followed the move to monetary ease late in 1966. The decline in market rates made borrowing through the issue of capital market instruments relatively attractive, since bank lending rates dropped less during this period.

Gross new public and private issues of corporate bonds during the first six months of 1967 are estimated at \$10.6 billion (compared with \$8.4 billion in the same period last year), a record amount for any half-yearly period. During the first half of 1967, as in the second half of 1966, the amount of new bonds publicly offered has substantially exceeded the amount of new bonds privately placed with insurance companies and other institutional investors. The last half-year period in which the volume of publicly offered bonds exceeded that of private placements was the first six months of 1962 (see Chart I). Individuals and mutual savings banks lent important support to the long-term corporate bond market by purchasing a sharply increased amount of corporate bonds in the first three months of this year.

With the sharp rise in the volume of new issues, and expectations of even heavier demands on the markets in the second half of 1967, long-term corporate yields have reversed the decline which began in the fourth quarter of 1966 and have approached—and in some cases have exceeded—the postwar highs recorded late last summer. The market has at times been quite congested with new issues and, partly as a result, the spread between underwriters' offering rates on new corporate bonds and the market rates on outstanding corporate issues has been widening. Nevertheless, the spread remains below the levels attained in the third quarter 1966 period of peak interest rate pressures.

Business firms appear to have recently placed somewhat more reliance on the equity markets as a source for long-term funds, although this source of financing continues to be marginal. Estimated new issues of common and preferred stock (net of repurchases and retirements of outstanding issues) increased in the first quarter of 1967 from the final quarter of 1966. With bond yields rising (see Chart II), corporations have turned increasingly to the issuance of convertible bonds, which, because they can be converted to equities, bear lower interest rates than comparable bonds which lack this feature. Moreover, convertible bonds may appeal to a wider spectrum of investors than regular debt issues.



In addition to having raised a record volume of funds in the long-term capital markets in the first half of this year, corporations have turned increasingly to the commercial paper market as a source of funds. Issues of commercial paper by nonfinancial corporations had risen sharply during the second half of 1966, as business firms strove to find a source of funds alternative to the use of commercial banks. Through the first five months of 1967, nonfinancial corporations appear to have expanded their outstanding volume of commercial paper at a somewhat faster rate. This partly reflects the lower cost of raising funds in the commercial paper market as compared with the cost of borrowing at commercial banks.

CONSUMER FINANCE

Consumer spending continued to grow through the first quarter of 1967, but at a slower rate than disposable personal income. As a result, personal savings rose to 6.5 per cent of disposable income, $\frac{1}{10}$ percentage point above the average savings ratio in the 1953-66 period. Total con-

sumer spending on durable goods absorbed a lower proportion of income in the first quarter of the year than in 1966, and the growth of consumer credit—which usually finances a major part of such expenditures—slowed during this period (see Chart III). During the second quarter, it appears that there was only very modest further growth of consumer borrowing as the demand for durables remained relatively weak. However, if the recent pickup in automobile sales is maintained, the growth of consumer credit should accelerate once more.

The thrift institutions—savings and loan associations and mutual savings banks—which are the major suppliers of home mortgage loans have experienced sharply increased savings inflows so far in 1967. These large inflows reflect the rise in consumer savings and the reduced rates on competitive savings instruments, such as short-term marketable securities. During the first five months of 1967, savings and loan associations recorded a \$4.1 billion net inflow of funds, in sharp contrast to the \$932 million inflow recorded during the comparable period of 1966. Similarly, mutual savings banks have also experienced greatly increased inflows of funds thus far in 1967.

A substantial portion of the enlarged savings flows to

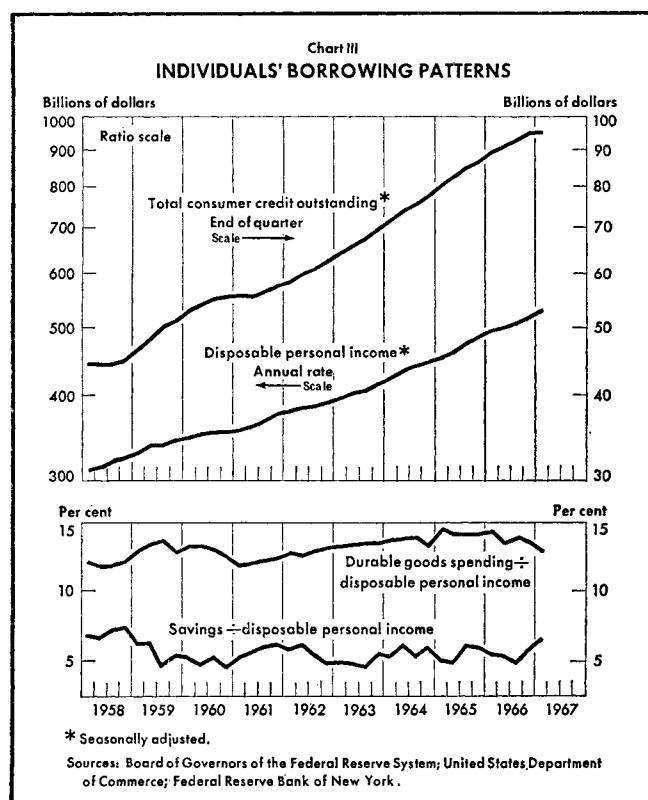
the thrift institutions has not moved into the mortgage market, reflecting in part a less rapidly expanding supply of immediately available mortgages. Savings and loan associations repaid \$2.5 billion of their borrowings from the Federal Home Loan Banks in the January-May 1967 period, in contrast to a net increase in borrowing of \$711 million during the same period last year. In addition, all thrift institutions have been rebuilding their liquidity through the purchase of short-term securities, and mutual savings banks have purchased a large amount of long-term corporate securities. Nevertheless, during the first five months of 1967, these institutions have expanded their mortgage holdings on a seasonally adjusted basis at a rate more than twice that recorded during the last half of 1966. Rates on FHA-insured thirty-year mortgages declined during the first four months of 1967, but edged upward again in May (see Chart II), reflecting rising rates throughout the long-term capital markets.

GOVERNMENT FINANCE

Despite a continuing rise in revenues, state and local governments have made record demands on the capital markets thus far in 1967. These borrowers marketed \$4.1 billion (gross) of new bond issues in the first quarter—the largest quarterly volume on record—and are estimated to have marketed an additional \$3.5 billion in the second quarter. Commercial banks, after having sharply reduced their net purchases of state and municipal bonds in 1966, have lent important buying support to this market thus far in 1967. Market yields on tax-exempt bonds declined during the early weeks of the year but have subsequently moved up sharply.

In contrast to state and local government financing, total Federal Government financing has been smaller in the first half of 1967 than in the same period a year ago. Total Treasury and agency financing in the first half of 1967 has resulted in an estimated increase of \$0.3 billion in outstanding securities, compared with an increase of \$4.7 billion in the first six months of 1966.

The first half of the calendar year is traditionally a period of debt redemption by the Treasury, and estimated net redemptions of direct Treasury obligations through June are expected to exceed \$3.0 billion, compared with redemptions of \$1.0 billion in the same period of 1966. At the same time, net agency debt outstanding is estimated to have fallen by over \$500 million in the January-June period, as opposed to the net increase of \$3.5 billion over the comparable period of 1966. The Federal National Mortgage Association increased its outstanding indebtedness at a much slower rate in the first six months of the



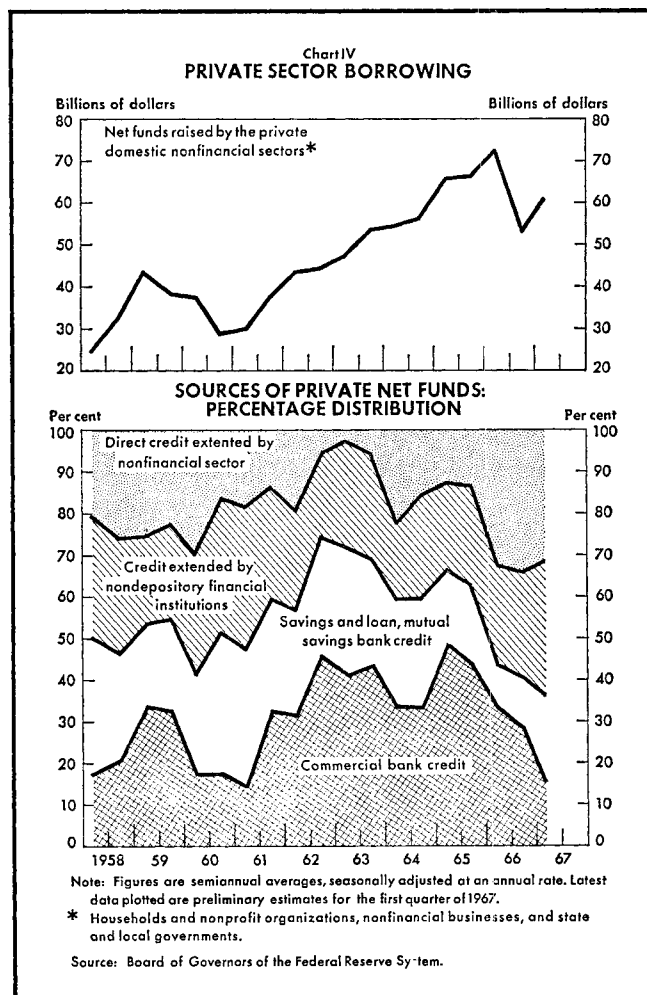
year, reflecting its declining mortgage purchases. The sharply increased growth of deposits at savings and loan associations has enabled these institutions to repay a large portion of their borrowings from the Federal Home Loan Banks. Consequently, the Federal Home Loan Banks reduced their own outstanding debt by \$2.3 billion in the first six months of the year, compared with a net increase in borrowing of \$1.1 billion in the same period of 1966. Sales to the public of participations in Federal loans have risen moderately in the first half of this year, with the total amounting to \$2.9 billion, up from \$2.2 billion in the first six months of 1966. An additional \$900 million of participation certificates was sold directly to United States Government trust funds during the first half of 1967.

Yields on some outstanding long-term Government bonds have recently surpassed the peaks recorded in late 1966, reaching the highest levels in forty years. With yields remaining substantially above the $4\frac{1}{4}$ per cent ceiling on interest rates for Government securities with maturities exceeding five years, Treasury financing operations have been confined entirely to short- and intermediate-term issues. Consequently, the average maturity of the public debt has been shortened from four years eleven months in June 1966 to an estimated four years seven months as of the end of June 1967.

ROLE OF THE BANKING SYSTEM

Net funds raised by domestic nonfinancial borrowers other than the Federal Government grew at a substantially increased rate during the first quarter of 1967, but commercial banks supplied a greatly reduced percentage of the funds obtained by these borrowers. In the first quarter of 1967, bank credit supplied only 15 per cent of total household, business, and state and local borrowing. This ratio has declined steadily from the peak level of 48 per cent in the first half of 1965 (see Chart IV). In view of the continued sluggishness of borrowing from banks in April and May, it is doubtful that commercial banks accounted for a significantly increased percentage of total funds supplied to the private sector during the second quarter. Reflecting both the reduced pressure of demands from the private sector for bank financing and their desire to rebuild liquidity, commercial banks acquired large amounts of Federal Government securities. As a result, in the first quarter, the commercial bank share of total credit—which includes funds supplied to the Federal Government—moved up sharply from the reduced levels of the third and fourth quarters of 1966.

Total bank credit appears to have grown at a seasonally



adjusted annual rate of 11 per cent over the first six months of the year, almost twice as large as the annual rate of increase recorded for the year 1966. Measured on a seasonally adjusted basis, commercial banks purchased \$3.1 billion of Government securities during the first five months of 1967, in contrast to their liquidation of \$2.7 billion of these securities during the same period of 1966. In the first quarter of 1967, commercial banks purchased an estimated 68 per cent of the net increase in state and local securities, up markedly from the depressed 30 per cent recorded in 1966. Preliminary data indicate that this proportion has remained high during the second quarter as well.

While bank holdings of securities have increased substantially so far this year, loan growth has been slower than in 1966. Business loans in the first six months of the year are estimated to have risen at a rate below last year's. The

net extension of real estate loans has remained markedly below last year's rate of growth. Consumer loans have also grown more slowly thus far in 1967, reflecting the weakness in demand for consumer durable goods.

Commercial bank time and savings deposits are estimated to have grown at a seasonally adjusted annual rate of 17 per cent during the first half of the year, more than

double the rate of increase recorded in 1966. Corporations, which had reduced their holdings of time deposits by \$2.1 billion (seasonally adjusted) during the last half of 1966, added an estimated \$2.5 billion to their time deposits during the first three months of 1967. These deposits were attractive to investors, given the relatively low yields then available on short-term Government securities.

The Business Situation

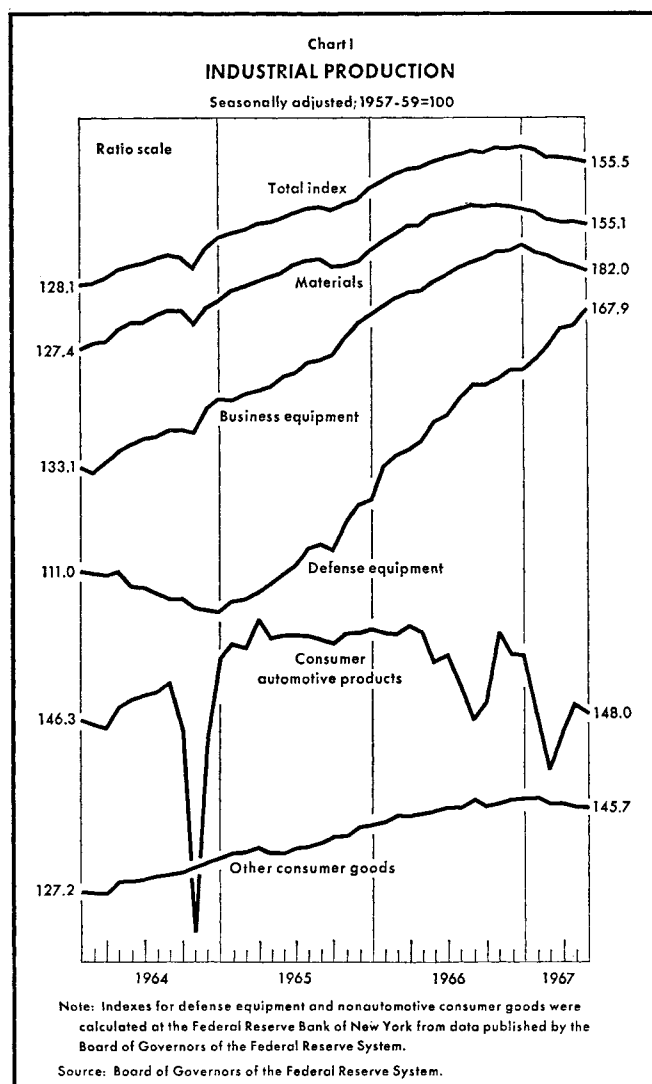
Business activity appeared to be gaining momentum as the economy moved through the second quarter. While the effects of the inventory readjustment continue to be felt in some sectors of the economy, the most recent data indicate a widespread strengthening of demand forces. May saw a strong and broadly based rise in new orders for durable goods, a further gain in residential construction, and—according to the advance report—the third consecutive increase in retail sales. At the same time, the latest survey of capital spending plans pointed to renewed growth in such outlays in the second half of the year. Prices rose on a broad front in May. The consumer price index climbed 0.3 per cent in both April and May after several months of relative stability. Food prices moved up for the first time in nine months, while prices for other nondurable commodities, durable goods, and services all showed substantial increases. Rising prices of farm and food products pushed the wholesale index up by 0.5 per cent in May, and preliminary data point to an increase of about the same magnitude in June.

PRODUCTION, INCOME, AND CONSUMER DEMAND

Industrial output eased slightly further in May. The Federal Reserve Board's seasonally adjusted production index declined by $\frac{1}{2}$ percentage point to 155.5 per cent of the 1957-59 average (see Chart I). Output of industrial materials continued to slacken and business equipment production also fell somewhat further, while overall production of consumer goods changed little. Automobile

manufacturers assembled new cars at a seasonally adjusted annual rate of about $7\frac{2}{3}$ million units, matching the April pace. However, partly because of a strike in the rubber industry, the overall production index for autos and related products dropped back a bit after having risen sharply in the two preceding months. The aggregate output of other goods for consumer markets was virtually unchanged in May. Television set production rose during the month, a gain which contrasted with the steep decline during the earlier months of 1967. May witnessed a further substantial advance in the output of defense equipment. In the course of the first five months of 1967, the index of defense equipment production rose at an annual rate of about 24 per cent, which represented a slight acceleration from the already rapid growth recorded in 1966.

The process of adjusting business inventories to bring them into better alignment with sales has played a major role in dampening the pace of industrial production this year. Trade firms have made some actual reductions in the level of their stocks, while manufacturers have added to their inventories at a slower rate. In May, the increase in manufacturers' inventories was the smallest in more than two years and was only about half as large as the average accumulation of the two preceding months. Though some further adjustments may occur in the trade sector, the problem of excessive inventories now appears to be centered in manufacturing. At the close of the first quarter, according to a Commerce Department survey taken in May, almost one third of total inventories in manufacturing was in the hands of firms that felt their stocks were too high relative to sales and orders. The survey also found,



however, that manufacturers were quite optimistic about sales prospects in the second and third quarters. In apparent reflection of this optimism, producers reported that they were planning further additions to inventory in both quarters, though at a rate slower than that of the first quarter and far below the pace in the second half of last year. Thus, there may well be some additional cutbacks in the rate of inventory accumulation and even further liquidation in some lines of business. These adjustments, however, are likely to be considerably smaller than those in recent months and should therefore exert less drag on economic activity.

The near-term outlook for production was brightened

by the large rise in May of new orders for durable goods. Following some months of virtual stability, the flow of orders increased in May by a strong $7\frac{1}{2}$ per cent. The advance was partly due to a sharp rise in orders received by the defense-oriented industries—that sector accounted for about one third of the overall rise—but sizable gains were widespread throughout other lines of durables manufacturing. Machinery and equipment producers reported a third consecutive improvement in orders volume, with bookings in May reaching the highest level since December. The general expectation that the investment tax credit and accelerated depreciation allowances would be restored retroactive to March probably accounted for some of the sharp increase in new orders. At the same time, total shipments of durable goods rose appreciably in May, recouping most of the April decline. The shipments volume was nevertheless substantially less than the large inflow of orders, and the backlog of unfilled durables orders expanded by a very large \$1 billion. This was the first increase this year in the orders backlog, which had dropped by almost \$2½ billion in the first three months of 1967 and then held about unchanged in April.

The continued sluggishness in May of activity in manufacturing and in some lines of construction was reflected in some further easing of demands for labor. This, in turn, dampened the growth of personal income. Total wage and salary payments in manufacturing were down for the second month in a row, with a strike in the rubber industry accounting for about half of the decline. In the private sector as a whole, employee income was about unchanged, but government wage and salary disbursements continued to grow at a substantial rate. Overall income growth in May was boosted by a sizable rise in payments for medical care under the social security program. The increase in total personal income, while double the April rise, was nevertheless somewhat smaller than the monthly average in the first quarter.

Preliminary data indicate that retail sales volume rose in May for the third consecutive month. The expansion of sales from February to May, at an annual rate of more than 9 per cent, represented the first sustained advance in nearly a year. The May rise was centered in sales of nondurable goods. In the durables sector, outlets selling motor vehicles and related goods reported a further increase in dollar volume, but sales in other durables lines moved lower. Sales of new domestically produced cars, which had recovered strongly in March and April, held about unchanged in May at an annual rate of approximately $7\frac{1}{2}$ million units. A renewed surge in June raised sales by nearly 15 per cent to an annual rate of more than $8\frac{1}{2}$ million units.

BUSINESS INVESTMENT PLANS AND CONSTRUCTION

The results of the latest survey of business capital outlay plans are in line with earlier indications that such spending will show renewed strength in the second half of 1967, following a dip in the first two quarters (see Chart II). According to the May survey by the Commerce Department and the Securities and Exchange Commission, business spending on plant and equipment in 1967 will total \$62.4 billion, a modest gain of 3 per cent over the 1966 figure. The survey finding represents a downward revision from the 4 per cent increase indicated by the previous Commerce-SEC survey taken in February. Virtually all this downward revision reflected a reduction in estimated outlays in the first half of the year in nonmanufacturing industries. Outlays in the third and fourth quarters combined are now expected to average 5 per cent, at an annual rate, over the first half.

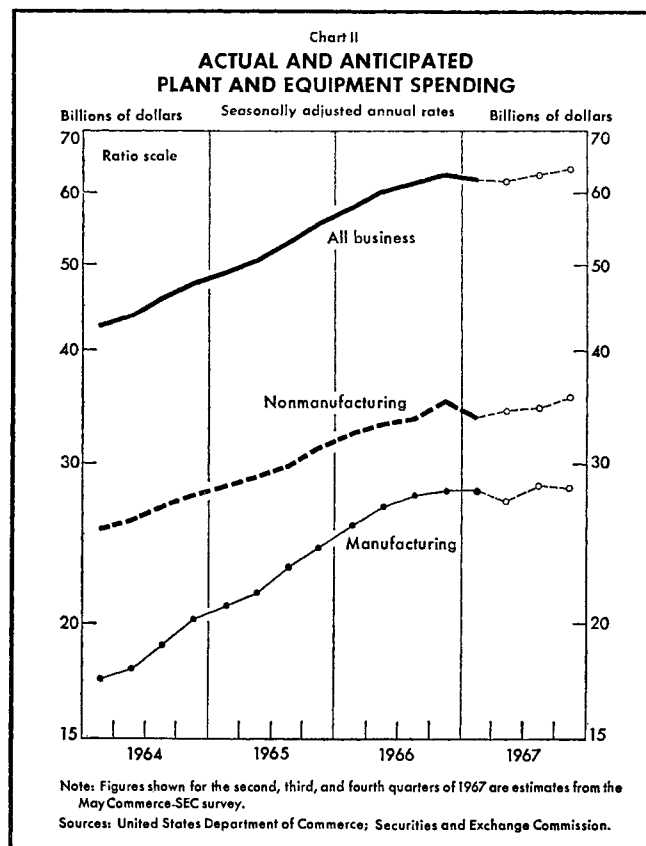
Total capital spending in the first quarter of 1967 is reported to have been at an annual rate of \$61.7 billion, more than \$1 billion under the fourth-quarter rate. At the time of the February survey, it was anticipated that first-quarter outlays would be only very slightly below the fourth-quarter rate. Following an expected small further decline in the April-June quarter, renewed growth is planned, with capital spending running at a \$63.2 billion rate in the second half.

Within the total for all businesses, manufacturers plan to expand plant and equipment spending by 3½ per cent this year. A majority of individual manufacturing industries anticipate that their capital expenditures in 1967 will be larger than last year, with the sharpest increases planned by the machinery and petroleum industries. Reduced spending, however, is foreseen in several industries, including motor vehicles. In the nonmanufacturing sector, the most striking feature of the survey was the very large drop in spending planned by the railroads, a decline from 1966 amounting to almost \$0.5 billion or nearly 25 per cent. It is generally believed that the suspension last fall of tax incentives for investment was felt particularly heavily by the railroads as well as by commercial firms, which also intend to reduce spending this year. Other nonmanufacturing industries anticipate increases in spending that, while smaller than the gains posted in 1966, are considerably stronger than those projected by the manufacturing sector.

The latest Commerce-SEC survey was taken before the actual passage of the legislation restoring the 7 per cent investment tax credit and the use of accelerated depreciation allowances. The general expectation that the incentives would be restored was probably reflected in

some of the plans reported in the survey. The restoration itself, however, has already accelerated spending in some lines. For example, immediately following the President's signature of the restoration law in mid-June, there was a strong surge in railroad orders for rolling stock. According to industry sources, such orders in 1967 had been running at only about one fourth of the year-earlier volume. Moreover, the pressure of labor costs may well provide some additional stimulus to capital investment in coming months.

Industrial and commercial building activity has been relatively weak in recent months, reflecting the general slackening of business fixed investment. In contrast, residential construction has been improving significantly. The seasonally adjusted rate of housing starts in May recorded a strong further advance, rising by more than 11 per cent over the April pace, with gains reported in most regions of the country. At the same time, there was another increase in the number of housing units authorized by new building permits, and the value of residential construction contract awards reached the highest point in a



year. The upturn in residential activity thus far in 1967 has been stronger than was apparently expected by many observers. Housing starts in the first five months of the year averaged 1.2 million units at a seasonally adjusted annual rate, equal to the 1966 total and almost 25 per

cent above the depressed pace in the fourth quarter of last year. Moreover, the restoration of accelerated depreciation allowances on apartments (and other buildings) costing more than \$50,000 may well provide a further stimulus to residential construction.

The Money and Bond Markets in June

Yields in the capital markets rose sharply again in June. The prospect of very substantial Treasury financing in the second half of the calendar year, as well as continuing heavy current and prospective demands for funds by corporations and state and local governments, led to increasing pressures on the markets. Against this background, the atmosphere in the Treasury market on several occasions became quite demoralized and prices fell at times with very little resistance. By the end of the month, some new corporate issues were being offered at record yields and yields on Treasury coupon issues were up by as much as 84 basis points from their end-of-May levels. In this environment, there was increasing discussion of the need for a tax increase to help ease the pressures in the markets during the months ahead. While most market participants seemed to feel that some tax increase would be enacted, there was widespread concern that it might not be large enough to relieve significantly the pressures in the capital markets.

In the Treasury bill market, rates moved down for a time in June—particularly on short maturities which were in heavy demand—but then rose very sharply in the final week of the month. Expectations that the Treasury was soon to begin its financing for the second half of the year were confirmed on June 28, when the Treasury announced that it would sell in early July \$4 billion of new tax anticipation bills and would also begin raising the size of the weekly and month-end auctions by \$100 million each. By the end of the month, the bid rate on the latest outstanding three-month bill had climbed to 4 per cent, 54 basis points higher than a month earlier, and bid rates on longer bills were as high as 4.90 per cent. Rates on other short-term market instruments also rose somewhat during June, particularly during the last week of the month when bill rates were un-

der such heavy upward pressure.

Money market conditions remained relatively comfortable in June. Nationwide net reserve availability was ample throughout the month, as free reserves fluctuated around the range for May. Although these reserves tended to shift away from banks in the money centers at times during the month, there was a substantial return flow through the Federal funds market, where funds traded predominantly in a $3\frac{3}{4}$ to $4\frac{1}{8}$ per cent range.

THE GOVERNMENT SECURITIES MARKET

Activity in the Government securities market came close to a standstill during the first week of June, while participants awaited developments in the Middle East. Prices of Government securities were marked temporarily lower upon the outbreak of hostilities on June 5, but no significant selling pressures developed, and a steady tone quickly emerged with the limited trading that did take place conducted in an orderly fashion. In fact, quotations of notes and bonds improved somewhat in subsequent sessions, when reports that the United States and the Soviet Union were cooperating toward bringing about a cease-fire relieved concern that the Middle East situation would escalate further.

By June 8, however, the atmosphere in the Treasury securities market began to deteriorate again, as market participants directed their attention to the heavy Government demand for funds anticipated for the months ahead on top of the already crowded calendar of other securities offerings. Moreover, the spread between yields on Treasury issues on the one hand and high-grade corporate and Government agency securities on the other continued to widen,

inducing some investor switching into corporate and agency issues. As midmonth approached, market attention focused upon the pricing of new participation certificates to be offered by the Federal National Mortgage Association (FNMA). When the initial offering yields on these certificates proved to be well above those anticipated earlier by market observers, expectations of higher interest rates were reinforced. In this atmosphere, trading activity was very light, and dealers' attempts to trim inventories of Treasury issues contributed to the sharp price declines.

Bond prices weakened further during the week ended June 21. A modest rally took place on June 22, largely reflecting some investment interest, professional short covering, and demand from other sources. However, during the remainder of the month, bond prices resumed their decline when participants again focused upon the heavy current and anticipated demands for funds in the capital markets. By the end of June, prices of most Government coupon issues were at their lows of the year and in some cases were below even the lows reached in August 1966. Yields in the one- to five-year and five- to ten-year maturity areas were as high as 5.34 per cent and 5.27 per cent, respectively, and were generally 28 to 84 basis points above their end-of-May levels. In the long-term end of the market, yields averaged around 4.95 per cent, compared with 4.93 per cent at the August 1966 peaks.

In the market for Treasury bills, rates moved irregularly during the first three weeks of June and then soared in the closing days of the month. At the beginning of June, the bill market displayed a fairly strong tone. Investment demand favored bills maturing within five months, and rate declines generally clustered at the shorter end of the maturity scale. Rates on longer bills edged higher. (See left-hand panel of the chart on page 133.) From June 6 through June 16, demand abated and some selling of bills by various types of investors developed. Augmented by aggressive attempts of dealers to lighten inventories, these pressures pushed bill rates up quite sharply.

With the passage of the midmonth quarterly corporate dividend and tax payment period, however, a steadier tone developed in the bill market. Substantial demand stemmed from the reinvestment of the proceeds of maturing tax anticipation bills, approximately \$3.5 billion of which was redeemed for cash on June 22. Part of the proceeds of a Federal agency issue maturing on June 26 also found its way into the bill market. In addition, there was some demand for bills from commercial banks preparing for publication of their midyear statements and from the Federal Reserve to meet the pre-July 4 reserve needs. Once again, private demand centered in the short maturity area

and, as these issues became increasingly scarce in the market, short bill rates moved down sharply. By June 23, the bid rate on the three-month bill was down to 3.33 per cent, its low for the year. Supplies of longer term bills were more adequate, and rates on some of these securities edged higher during this period. Thus, the yield spread between the latest outstanding three- and six-month bills widened to as much as 50 basis points, reflecting the general expectation in the market of a sharp turnaround in short rates once the special demands of the midyear period were satisfied.

If anything, the turnaround came sooner and was considerably sharper than had been expected. As investment demand contracted, and participants became cautious in view of the belief that an announcement of Treasury financing plans was imminent, the bill market became rather weak on Monday, June 26, and this atmosphere continued through the rest of the month. Bidding in the weekly bill auction on June 26 was quite restrained, as dealers tended to be more cautious about increasing their inventory positions. Average issuing rates were set at 3.462 per cent for the new three-month bill and 3.950 per cent for the new six-month bill (see Table III), about 2 basis points lower and 22 basis points higher, respectively, than average rates at the final weekly auction in May. Even greater restraint was evident in the auction of month-end bills on June 27, with the average issuing rate on the new one-year bills set at 4.732 per cent, up 80 basis points from the average set a month earlier. Some tenders were accepted in that auction at rates as high as 4.84 per cent.

On June 28, the Treasury announced the first steps in its program of borrowing to meet cash needs during the fiscal year beginning July 1. The Treasury scheduled a July 5 auction of \$4 billion of tax anticipation bills, including \$2 billion maturing on March 22, 1968 and \$2 billion maturing on April 22, 1968. Payments for the bills will be due on July 11, with commercial banks permitted to make payment in the form of credits to Treasury Tax and Loan Accounts. The Treasury also announced that its weekly offerings of three-month bills will be enlarged by \$100 million beginning with the July 10 auction, and that \$900 million in new cash will be raised through additions to the regular monthly auctions of nine-month and one-year bills during the new fiscal year. The heavy tone continued in the bill market following the announcement, and the upward trend in bill rates accelerated over the final days of the month. From June 27 through June 30, rates on bills maturing within three months rose 45 to 65 basis points, rates on issues maturing in three to six months increased by 38 to 63 basis points, and longer bill maturities rose by 40 to 58 basis points. By the close of the month, the latest outstanding three-month bill was quoted at 4 per

Table I

**FACTORS TENDING TO INCREASE OR DECREASE
MEMBER BANK RESERVES, JUNE 1967**

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

Factors	Changes in daily averages— week ended on				Net changes
	June 7	June 14	June 21	June 28	
"Market" factors					
Member bank required reserves*	- 153	- 8	- 654	+ 385	- 430
Operating transactions (subtotal)	- 101	+ 451	+ 442	- 591	+ 201
Federal Reserve float	+ 171	+ 59	+ 328	- 300	+ 258
Treasury operations†	+ 137	+ 271	- 52	- 431	- 75
Gold and foreign account	+ 27	- 1	+ 10	- 5	+ 31
Currency outside banks*	- 436	- 113	+ 72	+ 191	- 286
Other Federal Reserve accounts (net)‡	- 1	+ 235	+ 84	- 45	+ 273
Total "market" factors	- 254	+ 443	- 212	- 206	- 229
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 212	- 273	- 21	+ 349	+ 267
Bankers' acceptances	-	+ 3	- 1	+ 7	+ 9
Special certificates	-	-	+ 12	- 12	-
Repurchase agreements:					
Government securities	+ 15	- 84	+ 07	- 51	- 53
Bankers' acceptances	+ 24	- 30	-	+ 48	+ 42
Federal agency obligations	+ 2	- 2	-	-	-
Member bank borrowings	- 25	- 34	+ 48	+ 50	+ 39
Other loans, discounts, and advances	-	-	-	-	-
Total	+ 226	- 419	+ 106	+ 390	+ 303
Excess reserves*	- 28	+ 24	- 106	+ 184	+ 74

	Daily average levels				
	June 5	June 12	June 19	June 26	
Member bank:					
Total reserves, including vault cash*	23,183	23,215	23,763	23,562	23,431§
Required reserves*	22,840	22,848	23,602	23,117	23,077§
Excess reserves*	343	367	261	445	354§
Borrowings	77	43	91	141	88§
Free reserves*	+ 266	+ 324	+ 170	+ 304	+ 266§
Nonborrowed reserves*	23,106	23,172	23,672	23,421	23,343§

	Changes in Wednesday levels				
	June 5	June 12	June 19	June 26	
System Account holdings of Government securities maturing in:					
Less than one year	- 260	- 566	+ 832	- 164	- 158
More than one year	+ 113	-	+ 102	+ 55	+ 270
Total	- 147	- 566	+ 934	- 109	+ 112

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 on June 28.

Table II

**RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS
JUNE 1967**

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Average of four weeks ended on June 28*
	June 7	June 14	June 21	June 28*	
Eight banks in New York City					
Reserve excess or deficiency(—)†....	27	10	8	15	15
Less borrowings from					
Reserve Banks	7	—	25	—	8
Less net interbank Federal funds					
purchases or sales(—)	567	559	922	451	625
Gross purchases	1,212	1,284	1,669	1,333	1,375
Gross sales	645	725	747	882	750
Equals net basic reserve surplus					
or deficit(—)	— 547	— 550	— 939	— 436	— 618
Net loans to Government					
securities dealers	729	1,077	1,086	584	869

Thirty-eight banks outside New York City

Reserve excess or deficiency(-)†...	27	21	11	- 9	13
Less borrowings from					
Reserve Banks	17	2	40	28	22
Less net interbank Federal funds purchases or sales(-)	1,465	1,703	1,622	1,051	1,460
Gross purchases	2,222	2,342	2,437	2,028	2,257
Gross sales	757	638	815	977	797
Equals net basic reserve surplus or deficit(-)	-1,454	-1,684	-1,651	-1,088	-1,469
Net loans to Government securities dealers	424	484	516	274	425

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

* Estimated reserve figures have not been adjusted for so-called "as of" debits and credits. These items are taken into account in final data.

† 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

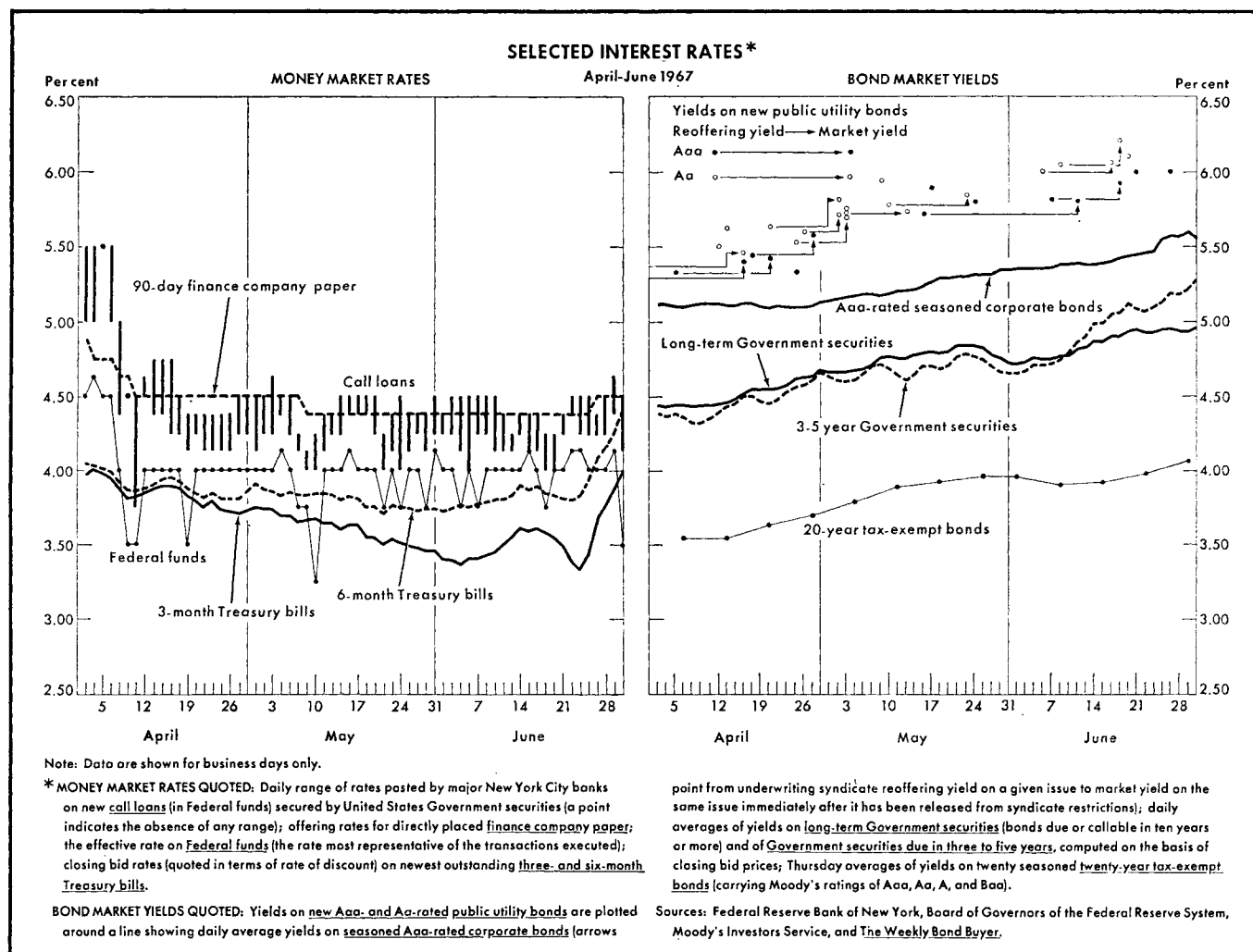
Maturities	Weekly auction dates—June 1967			
	June 5	June 12	June 19	June 26
Three-month.....	3.386	3.505	3.572	3.462
Six-month.....	3.758	3.796	3.841	3.950
	Monthly auction dates—April-June 1967			
	April 25	May 24	June 27	
Nine-month.....	3.842	3.944	4.723	
One-year.....	3.832	3.933	4.732	

* 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.

cent (bid), 54 basis points above the rate quoted at the end of May, while the newest six-month bill was bid at 4.41 per cent on June 30, 67 basis points above its May 31 rate level.

The market for Government agency securities concentrated during the early part of the month on preparations for the June 15 public offering of \$650 million of FNMA participation certificates. (An additional \$250 million of the certificates was placed with Treasury trust accounts.) The public part of the offering consisted of \$350 million of 27-month notes priced at par to yield 5.25 per cent and \$300 million of five-year notes priced at par to yield 5.50 per cent. These yields—in each case $\frac{1}{2}$ percentage point higher than had been offered on similar maturities of

participation certificates last March—seemed quite attractive relative to yields available on comparable maturities of Treasury issues. However, investors apparently were focusing on recent increases in rates on negotiable certificates of deposit (C/D's), to around 5 per cent on longer maturities, as a base for comparison. Thus, even though market reports indicated that the shorter issue was fully sold on the offering day and that the longer term issue was accorded a good, albeit somewhat less enthusiastic investor reception, both issues turned out to be less than completely placed when released for free trading in the secondary market on June 20, and their prices dropped sharply below par. Other agency issues floated during June encountered mixed investor receptions.



OTHER SECURITIES MARKETS

The corporate bond market was still dominated by the heavy volume of current and prospective financing. Approximately \$1.6 billion of new corporate issues was floated publicly in June, roughly matching the record set in March. Thus it appears that the volume of public corporate flotations in the first half of 1967 exceeded \$7 billion, roughly double the \$3.5 billion issued in the first half of 1966. The new corporate issues in June met with mixed investor response, despite rising yields which approached, and in some cases exceeded, the peak levels reached last August. Some scheduled offerings were postponed because of adverse market conditions. On June 20, underwriters reoffered a \$75 million issue of Aa utility bonds carrying five-year call protection at a yield of 6.10 per cent; this was a record for such an issue at the original underwriting terms. The next day, a \$40 million Aaa-rated utility issue was reoffered to yield 6.00 per cent—a record yield for a Aaa-rated utility offering. Both issues were very well received and quickly moved to premiums in secondary market trading. Subsequent issues came out at roughly comparable rates, and by the end of the month some market participants expressed the hope that 6 per cent might prove a viable yield level for high-grade corporate bond offerings at least for a time.

Prices in the municipal market remained fairly firm through midmonth, with substantial demand from banks and insurance companies. Particularly good support appeared for longer maturities for the first time in some weeks. After midmonth, however, prices of tax-exempt bonds began to decline under the mounting pressure of a congested market and the relatively heavy schedule of new offerings. Receptions of new issues were only fair, and sales from dealers' inventories proceeded slowly. By the end of the month, the volume of tax-exempt issues advertised on the Blue List stood at \$638 million, compared with \$576 million at the end of May. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying ratings ranging from Aaa to Baa, rose by 10 basis points to 4.06 per cent (see chart). This index is, however, based on only a limited number of seasoned issues and does not necessarily reflect market movements fully, particularly in the case of new and recent issues.

BANK RESERVES AND THE MONEY MARKET

Conditions in the money market continued generally comfortable in June. Pressures stemming from the heavy

midmonth corporate dividend and tax payments were generally accommodated with ease. On a nationwide basis, free reserves averaged \$266 million during the month (see Table I), roughly in line with the average level in May. Free reserves did drop temporarily to an average of \$170 million in the week ended June 21, partially under the pressure of sharply rising bank loans and accompanying increases in required reserves, but a good flow of money was in evidence as "country" banks turned loose previously accumulated excess reserves. Most trading in the Federal funds market during this week as well as during the month as a whole was in a $3\frac{3}{4}$ to $4\frac{1}{8}$ per cent range. This ready flow in the funds market enabled most banks to cover their reserve deficiencies with little recourse to the Federal Reserve "discount window". Thus, member bank borrowings from the Reserve Banks averaged only \$88 million during June, compared with an average of \$94 million in May.

The basic reserve positions of the forty-six major money market banks, which had improved late in May, deteriorated sharply in the first several weeks of June. The combined basic reserve deficit deepened to an average of about \$2.6 billion by the third week (see Table II). At the major banks in New York City, reserves employed in dealer financing operations increased substantially over the period, since other sources of dealer borrowing tended to recede around the quarterly dividend and tax payment dates. In addition, business loans rose sharply in the weeks before and after the midmonth tax date, following earlier weakness in such lending.

The money market banks stepped up their efforts to attract and hold C/D's during June. (During the month, over \$3½ billion of C/D's matured at large commercial banks.) Such certificates outstanding at thirteen large New York City banks rose by \$296 million during the first two weeks of the month, declined by \$203 million in the week ended June 21, and then edged upward by \$15 million in the final June statement period. Banks gradually raised their offering rates; by the end of the month, the most frequently quoted rates on new C/D's ranged from 4.25 per cent for the shortest maturities to 5 per cent for longer C/D's, with the actual rates offered prime customers tending to be well up toward the top of this range.

Interest rates on several other short-term money market instruments also were raised during the month. By the end of June, offering rates on 30- to 239-day directly placed finance company paper had advanced by $\frac{1}{8}$ percentage point to $4\frac{1}{2}$ per cent and dealers in bankers' acceptances had raised their rates by $\frac{1}{2}$ percentage point.