The Money and Bond Markets in November

Interest rate movements were mixed in November. Most money market rates continued the declines that had ensued upon President Nixon's announcement on August 15 of new economic policies to restrain inflation while stimulating the economy. The Federal Reserve Banks reduced the discount rate by ¼ percentage point to 4¾ percent to bring it into closer alignment with other short-term rates. The reduction by seven of the banks was approved by the Board of Governors of the Federal Reserve System November 10, and by November 18 the other five had followed suit. The effective rate on Federal funds dropped steadily on a weekly average basis to a level about ¾ percentage point below the level that had prevailed during the first half of August, just before the President's new economic initiatives. Declining rates on commercial paper triggered several reductions in the prime business loan rates of the few banks that have tied their prime rates to market rates. At the end of November, prime rates ranged from ¼ to ¾ percentage point below the 6 percent level of August. After posting declines early in November, a few short-term rates reversed direction and closed higher for the month although well below recent peaks. For example, the three-month Treasury bill rate was still a full percentage point below its late-July levels.

In contrast to most short-term rates, bond yields generally rose during November but still closed well below the pre-August 15 levels. Dealers in all sectors of the capital markets were burdened with unusually large inventories as the month began. After some active selling early in the month, dealers' holdings swelled further as a large flow of new issues encountered resistance amid mounting investor concern over the outcome of the Phase Two program to combat inflation. Yields on high-quality utility bonds increased slightly over the month but were still down about 60 basis points from the middle of August. Yields backed up somewhat more in the tax-exempt sector but, because of earlier declines, closed about 67 basis points lower than the mid-August levels, according to *The Weekly Bond Buyer's* twenty-bond index. Yields on Treasury securities also rose during November, but at the month end still showed net declines from mid-August averaging about 25 basis points on long-term bonds and more than 100 basis points on intermediate-term issues.

THE MONEY MARKET

Although most short-term interest rates continued to edge downward in November, the pace of the decline in some cases was slower than in October, and there were some reversals late in the month. Major banks' offering rates on large certificates of deposit (CDs) were unchanged to ¼ percentage point lower in November. Bankers' acceptance rates were reduced by a net ⅛ percentage point. Three-month Euro-dollar rates, which had dropped from 10 percent in mid-August, slipped below 6 percent early in November. They rebounded to 7 percent in the Thanksgiving holiday week, but retreated to 6½ percent by the end of the month.

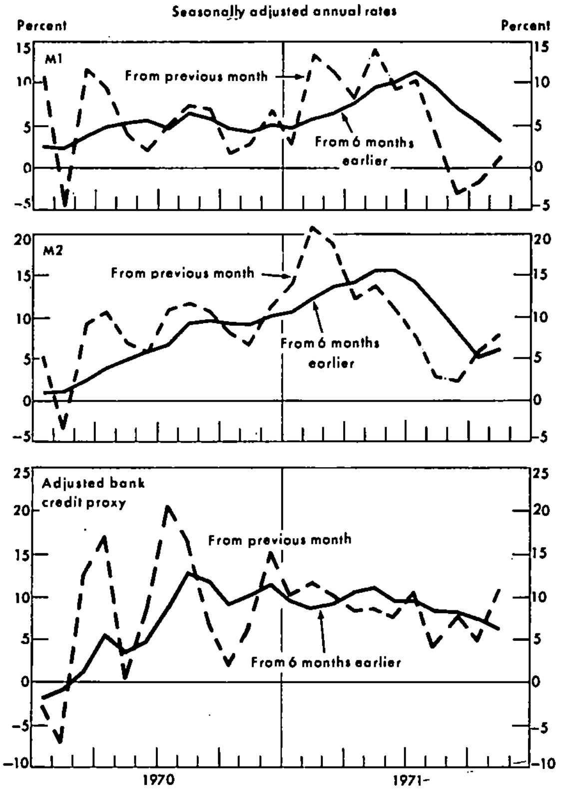
Rates on most maturities of commercial paper declined on balance over the month. For example, rates on dealer-placed 90- to 119-day paper fell from 5⅛ percent to 4¾ percent. Several banks are now tying their prime rate to commercial paper rates according to various formulas. One of these banks in New York City reduced its prime rate four times over the month from 5¾ percent to 5¼ percent, while another bank accomplished the same net reduction in two steps. Most major banks that are still administering the prime rate reduced it on November 4 from 5¾ percent to 5½ percent.

The effective rate on Federal funds continued to drop steadily on a weekly average basis, declining from 5.11 percent in the statement week ended October 27 to 4.86 percent in the week ended November 24. The money market suddenly tightened in that week, however, and the effective rate on Federal funds rose from 4¾ percent before the weekend to 5⅛ percent on the Wednesday settlement date. That day member bank borrowings from the Federal Reserve Banks surged to nearly $2.4 billion. For the statement week as a whole, such borrowings averaged $539 million, compared with an average of $209

Chart I

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for November 1971 are preliminary estimates.

M1 = Currency plus adjusted demand deposits held by the public.

M2 = M1 plus commercial bank savings and time deposits held by the public, less negotiable certificates of deposit issued in denominations of $100,000 or more.

Adjusted bank credit proxy = Total member bank deposits subject to reserve requirements plus nondeposit sources of funds, such as Euro-dollar borrowings and the proceeds of commercial paper issued by bank holding companies or other affiliates.

Source: Board of Governors of the Federal Reserve System.

million during the three previous weeks (see Table I).

The tautness in the money market in the November 24 week, which occurred despite large injections of reserves by the Federal Reserve, came as a surprise. It turned out that reserve availability had been $400 million less on average during the week than had been thought. The error, which was not discovered until after the end of the statement period, resulted from a miscalculation of member bank holdings of vault cash. Thus, net borrowed reserves during the week averaged $344 million, whereas it had been assumed that there were free reserves averaging $56 million.

The tight reserve positions were reversed in the following statement week, and the Federal funds rate declined day by day to an effective rate of 3¾ percent on December 1. The banks had to maintain their heavy November 24 level of borrowings through the Thursday holiday. As a result, the member banks held an exceptionally large $558 million of excess reserves for the week, even though total borrowings from the Federal Reserve were reduced to $64 million by the closing day of the statement week.

The annual revisions in the money supply, based on new benchmark data from the call reports of nonmember banks for December 1970 and June 1971 and revised seasonal factors, have been announced. Minor adjustments were made in the data back through 1964.[1] The revisions in the 1971 figures did not alter the basic pattern that had been indicated by the unrevised figures of rapid growth in the money supply in the six months ended in July and slow growth or decline in each of the months since then (see Chart I). The seasonally adjusted annual rate of growth of M_1 over the six months ended in July was revised downward slightly to 11.2 percent from 11.8 percent, while the rate of decline for the succeeding three months was revised to 0.5 percent from 1.4 percent. This brought the annual growth rate of M_1 over the six months ended in October to a moderate 5.3 percent. According to preliminary data, growth of M_1 resumed in November, albeit at a modest rate of about 1 percent annually.

M_2 grew at an annual rate of about 7½ percent in November, reflecting continued strength in time deposits other than large CDs. Revisions in the M_2 series also were generally small. M_2 showed a pattern of very rapid growth in the first part of the year followed by smaller advances thereafter. In the case of M_2, however, the deceleration began earlier than it did for M_1. The slowdown was more gradual, and the series has turned around and risen moderately in the last two months as time deposits have picked up renewed strength.

The growth rate of the adjusted bank credit proxy, revised to take account of new seasonal factors, diverged considerably from the rates of increase of M_1 and M_2 in November as it had in several months earlier this year. In November, the growth of the proxy accelerated to a seasonally adjusted annual rate of about 11 percent in spite of weak demand deposit growth and a decline in large CDs. A sharp advance in seasonally adjusted Govern-

[1] Revised data are reported in the *Federal Reserve Bulletin* (November 1971), pages 880-93.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, NOVEMBER 1971

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

Factors	Changes in daily averages— week ended				Net changes
	Nov. 3	Nov. 10	Nov. 17	Nov. 24	
"Market" factors					
Member bank required reserves	— 192	— 5	— 413	+ 419	— 191
Operating transactions (subtotal)	+ 630	— 252	+ 122	—1,044	— 544
Federal Reserve float	+ 171	— 157	+ 177	— 24	+ 167
Treasury operations*	+ 357	+ 202	+ 46	— 341	+ 264
Gold and foreign account	+ 22	+ 15	— 4	—	+ 33
Currency outside banks	+ 167	— 261	— 260	— 697	—1,051
Other Federal Reserve liabilities and capital	— 89	— 51	+ 163	+ 19	+ 42
Total "market" factors	+ 438	— 257	— 291	— 625	— 735
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 57	— 68	+ 539	+ 590	+1,118
Outright holdings:					
Treasury securities	+ 19	— 156	+ 211	+ 453	+ 527
Bankers' acceptances	+ 1	+ 1	+ 5	— 6	+ 1
Federal agency obligations	—	+ 35	+ 48	—	+ 83
Repurchase agreements:					
Treasury securities	+ 29	+ 40	+ 234	+ 93	+ 396
Bankers' acceptances	—	+ 14	+ 13	+ 24	+ 51
Federal agency obligations	+ 8	— 2	+ 28	+ 26	+ 60
Member bank borrowings	— 197	— 94	+ 167	+ 250	+ 126
Other Federal Reserve assets†	+ 47	+ 33	— 179	— 265	— 364
Total	— 93	— 129	+ 527	+ 574	+ 878
Excess reserves	+ 345	— 386	+ 236	— 51	+ 144

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash	30,961	30,580	31,229	30,759	30,882‡
Required reserves	30,565	30,570	30,983	30,564	30,671‡
Excess reserves	396	10	246	195	212‡
Borrowings	216	122	289	539	292‡
Free, or net borrowed (—), reserves	180	— 112	— 43	— 344	— 80‡
Nonborrowed reserves	30,745	30,458	30,940	30,220	30,591‡
Net carry-over, excess or deficit (—)§	40	222	54	70	98‡

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ Average for four weeks ended November 24.
§ Not reflected in data above.

ment deposits at commercial banks, along with an increase in liabilities to foreign branches of United States banks, contributed to the strength of the proxy advance.

THE GOVERNMENT SECURITIES MARKET

The October rally in the Treasury securities market extended into the first few days of November. The ebullience faded, however, as dealers emerged from the refunding[2] with inventories of coupon issues at a record-high level. In the face of declining prices, the auction by the Treasury on November 9 of \$2.75 billion of a fifteen-month note received a less enthusiastic response than had been expected at the time of its announcement. The average issuing yield was about 4.91 percent, with bids accepted for yields as high as 4.96 percent. The cut in the discount rate by seven Federal Reserve Banks, announced November 10, did little to buoy the market, inasmuch as the action had been widely anticipated. The comments the next day by Chairman Burns of the Board of Governors that the Federal Reserve System "intends to see that adequate bank reserves are provided to finance a vigorous, but sustainable, expansion" helped to lend some strength to the market, encouraging modest price increases in the following days. The advances were short-lived, and by the Thanksgiving holiday week prices were again moving downward. Large additions to the supply of Federal agency issues and Treasury bills weighed upon the market. The market was also affected by considerable uncertainty regarding some aspects of the Administration's Phase Two program to restrain inflation.

Treasury bill rates generally declined through midmonth. The issuing rates moved steadily lower in the first three regular weekly auctions held during November (see Table II). Orders from foreign central banks continued to provide support for bill prices. The Treasury announced, on November 18, that it would auction \$2.5 billion of tax anticipation bills (TABs) on November 24 to mature April 21, 1972. With the weekly auction of three- and six-month Treasury bills already scheduled for November 22 and the monthly auction of nine- and twelve-month bills scheduled for November 23, the addition of a further bill auction in a holiday-shortened week crowded the calendar.

This heavy load of offerings, combined with some feeling that international monetary negotiations might lead to reductions in foreign bill holdings, resulted in sharply higher yields during the week. Interest rates in the weekly bill auction jumped up by 11 basis points to 4.236 percent on the three-month bills and by almost 16 basis

[2] For details of the refunding, see this *Review* (November 1971), page 264.

points on the six-month bill. The next day, the one-year bills were auctioned at an average issuing rate of 4.563 percent, 7 basis points above the rate set in the October auction. The April TABs were sold at an average rate of 4.558 percent, about 8 basis points higher than the bid rate on outstanding Treasury bills maturing April 20, 1972. This spread occurred despite the granting of a 50 percent Treasury Tax and Loan Account credit on the new issues. The rate on these outstanding bills had advanced about 20 basis points during the statement week. Treasury bill rates fell in the final days of November but remained above the pre-Thanksgiving week levels. In the weekly bill auction on November 29, the average issuing rate on three-month bills advanced 9 basis points from the rate set the week before.

With the new offerings of marketable debt in November, the Treasury raised $2.35 billion of cash, net of repayments of maturing marketable issues, and issued a further $312 million of nonmarketable debt. During the first five months of the fiscal year that began on July 1, 1971, the Treasury raised $9.03 billion in net new cash through marketable issues and a further $5.89 billion through nonmarketable debt. This heavy use of nonmarketable debt contrasts sharply with the pattern of finance during the corresponding period last year, when $13.40 billion of cash was raised, $11.94 billion of it through marketable debt. Most of this fiscal year's increase in nonmarketable debt has consisted of special certificates of indebtedness sold to foreign central banks that have absorbed dollars in the foreign exchange markets. Savings bonds outstanding have also increased at a faster pace, advancing by a net $1.06 billion during the first five months of fiscal 1972 as compared with $408 million in the corresponding year-earlier period.

The volume of new issues by Federal credit agencies jumped in mid-November following three weeks in which there had been no offerings at all. Between November 16 and November 23 a total of almost $2.17 billion of issues by the Export-Import Bank, the Federal National Mortgage Association, the Banks for Cooperatives, and the Federal Intermediate Credit Banks reached the market. Of this, $1.43 billion was used to retire outstanding debt, while the remaining $742 million represented new cash. Net new cash raised so far in the second half of the year has been substantially above the average of the last few years, in contrast to the first half of 1971 when more debt was retired than was issued. Earlier this year, large savings inflows to savings and loan associations enabled the repayment of loans from the Federal Home Loan Banks. The FHLBs, in turn, retired a substantial portion of the debt that they had issued in early 1970. In October the FHLBs again became net borrowers. Other agencies have stepped up their net issues as well.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—November 1971				
	Nov. 1	Nov. 8	Nov. 15	Nov. 22	Nov. 29
Three-month	4.233	4.174	4.122	4.236	4.324
Six-month	4.346	4.340	4.255	4.411	4.431

Maturities	Monthly auction dates—September-November 1971		
	Sept. 22	Oct. 26	Nov. 23
Nine-month	5.242	4.495	4.581
One-year	5.279	4.490	4.563

* 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.

OTHER SECURITIES MARKETS

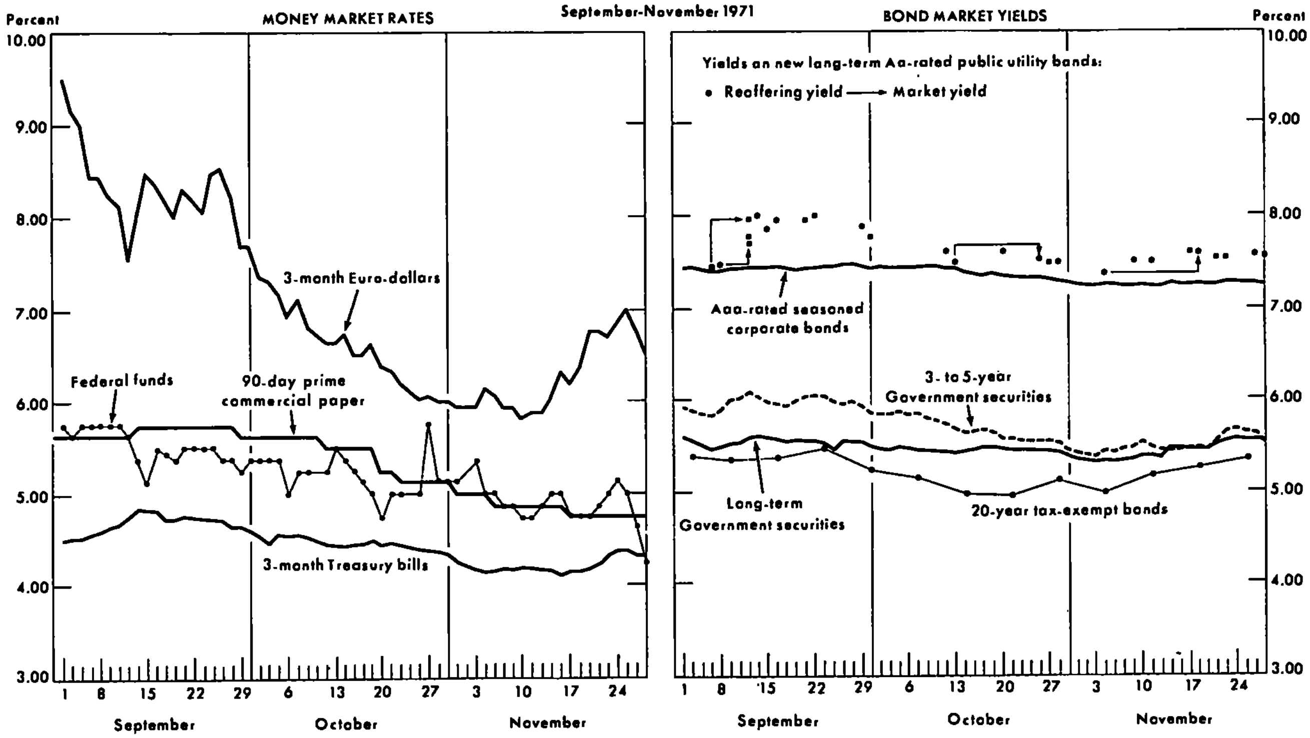
The corporate bond market rally that had begun in late September continued into the first week of November, enabling dealers to sell a part of their sizable inventories. However, the rally quickly faded in the next weeks. Soon, only securities offered at somewhat higher yields than had been experienced in the previous few weeks managed to sell quickly. Several factors appeared to have contributed to this reversal. Concern continued to be expressed as to the degree of success that could be expected from Phase Two of the President's new economic program as it went into effect in mid-November. The uneasiness, which had led to a falling stock market the month before, began spilling over into the bond market. Furthermore, investors became quite conscious of the large size of dealer inventories, and the calendar of new issues continued to be heavy until the Thanksgiving holiday week.

The early enthusiasm exhibited in the market led underwriters to price a utility bond rated Aa and marketed November 4 to yield 7⅜ percent, ⅛ percentage point below a similar late-October issue. In the face of the poor reception given to that and other aggressively priced issues, two Aa utilities marketed November 9 and 11 were priced to yield 7.50 percent, the same rate that had prevailed in late October. Both issues sold well. Even so,

Chart II

SELECTED INTEREST RATES

September-November 1971



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; offering rates (quoted in terms of rate of discount) on 90- to 119-day prime commercial paper quoted by three of the four dealers that report their rates, or the midpoint of the range quoted if no consensus is available; 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 Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new 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.

further weakening of the market led dealers to offer an even more generous 7.60 percent on another Aa utility bond offered November 17. This issue was well received, and underwriters reoffered two similar issues to yield 7.54 percent early in the following week. While one sold well, the larger of the two encountered some resistance. At the end of November, another Aa utility bond was offered to yield 7.55 percent and sold slowly. Similar price declines were exhibited by other bonds. A Bell Telephone subsidiary bond offering on November 15 sold slowly even though it yielded 7.45 percent, 10 basis points above the yield offered in late October on a bond sold by another Bell Telephone subsidiary.

The tax-exempt sector suffered from considerable congestion, as a heavy calendar of new issues further burdened already swollen dealer inventories. The Blue List of advertised inventories had reached the highest level of the year at the end of October, standing at $970 million. After a slight decline early in November, it climbed again to $1,126 million on November 18, an all-time high. The congestion was exacerbated by waning institutional demand. Commercial banks, which had been major buyers of tax-exempt securities in October, bought smaller quantities in November. *The Weekly Bond Buyer's* twenty-bond municipal index rose 25 basis points to 5.36 percent from late October to November 24 (see Chart II).