THE NEW YORK MONEY MARKET

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I Definition

Broadly defined, the money market includes all forms of short-term credit, as contrasted with the capital market which deals in long-term debt obligations and equities. Narrowly defined, the money market includes only the most liquid form of money — currency, and deposits at Federal Reserve Banks, i.e. Federal funds.

While the money market is concerned only with the borrowing and lending of short-term funds, it is closely related to a number of other markets, such as the capital and commodity markets, which rely on it for financial accommodation.

Unlike other markets which have a physical meeting place, the NY money market is located in the offices of every commercial and financial institution dealing in short-term funds.

II Institutions of the ~~NY~~ Money Market

The institutions of the NY Money market can be classified as those which supply and those which demand short-term funds. On the supply side, the principal lenders in the money market are the Federal Reserve Banks, commercial banks, foreign banks, (especially central banks), factoring and finance companies (which are also large borrowers), and business enterprises.

The FRB of New York is the primary source of credit for commercial banks. Normally, it extends credit only to member banks. As of October 29, 1959 outstandings Reserve Bank credit totaled $27.3 Billions (49% of its total assets), of which acquisition of U.S. Government securities accounted for 26.3 billion.

The commercial banks are the most important source of short-term credit. Aside from business and consumer loans, Treasury obligations are the principal outlet for the banks' short term funds, which also go to acceptances and commercial paper, and the call money market.

Other suppliers of short-term commercial credit are factors and finance companies. The former make funds available to business concerns by purchasing accounts receivable while the latter advance funds against a pledge of receivables.

Short term funds accumulated by large corporations play an important role in the NY money market. These funds which represent reserves for tax payments and temporary surplus funds, are invested primarily in short-term Government securities.

The borrowers in the NY money market comprise the Federal government, state and local governments, public authorities, and private borrowers, primarily business concerns. In recent years the U.S. Government has usually operated at a ~~loss~~ deficit and in addition, huge sums are necessary each year for refunding maturing obligations. States and municipal agencies borrow large amounts to finance construction of school, hospitals and other types of public works. Industrial and commercial concerns borrow to obtain additional funds for working capital and for acquisition of fixed assets.

Other important private borrowers include stock exchange ~~Houses~~ brokers, dealers in Government and other securities, investment banking houses, acceptances dealers, commodity dealers and traders, and sales finance and factoring companies. These concerns borrow both for their own and for their customers' accounts to carry securities purchased pending their resale or to finance new securities issues during the process

of distribution, the purchase and carrying of commodities, etc.

The demand for short-term commercial credit and consumer credit tends to rise during periods of high economic activity, and at times when businessmen are optimistic about the future

III Functions of the NY Money Market

The NY money market has important advantages not only for commercial banks, but also for other financial institutions, businesses, and individuals, and for the economy as a whole. For the commercial banks, such a market make possible a rapid and relatively inexpensive evening-out of their reserve positions, by helping to match off among the banks the excesses and deficiencies of reserves that result from shifts of deposits from one bank to another. It also enables the banks to employ a part of their reserves in income-earning assets, since it assures the liquidity of such secondary reserves.

The NY money market, moreover, provides a convenient outlet for the short-term investment by corporations and other nonbank investors of surplus funds. This market also facilitates short-term

borrowing by business firms ~~and other~~ in the forms of marketable instruments such as bankers' acceptances, commercial paper, finance company paper, collateral loans, or ~~loans~~.

By providing diversified, competitive facilities that reach into all other credit and capital markets, the NY market helps to assure the channeling of funds into the uses most needed for the expansion of the economy, and facilitates the most efficient utilization of domestic savings.

~~The NY~~ money market also makes a major contribution to the effectiveness of monetary policy. It provides a sensitive barometer of monetary conditions and constitutes an effective ground for the central bank to carry out its policy. Furthermore, it is a broad market, capable of absorbing transactions of reasonable size without undue price fluctuations, and thus makes an effective and flexible open market policy possible.

~~The fact that secondary reserves can be readily be shifted among banks make it possible for the banks to operate with smaller excess reserves and with a relatively stable cash ratios~~

Since an efficient money market operates with a relatively narrow margin of excess bank reserves, the commercial banks, in the normal

day-by-day fluctuations in money payments, resort to central bank credit. The discount rate thus has a great influence on commercial bank lending policy.

The NY money market provides facilities in which the U.S. Treasury's short-term financing requirements can be met more efficiently. It reduces the need for direct central bank loans to the U.S. Treasury, and thus minimizing the inflationary pressures.

IV Composition of the N.Y. money Market

The NY money market is not a homogeneous market but comprises several distinct markets, each dealing with a different type of short-term credit; commercial paper, collateral loan, acceptance, federal fund and short-term government securities.

A- Commercial Paper Market

"Open market commercial papers" are unsecured one-name promissory notes of well-known business concerns with strong credit ratings. Ordinarily these are sold to commercial paper houses (dealers) which resell them to financial institutions, chiefly Banks. The notes, in denominations of $5,000 and multiples thereof up to $500,000, are payable to the order of the borrowing corporation and endorsed by it.

This makes possible transfer without further endorsements. The note usually have a maturity of from four to six months. Interest at the prevailing rate is deducted in advance by the dealer, as well as a commission of 1/4 percent of the principal amount of the note regardless of maturity. Additional earnings may be derived from selling the paper at a lower discount rate than that charged to the borrowing corporation.

The absence of direct contact between the issuer of notes and the ultimate buyers, ~~eliminates~~ eliminates the possibilty of renewals and enhances the quality of this paper as a proper outlet for bank is secondary reserves or for surplus funds of corporations. By spacing maturities the buyers assure themselves a source of cash on definite dates. When in need of money, member banks may sell commercial papers in the market, or rediscount it or use it as collateral for advances from the FRB, provided the paper is eligible and within 90 days of maturity. The FRB, however, may not purchase commercial papers in the open market.

Although dealers do not endorse the paper they resell, they constantly check the credit portion of the note issuers, since their ability to stay

in business depends on the quality of paper they handle.

Business firms able to place commercial paper in the open market are called "prime names", i.e., corporations with an established record of meeting their obligations punctually and a high credit rating.

Commercial paper is issued to finance seasonal or temporary working capital requirements, such as meeting payrolls, building up inventories, or carrying accounts receivable. It is not used for financing permanent working capital or acquisition of fixed assets.

Corporations obtain certain advantages from selling their paper in the open market:

1. As a rule the interest rate on commercial paper, including the ¼ percent commission on each note, is lower than the discount rate charged by banks on business loans.

2. It enables a corporation to borrow in the open market whenever its bank cannot grant it additional loans because of the legal limitation on the total amount of credit a bank may extend to a single borrower.

3. It makes the corporation better known, which is an important factor in raising long-term capital.

B- Collateral Loan Market

The term "collateral loan" applies to loans granted on the security of pledged stocks, bonds, and other forms of property. In a narrower ~~sense~~ meaning, it is referred to "brokers' loans" or "street loans", i.e. bank loans to brokers and dealers in securities, either on a demand or time basis, secured by a pledge of stocks and bonds. The greater part of the broker borrowing is on a "call loan" basis, i.e., repayable on demand in Clearing House funds on one day's notice by the lender. If not called, the loan is automatically renewed for another day.

Brokers and dealers borrow from banks to finance:

1- customers' purchase of securities on margin;

2- their own positions in securities held in trading or investment accounts;

3- carrying of new security issues pending sale to investors.

The call and time loan agreements between banks and brokers and dealers stipulate the margin, i.e., the difference between the ~~pledged~~ market value of the pledged securities and the amount of the loan, and empower the banks to sell the pledged securities in case of default or failure to deposit additional

securities when, due to a decline of market prices, the collateral is below the stipulated margin. The call loan may be increased, decreased, or terminated either by the lender or by the borrower. Interest charges are calculated daily at the prevailing rate.

There are four principal factors affecting the volume of brokers' loans:

1. The volume of stock exchange trading on margin. If all buyers of securities paid with their own funds for their purchase, there would be a small demand for brokers' loans.

2. A second factor is the level of security prices. When stock prices are high, a larger amount is required to purchase a given number of shares, and the amount which must be borrowed for a margin transaction is correspondingly greater.

3. The volume of brokers' loans depend on the margin requirements prescribed by the Board of Governors of the Federal Reserve System. Assuming no change in the price level and the volume of shares traded, the lower the margin the greater will be the brokers' loans. A 35 percent margin makes it possible to purchase securities with a market value of $10,000 by paying $3,500, and borrowing $6,500 while a 90 percent margin (at the time of this writing) would

require a loan of only $1,000.

4. The volume of new securities issues is the fourth factor influencing the amount of brokers' loan outstanding.

C. Acceptance Market

A banker's acceptance, also called "banker's bill", is a draft drawn by an individual or a firm (drawer) on a bank (drawee) ordering it to pay to the order of a designated person (payee) a certain sum of money, at a certain date, and accepted by the bank (acceptor). The maturity of acceptances is usually 30 to 180 days. The bank expects the drawer of the draft to provide funds for payment on the due date. By accepting the draft the bank becomes the principal debtor and the drawer becomes secondarily liable.

In addition, the banker's acceptance enables the payee or a holder in due course to sell the acceptance in the open market and obtain funds quickly at a relatively low interest rate. Thus, for example, on January 11, 1955, the rate on bankers' acceptances with maturities of 30 to 90 days was 1 3/8 to 1 1/4 percent, while the bank loan rate to prime borrowers was 3 percent.

Accepting Institutions - The Federal Reserve Act of 1913, Section 13, authorized the member banks to accept drafts or bills of exchange drawn upon them to finance the following four types of transactions: (1) the foreign trade of the United States and the movement of goods between foreign countries; (2) the shipment of commodities within the U.S., (3) the storage of readily marketable staple commodities in the U.S. or abroad, and (4) the supply of dollar exchange. The purpose of making available dollar credits to banks in foreign countries is to enable the latter to pay for imports from the U.S. in periods during which, because of the seasonal character of their principal export products, their sales to the U.S. show a considerable decline. Member banks are prohibited from accepting drafts drawn to obtain ~~to~~ dollar balance because dollar exchange is at a premium, or for other speculative purposes.

Legal Limit of Acceptances by Banks - Since accepting of draft does not create deposits subject to reserve requirements, ~~the~~ and consequently there would be no limit to the aggregate amount a bank could accept, the Federal Reserve Act stipulates that the total amount of a bank's acceptances outstanding at any one time must not exceed 50 percent of the bank's paid-up and unimpaired capital stock and surplus. However, the Board of Governors may derogate this regulation

in case of emergency.

Eligibility of Acceptances for Discount - The FRB are authorized to discount eligible acceptances with a maturity at the time of discount of not more than 90 days, except that acceptances drawn for agricultural purposes and secured by warehouse receipts or other documents securing title to readily marketable staples may be discounted with a maturity up to six months. The FRB may buy and sell eligible acceptances in the open market in the U.S. or abroad.

Dealers - The acceptance market also includes dealers, i.e., middle men who make the market, and buyers who hold acceptances. Dealers ordinarily buy acceptances outright as principal rather than act as brokers for a commission. They carry only a small portfolios and try to sell immediately all bills they acquire. Acceptances are traded on a discount basis and the dealer's profit derives from the spread between the rate of interest at which he buys and that at which he sells. The spread is currently one eighth of one percent. The discount rates at which acceptances are traded in the money market are very close to the buying rate of the Federal Reserve Banks. The rate may, however, go below the Reserve Banks' buying rate whenever the supply of funds of banks is large. But the

discount rate at which dealers purchase acceptances cannot for a long time be significantly higher than the buying rate of the Reserve banks, since in such a situation dealers would offer eligible acceptances to the Reserve banks until the market supply of acceptances declined and the rate dropped close to the Reserve bank buying rate.

Dealers are required to endorse bills sold to the Reserve banks but do not endorse bills sold to other buyers unless requested to do so, in which event they allow a slightly lower discount rate, i.e., charge a higher price. Dealers ordinarily market the acquired acceptances by sending to prospective buyers a daily offering sheet giving the names of the accepting banks, denominations, maturities, and rates at which the acceptances are offered.

Buyers - The principal purchasers of bankers' acceptances are the commercial banks, the Federal Reserve banks, foreign agencies in the U.S., savings banks, insurance companies, etc...

The demand of bankers' acceptances from foreign sources has been strong for years because they provide a safe short-term investment for temporarily idle dollar balances. Moreover, the income earned on acceptances acquired by non-residents, foreign corporations

is exempt from Federal income taxes while the income on Treasury bills is subject to 30 percent withholding tax.

The Federal Reserve banks traditionally do not bid for their own account for acceptances ~~offered by~~ in the market, but they are ready to purchase at ~~a~~ stated buying rates all eligible acceptances offered by banks and dealers. Thus, commercial banks and dealers may acquire acceptances freely, knowing that in case of need they can sell them to the Reserve banks.

It is also the policy of the Reserve banks not to sell acceptances purchased for their own account but to hold them to maturity except when acquired under repurchase agreements. The Reserve banks, however, actively buy and sell acceptances in the market for foreign central banks. When a foreign central bank requests ~~the~~ the Reserve the FRB of New York to buy for its account, the latter charges a fee of ⅛ percent per annum on the face amount of the ~~the~~ acceptances purchased; this fee represents the Fed's guarantee of payment, since it ~~has~~ endorses all acceptances purchased. Endorsed acceptances are shown in the Wednesday statement of the twelve Federal Reserve banks as a contingent liability.

~~The~~ In executing their open market policy, the Federal Reserve banks play an active role in fixing the acceptances' rates. Whenever they want to buy acceptances for their own account, they merely have to reduce their buying rates. This induces offers of acceptances

to the Reserve banks. Conversely, by putting the rate above the market level they assure that few acceptances will be offered.

D - Federal Fund Market

Federal funds are right claims on the Federal Reserve banks consisting of balances maintained with the Reserve banks by member banks, par collection banks, and foreign central banks, checks of the U.S. Treasury, and ~~the~~ cashiers' (officers') checks of the Federal Reserve banks. These claims represent to the holder immediately available funds at the Reserve banks, while funds in the form of checks drawn on commercial banks become available at the Reserve banks only the next day, when clearing house balances are settled on the books of the Federal Reserve banks. The term "Federal funds" is commonly refered to the amount of reserve balances that individual member banks have in excess of legal requirements and are willing to lend to banks deficient in reserves. Deals in Federal funds are day-to-day loans made through the transfer of reserve balances on the books of the Federal Reserve banks.

The lending of Federal funds between banks in the same locality is transacted usually

through an exchange of checks. The lending bank gives a check on the FRB and for which it receives immediate credit. The borrowing bank gives a check drawn on itself (cashier's check) for the amount of the loan plus interest, which will be credited the following business day to the account of the lending bank at the FRB and charged to the borrowing bank.

Loans (sales) of Federal funds between banks in different financial centers are made by utilizing the Federal Reserve wire transfer service. The lending bank transfers the funds to the borrowing bank's account at the FRB and the next day the borrowing bank wires back the amount plus interest to the account of the lending bank.

While banks are the main source of Federal funds, non-banking institutions also supply Federal funds to the market. The most important of them are Government security dealers who may offer Federal funds acquired through the sale of Government securities to the FRB. They may also acquired Federal funds through the sale of Government securities to non-banks investors who have received U.S. Treasury checks for redeemed Treasury issues and hand them over to dealers in payment for the purchased securities.

The demand for Federal funds comes chiefly

from member banks which have to remedy to a temporary deficiency in legal reserves. The banks prefer to borrow Federal funds instead obtaining advance from the FRB because the rate of Federal funds is generally lower than the discount rate, and because the banks are by tradition reluctant to be indebted to the FRB. Other users of Federal funds are government security dealers who need such funds to make payment to the FRB on the day of delivery of securities purchased by them from the FRB.

The rate charged for Federal funds fluctuates from day to day with changes in the money market conditions. Drawing by banks on their balances with correspondent banks in large cities, shifting of funds by the U.S. Treasury from member banks ~~to their balances~~ to the FRB, an outflow of gold, month-end or preholiday heavy demand for currency, transfer of funds by corporations from large banking centers to banks in other localities, may render some banks deficient in reserve and increase the demand for Federal funds. Under these circumstances, the rate on Federal funds could move close to the discount rate of the FRB.

E- The Treasury Bill Market

Although the Treasury bill market is the youngest member of the NY money market, it has become by far the most important market, in terms of amount outstanding and trading activity. The high degree of safety and marketability and the short maturity make the Treasury bill suitable as a secondary reserve for banks, and for temporary employment of surplus funds by corporations, public authorities and political subdivisions. Treasury bills were issued for the first time in 1929. The Secretary of the U.S. Treasury is authorized to sell Treasury bills on a discount basis and payable at maturity without interest.

U.S. Treasury bills are non-interest-bearing obligations maturing in 90 to 92 days offered weekly for competitive bidding on a discount basis. They are issued in denominations of $1,000, $5,000, $10,000, $100,000, $500,000 and $1,000,000 maturity value.

Beginning 1934, the maturity of some issues of Treasury bills was lengthened to six months

Dealer's quotations - Treasury bills are quoted in the dealer market on a discount basis, and the quotations, given in term of percentage yield, are refined to 1/100 of 1 percent (or 1 "basis-point"). Thus, the Treasury bill of thirteen-week maturity like the issue of December 11,

1958, maturing March 13, 1959, was quoted on December 11 at 2.84 percent bid and 2.81 percent asked. The spread between the bid and offer quotations represents the dealer's profit margin. On a 13-week bill, this 3 basis-point spread would be equal to US$75 per million dollars per value of bills traded. In fact, the dealer's profit is less than that: if the bills had 3 weeks to go to maturity, the spread would be equal to about $17 per million. The spread widens during times of market uncertainty as the dealer tries to protect himself from losses; also it widens as bills approach maturity.

The same kind of spread is maintained for certificates of indebtedness, Treasury notes and Treasury bonds. However, all these securities are quoted on a price basis. For example, the outstanding certificates due in February 1957, bearing a 2 5/8 percent rate of interest, is generally quoted by dealers as this is written at 99.31 bid and 100.1 offered. Actually this quotation must be understood respectively 99. 31/32 and 100. 1/32. The figure after the decimal point does not represent hundredths of a percentage point; it represents thirty-seconds. Although it never states clearly, it is understood that the prices will in addition include the interest accrued

from the last interest-payment date to the date of delivery. Thus a purchaser of a $1,000 certificate of the issue June 12, 1956, for regular delivery on June 13 would have paid the following:

Principal (100 1/32, the offered price)	$1,000.31
Accrued interest to June 13	7.19
Total cost	$1,007.50

In this case, the certificate purchaser will get at maturity the face amount of the certificate ($1000), the accrued interest ($7.19) and the interest mentioned on the coupon.

Security Marketing - Virtually all the trading in Government securities takes place in the over-the counter market, although Treasury bonds are also listed on the New York Stock Exchange. The over-the counter market is made up of a group of ~~dele~~ dealer firms and dealer banks. Some ~~dele~~ dealer firms specialize almost in Government securities while ~~ofher~~ other trade in a host of other securities such as state, municipal, and revenue securities, corporate bonds, preferred and common stocks, banks and ~~fire~~ insurance company stocks, bankers' acceptances, and foreign dollar bonds.

The security quotations are subject to changes as the buying and selling develops, and the market is reflected in dealers' bid and offer prices in every minute. Most deals are made over the telephone

in units of millions of dollars. If the customer calls several dealers he may practically receive the same quotations. This is because the keen competition among dealers. A dealer may call a competitor and "ask for a run", that is, get the other's bid and offer prices. Though runs are not necessarily firm bids and offers from dealer to dealers, the price keeping serves to keep quotations of all dealers close together.

When a deal is completed, payment may be in "cash", i.e., same-day delivery of securities and payment, or "regular" - i.e., delivery and payment next business day. There is a heavy traffic in securities via wire transfer between New York and other money centers. In this connection, the Federal Reserve leased wire system is one of great help to smooth out the nationwide money market centered in New York. For example, it costs about $220 for postage and insurance to ship $1 million in bearer Government securities from New York to Chicago. With the leased system, transfer of bearer Treasury bills can be accomplished within an hour at no cost. Such "CPD" transfers are made possible by the Commissioner of Public Debt of the Treasury, which thus helps to facilitate the marketing of Treasury securities.

Suppose someone in Chicago wants to sells security to be delivered to a buyer in New York. The seller is dealer or bank delivers the security to the Chicago Fed which retires it, and asks the New York Fed to deliver the same amount of the security from its unissued stock to the named buyer.

For transactions within the New York area, physical details - payments, handlings and transfers of securities - are mostly handled by one New York bank, acting as a clearing agent. This bank sends messengers to and from dealer "cages"; it keep accounts of transactions and offsets amounts owed by and owed to dealers from a day's trade.

Marketing New Issues - Each Thursday the Treasury invites "tenders" from subscribers, competitive or noncompetitive, for a stated amount of 91-day and/or 182-day Treasury bills to be issued seven days later. The tenders must be received by a FRB or branch by 1:30 p.m. New York time on the following Monday.

Since bills are sold on a discount basis, subscribers bid for the chosen amounts a price below par or face value. For example, bills bought at $99.532 will pay the holder $100 in 91 days, giving him an interest rate return equivalent to $\frac{(100 - 99.532) \times 360}{91} = 1.85$ percent a year,

Tenders must be made for amounts that are even multiples of $1,000 maturity value, and the bid price must be stated on the basis of 100 with not more than three decimals.

A person may enter a noncompetitive bid for not more than $200,000; the subscriber is awarded bills at the average of the accepted bids. Noncompetitive bids appeal to small country banks and others not in close touch with the market.

After 1:30 p.m. each Monday, ~~Boston~~ FRB send subscription data to the Treasury. The Treasury allots noncompetitive bids in full, allocates the remainder of the total issued to the highest bidders on a competitive basis. By Tuesday morning the Treasury tells bidders how many bills they have been awarded. Government security dealers usually bid for sizable amounts to sell to others.

Buyers may pay the bills on Thursday either in Federal funds or in maturing Treasury bills. The FRB itself, which is an important holder of bills, also enters the auction although never for an amount greater than that of the maturing Treasury bills which it holds for foreign accounts for the most part. It may bid to exchange its maturing issue for the new issue, or, if it wants to cut down the amount of money

on the money market, may intentionally bid to miss in the auction and thus allow its maturing bills to run off, i.e. redeem them for cash.

Tax Anticipation Bills - The Treasury offers from time to time bills with maturities close to the quarterly tax payment dates which could be used in payment of taxes. These tax bills were issued to minimize the impact of concentrated heavy tax collections on member bank reserve balances.

V - The Federal Reserve and the Money Market

The basic function of the Federal Reserve System is to regulate the flow of money and credit with a view to promoting orderly economic growth and a stable dollar. According to the economic conditions prevailing in the country, the FRB make credit more readily available, less readily available, or about the same in availability, through two groups of instruments of control: qualitative and quantitative. Quantitative credit control instruments are (1) the discount rate, (2) open market operations, (3) raising or lowering reserve requirements, (4) the float, and (5) moral suasion. Quantitative credit control is aimed at expansion or contraction of the total volume of credit. It characteristic is the impersonality of the operations. The tools are not directed toward particular banks, certain types of loans or investments, or some

segments of the economy. Hence, their use is less difficult and more flexible than that of selective controls.

Qualitative or selective control endeavors to prevent the use of bank credit for purposes not considered desirable, and to direct the flow of credit into channels deemed essential to the national economy.

Selective control instruments are: (1) regulation of security loans, (2) authority to fix margin requirements, (3) power to suspend the borrowing privilege of individual banks from the Reserve Banks, (4) acceptability of eligible papers, (5) control of consumer credit, (6) control of real estate construction credit (7) voluntary credit restraint, and (8) moral suasion

Armed with these credit tools, is the Federal Reserve able to assure economic stability? Surprisingly, no, because ~~that~~ a great variety of other forces also affect the credit and money flow. These include, among others, governmental policies in regard to expenditures, taxes and debt; the distribution of income among different strata of the population; policies of management, labor, agriculture and other sectors of the economy; the course of foreign trade and foreign investment; and the prospects for peace or war.