The Money and Bond Markets in December

The pressure of monetary restraint continued to be felt in the money and bond markets during December, when interest rates on many instruments climbed to record highs. Quotes on prime four- to six-month dealer-placed paper and ninety-day bankers' acceptances rose ⅜ percentage point, and rates on most maturities of directly placed commercial paper also advanced. The effective rate on Federal funds averaged 8.9 percent, up from its 8.7 percent level in November, but net borrowed reserves declined somewhat during December.

Following a brief rally in the first week of December, prices of long-term Governments fell sharply and broke through the previous record lows established the month before. Prices were also down on most other Treasury notes and bonds, but these remained above the low levels reached in early October until unexpectedly heavy selling for tax losses developed throughout the Government bond market on December 29. Despite a rebound on the succeeding two days, several of the high-coupon issues with intermediate maturities closed the month below their October lows. The price declines on long-term issues in December were generally 1$\frac{1}{16}$ to 2¾ points, while most intermediate-term issues were down 1 to 2⅞ points. The only price rises among coupon issues during the month were on maturities within eight months.

The Treasury bill market also came under fire during December, largely as a result of restrained investor interest and a sizable amount of selling pressure which was particularly intense toward the close of the month. The average issuing rates on new three-, six-, and nine-month bills reached all-time highs during the period, climbing to 8.096, 8.101, and 7.801 percent, respectively. Over the month as a whole, yields on Treasury bills generally increased by 8 to 58 basis points.

On December 2 a triple A-rated corporate issue was priced to yield investors a record 9.10 percent, and the debentures were not only a rapid sellout but also apparently sparked an interest in other new and outstanding issues. Within two days underwriters began to raise prices on subsequent new offerings, and these also met with successful receptions. The rally subsided after about a week, and yields once more began to rise. Rates did not reach the levels set in the early part of the month, however, and were again trending downward as December closed. In the tax-exempt market, successively new record yields occurred through midmonth, after which a somewhat better tone emerged that reflected in part the minimal supply of new offerings scheduled during the holiday period.

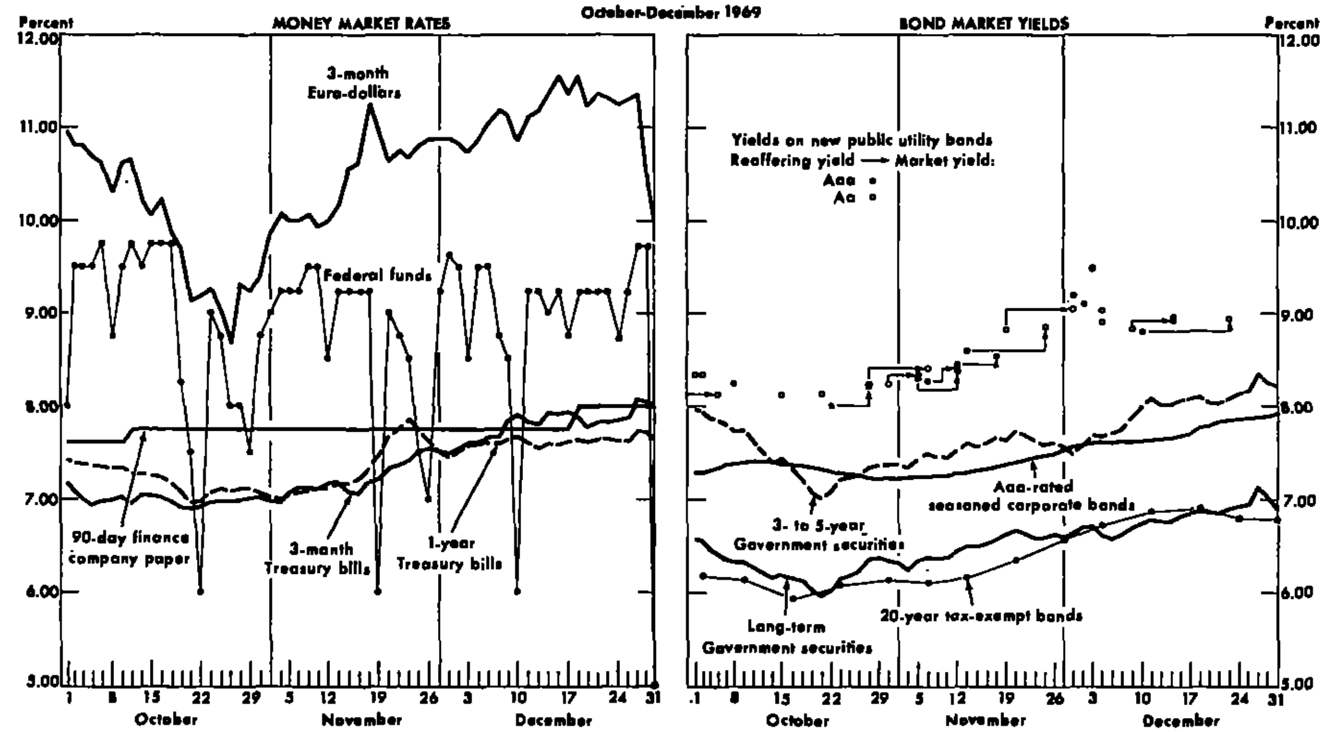
BANK RESERVES AND THE MONEY MARKET

Money market conditions remained firm during December though no undue pressures resulted from the quarterly corporate tax payment date. Over the month as a whole the effective rate on Federal funds averaged 8.9 percent, somewhat above the 8.7 percent level in November. Trading in Federal funds displayed the usual pattern of a buildup in rate at the start of each week, as money center banks bid aggressively, and a decline at the close when reserve pressures were reduced somewhat (see Chart I). Daily average excess reserves of member banks increased by $22 million, to $259 million, while borrowings at the discount window were reduced by $87 million. As a result, nationwide net borrowed reserves averaged $867 million in December (see Table I), $108 million less than in the preceding month.

Both the eight New York City banks and the thirty-eight money center banks outside New York experienced a deterioration in their basic reserve positions over the month, and the deficit of the forty-six together totaled $4.9 billion at the end of December (see Chart II). The deterioration was only partly seasonal and, to a large extent, reflected a sizable year-end increase in loans and investments outstanding.

Despite a rise in United States Government and private demand deposits, the average basic deficit at the eight New York City banks climbed by $766 million in the week ended on December 3, as net loans to dealers increased some

Chart I
SELECTED INTEREST RATES
October-December 1969



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; offering rates for directly placed finance company paper; the effective rate on Federal funds (the rate most representative of the transactions executed); closing bid rates (quoted in terms of rate of discount) on newest outstanding three-month and one-year Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new Aaa- and Aa-rated public utility bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); daily averages of yields on seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields on twenty seasoned twenty-year tax-exempt bonds (carrying Moody's ratings of Aaa, Aa, A, and Baa).

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, and The Weekly Bond Buyer.

$400 million and other loans and investments grew by about $750 million on average. A further deepening of the basic deficit at these banks occurred in the following week (see Table II), when the Treasury and private demand depositors ran down their balances by substantial amounts while loans and investments remained at a high level. There was progressive improvement in the basic position of the eight New York City banks during the two weeks ended on December 17 and December 24, resulting chiefly from renewed inflows of United States Government and private demand deposits which more than offset the rising level of loans and investments.

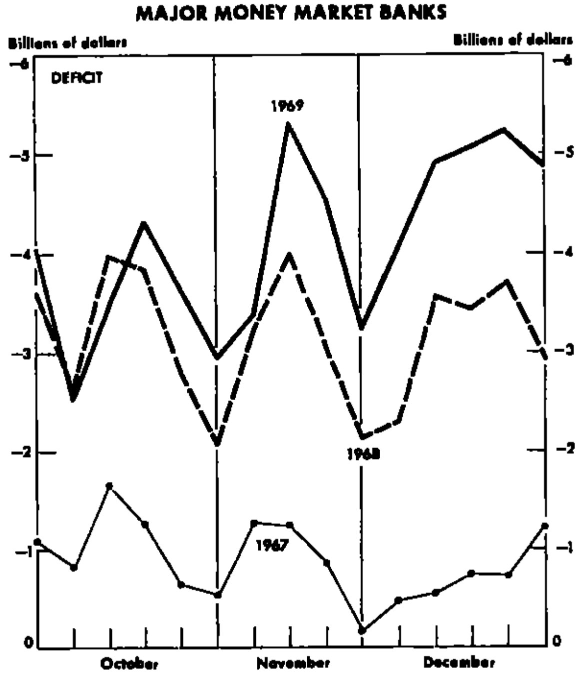
In the final statement week, however, the basic deficit of these banks increased despite an average inflow of almost $1.7 billion in private demand deposits. The worsening resulted from declines in all other liability items combined with increases in all asset categories. Over the month as a whole the deterioration in the basic position of the New York City banks amounted to $891 million.

In contrast to the pattern in New York City, the thirty-eight other money center banks did not increase their loans and investments until the middle of December when quarterly corporate tax payments came due. Nonetheless, their basic deficit showed a continued worsening until the final week of the month. Factors affecting the basic position varied from week to week, but over the month as a whole the primary sources of the deterioration were the increase in loans and investments, a decline in their Euro-dollar holdings, and a rise in required reserves.

System open market operations provided $632 million in reserves on a daily average basis during December primarily through outright transactions and repurchase agreements (see Table I). Market operating factors provided reserves totaling $536 million on a daily average basis, largely the result of an increase in float. A rise in required reserves, however, more than offset this supply of reserves from operating transactions.

The money supply expanded at a seasonally adjusted annual rate of 1.8 percent in December, according to preliminary data, following a rise of 1.2 percent in November. Over the fourth quarter as a whole the money supply grew at a rate of 1.2 percent, and at a rate of 2.5 percent for the year 1969. Total member bank deposits subject to reserve requirements and including Euro-dollar liabilities (the adjusted bank credit proxy) declined at a seasonally adjusted rate of 1.2 percent in December, resulting in a 0.3 percent contraction at an annual rate from the end of the third quarter. For the year as a whole the adjusted bank credit proxy fell by 1.7 percent.

Chart II
BASIC RESERVE POSITION OF MAJOR MONEY MARKET BANKS



Note: Calculation of the basic reserve position is illustrated in Table II.

THE GOVERNMENT SECURITIES MARKET

Yields moved further upward in most sectors of the market for United States Treasury issues during December. Prices on long-term bonds fell to record lows, and rates on newly auctioned three-, six-, and nine-month bills climbed to all-time highs. Over the month as a whole, yields increased on all Treasury securities except short-term coupon issues. The market was buffeted by a number of forces, however, and the upward pressure on yields was not unrelenting.

During the first week of December, long-term Treasury bonds rose in price by as much as $^{29}/_{32}$ in a spillover from the rally which developed in the market for corporate bonds. Notes and bonds with shorter maturities also showed some improvement at the start of the month. However, prices deteriorated after statements by Federal Reserve governors concerning the need for continued tight monetary policy as well as the unenthusiastic reception given a Federal National Mortgage Association offering.

The market for Treasury notes and bonds underwent price declines in the early part of the next two weeks, establishing record lows for long-term bonds, but rallied at the close of each period. In the week ended on December 12 the market turned sharply lower, at first largely in reaction to selling pressures and to a statement by Governor Robertson that tighter and more painful controls might be required in order to curb inflation. Announcement of another Federal agency offering and investor switching from Government securities into corporates contributed further to the price declines. Toward the close of the week, however, some improvement occurred as a result of professional short covering and the report of a large rise in business inventories during October. Prices again declined in the early days of the week ended on December 19 in response to slackened investor interest and a resurgence of selling pressures from dealers and investors alike. A favorable interpretation of remarks by Chairman-appointee Burns, together with lessened seasonal tax-selling pressures and the report of a drop in orders for durable goods during November, brought about price rises as the week drew to a close. On balance, however, prices of notes and bonds were lower over the two-week period ended on December 19.

Prices of coupon issues registered further declines during the Christmas holiday week in quiet dealer trading with little investment demand. Then, on December 29, prices fell sharply in response to sizable, last-minute tax selling associated in part with changes in the Tax Reform Act awaiting the President's signature. In the wake of the selling, most coupon issues fell to new lows, though a con-

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, DECEMBER 1969

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

Factors	Changes in daily averages— week ended on					Net changes
	Dec. 3	Dec. 10	Dec. 17	Dec. 24	Dec. 31	
"Market" factors						
Member bank required reserves	— 71	+ 42	— 434	+ 311	— 546	— 698
Operating transactions (subtotal)	— 427	— 193	+ 610	+ 66	+ 480	+ 536
Federal Reserve float	— 183	+ 118	+ 357	+ 559	+ 399	+1,250
Treasury operations*	— 3	— 186	+ 209	— 261	— 165	— 356
Gold and foreign account	— 1	— 16	— 11	+ 6	— 20	— 41
Currency outside banks	— 105	— 185	— 226	— 333	+ 120	— 679
Other Federal Reserve accounts (net)†	— 135	— 25	+ 281	+ 95	+ 144	+ 360
Total "market" factors	— 498	— 151	+ 176	+ 377	— 66	— 162
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 577	+ 197	— 219	— 209	+ 286	+ 632
Outright holdings:						
Government securities	+ 402	+ 172	— 204	— 106	— 19	+ 245
Bankers' acceptances	+ 2	+ 6	+ 3	+ 1	— 1	+ 11
Repurchase agreements:						
Government securities	+ 159	+ 3	— 30	— 81	+ 215	+ 266
Bankers' acceptances	+ 5	+ 6	+ 7	— 12	+ 33	+ 39
Federal agency obligations	+ 9	+ 10	+ 5	— 11	+ 58	+ 71
Member bank borrowings	— 14	+ 6	— 156	+ 51	+ 10	— 103
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+ 563	+ 203	— 375	— 158	+ 296	+ 529
Excess reserves	+ 65	+ 52	— 199	+ 219	+ 230	+ 367

	Daily average levels					
Member bank:						
Total reserves, including vault cash	27,737	27,747	27,982	27,890	28,666	28,004‡
Required reserves	27,534	27,492	27,926	27,615	28,161	27,746‡
Excess reserves	203	255	56	275	505	259‡
Borrowings	1,191	1,199	1,043	1,094	1,104	1,126‡
Free, or net borrowed (—), reserves	— 988	— 944	— 987	— 819	— 599	— 867‡
Nonborrowed reserves	26,546	26,548	26,939	26,796	27,562	26,878‡
Net carry-over, excess or deficit (—)§	90	114	165	92	176	127‡

	Changes in Wednesday levels					
System Account holdings of Government securities maturing in:						
Less than one year	+1,124	— 679	+ 431	+ 25	— 455	+ 446
More than one year	—	—	—	—	—	—
Total	+1,124	— 679	+ 431	+ 25	— 455	+ 446

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

* Includes changes in Treasury currency and cash.

† Includes assets denominated in foreign currencies.

‡ Average for five weeks ended on December 31, 1969.

§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS DECEMBER 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Average of five weeks ended on Dec. 31
	Dec. 3	Dec. 10	Dec. 17	Dec. 24	Dec. 31	
Eight banks in New York City						
Reserve excess or deficiency (—)*	— 4	90	93	12	102	59
Less borrowings from Reserve Banks	266	293	164	296	319	268
Less net interbank Federal funds purchases or sales (—)	1,065	1,528	1,394	974	1,242	1,241
Gross purchases	2,065	2,231	2,392	2,071	2,204	2,193
Gross sales	1,000	703	998	1,098	961	952
Equals net basic reserve surplus or deficit (—)	—1,334	—1,730	—1,465	—1,258	—1,459	—1,449
Net loans to Government securities dealers	532	563	516	679	768	670
Net carry-over, excess or deficit (—)†	17	15	58	30	31	30
Thirty-eight banks outside New York City						
Reserve excess or deficiency (—)*	— 2	6	— 40	— 60	— 9	— 21
Less borrowings from Reserve Banks	307	264	297	356	334	312
Less net interbank Federal funds purchases or sales (—)	2,397	2,864	3,140	3,576	3,076	3,011
Gross purchases	4,424	4,350	5,017	5,067	4,895	4,851
Gross sales	2,028	1,987	1,877	1,491	1,819	1,840
Equals net basic reserve surplus or deficit (—)	—2,706	—3,122	—3,477	—3,993	—3,419	—3,343
Net loans to Government securities dealers	269	121	97	60	128	135
Net carry-over, excess or deficit (—)†	5	23	28	1	61	24

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

* Reserves held after all adjustments applicable to the reporting period less required reserves.

† Not reflected in data above.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—December 1969				
	Dec. 1	Dec. 8	Dec. 15	Dec. 19	Dec. 29
Three-month	7.453	7.702	7.920	7.804	8.096
Six-month	7.618	7.803	7.922	7.815	8.101

Maturities	Monthly auction dates—October-December 1969		
	Oct. 28	Nov. 25	Dec. 23
Nine-month	7.244	7.778	7.801
One-year	7.127	7.592	7.561

* 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.

siderable recouping occurred on the final two days of the month.

Improved retail interest in the bill market and optimistic press reports combined to extend the late-November rally into early December. At the weekly auction on December 1 the average issuing rates on new three- and six-month bills were down 2 and 41 basis points, respectively, from their highs set on November 24. The improvement was short-lived, however, and rates on most bills increased from 3 to 16 basis points over the week. Factors contributing to the weaker tone included some foreign account selling and attempts by dealers to pare their inventories in anticipation of the return of a large supply of bills under corporate repurchase agreements on the December 10 dividend date. There was sizable corporate demand for bills with December maturities, though, and these issues registered gains during the first week of the month.

At the next two weekly auctions on December 8 and December 15, record rates were set on the new issues of three-month bills. Rates on the six-month bills also rose (see Table III), though they remained below the 8.027 percent high set on November 24. Additional foreign account selling emerged during this period, and the market also reacted negatively to Governor Robertson's remarks. There was a temporary improvement in bill rates toward the end of the week of December 12, when some commercial banks and state and local governments became purchasers and reinvestment demand from holders of maturing Government bonds also emerged. The rally was brief, however, and the market resumed its decline following the weekend. The weaker tone continued until good investor interest emerged on December 18, and participants also interpreted Dr. Burns' testimony in an optimistic light. Average issuing rates declined on both the three- and six-month bills in the auction held on Friday, December 19, giving a further lift to the market.

Over the following holiday-shortened week, bill rates moved irregularly higher, as reinvestment demand from maturing tax anticipation bills proved somewhat disappointing and the market faced the monthly auction. At this auction held on Tuesday, December 23, the average issuing rate on the new nine-month bills was set at a record 7.801 percent but the rate on the new twelve-month bills was slightly below the high established in November (see Table III). Rates on outstanding bills edged upward over the remainder of the week, and then rose sharply following the weekend when substantial investor selling developed. Reflecting the pressures in the market, average issuing rates on the new three- and six-month bills jumped 29 basis points on December 29 from the previous auction and reached all-time highs. The higher bill rates attracted substantial investor interest, and rates improved at the close of the month.

OTHER SECURITIES MARKETS

The corporate bond market was still in the doldrums at the start of December and, when three slow-moving recent issues were released from price restrictions, the upward yield adjustments ranged as high as 40 basis points. On December 2, Pacific Telephone and Telegraph Company marketed $150 million of Aaa-rated debentures at a yield of 9.10 percent, the first Aaa-rated issue ever to reach a 9 percent level. The debentures quickly sold out on the first day. Small investors were the chief buyers of these bonds, which have five-year call protection, but some institutions also evinced interest in this offering. Crossing the 9 percent mark was apparently the stimulus that the market needed at the time, and the resulting rally extended into the succeeding week. Immediately following the telephone offering, record returns were also made available on lower rated issues, and underwriters were able to move these quickly as well. By December 4, underwriters began to price new issues more aggressively and investor reception remained quite favorable. Thus, a double A-rated issue priced to yield 8.825 percent was about 90 percent sold on the first day.

The rally in corporate bonds soon ended, with investor resistance to a new utility issue developing on December 10. Several public statements concerning the tenacity of inflationary pressures contributed to the cautious market tone which continued into the week of December 19. Postponements of some scheduled offerings occurred during this period, and yields on the new issues which were marketed rose though they remained below the highs of early December. The corporate bond market registered some gains following Dr. Burns' testimony on December 18, and showed some additional modest improvement over the remainder of the month when activity was very light and no additional issues of any consequence were marketed.

Rates on tax-exempt bonds rose steadily over the first half of the month. Several new A-rated issues were priced to yield well over 7 percent, and a triple A-rated offering provided a record 6.60 percent return. *The Weekly Bond Buyer's* index of the average yield on twenty municipal bonds rose from 6.58 percent on November 27 to a new high of 6.90 percent on December 18. Once again there were a number of postponements, due to statutory interest-rate ceilings and voluntary withdrawals, as this market experienced the effects of sizable tax selling and the continuing low level of commercial bank participation. Moreover, in the short-term tax-exempt area, the Department of Housing and Urban Development had to pay more than $900,000 in placement fees to underwriters in order to sell $317.9 million of local renewal project notes for which the bids exceeded the 6 percent interest ceiling. An additional $1.7 million was sold within the ceiling, resulting in an effective cost including the subsidy of about 6.45 percent. A month earlier the cost had been 5.49 percent for similar notes, which needed no subsidy.

The tone of the municipal bond market improved considerably after midmonth, however, and on December 18 a $125 million issue of State of Pennsylvania bonds was aggressively bid for and oversubscribed by investors. The 5.90 to 7.25 percent yield on the $75 million Aa-rated portion of these serial bonds was estimated to be, on average, some 20 basis points higher than the previous record on a comparable offering earlier in the month. However, the yields on the remaining $50 million portion rated A-1 were lower than those on a similarly rated issue a week before. Reflecting the better market tone, the *Bond*

Buyer's index for December 24 declined for the first time in seven weeks to 6.79 percent, a drop of 11 basis points over the week, and remained at this level on December 31.