The Money and Bond Markets in November

The money market last month adjusted to revisions in Federal Reserve regulations governing member bank reserves and the collection of checks, which were implemented beginning November 9. In general, the revisions lowered reserve requirements through a restructuring of such requirements against demand deposits; they also speeded up the collection of checks, thereby reducing the Federal Reserve credit extended to member banks through float. Federal funds rates fluctuated rather widely from week to week, averaging about the same as in October. Other short-term interest rates were generally unchanged or showed modest increases. In the Treasury bill market, rates declined initially against the background of the relatively comfortable tone of the money market in recent weeks. Some hesitancy developed at the lower rate levels in the face of increases in the supply of bills, however, and bill rates edged higher over the latter part of the month.

In the capital markets, yields declined on balance despite some increases late in the month. A generally optimistic outlook for near-term stability of interest rates was encouraged by the prospects for a peace settlement in Vietnam as well as by indications that the Administration intends to impose strict restraints on Federal spending in the future. As the month wore on, investor demand contracted and some participants sought to realize profits in anticipation of substantial increases in the supplies of corporate and Federal agency securities. The resulting increases in yields, however, were generally modest relative to the declines earlier in November.

BANK RESERVES AND THE MONEY MARKET

Money market conditions and the monetary and reserve aggregates were influenced by the implementation of the changes in Federal Reserve Regulations D and J beginning November 9. These regulation changes, originally scheduled to go into effect on September 21 but delayed by court action, were described in this *Review* (July 1972, page 154). Briefly, the change in Regulation D makes bank size rather than bank location the primary determinant of reserve requirements.[1]

The amendments to Regulation J require all banks served by the Federal Reserve check-collection system to pay for checks in immediately available funds on the same day that the checks are presented to the banks. This change resulted in a decline in reserves that was smaller than the reduction in requirements arising from the change in Regulation D.

In the statement week in which the regulation changes were made, it was difficult for the Federal Reserve to estimate accurately the resulting impact on reserve positions. It was realized that, for the banking system as a whole, reserve positions would ease, but some banks could be adversely affected. Therefore, penalties for reserve deficiencies up to a fixed amount are temporarily being waived for certain banks during the transition period. These waivers amount to $450 million, and this figure has been added to reported excess reserves beginning with the week ended November 15 (see Table I).

During that week, reserve positions turned out to be easier than expected so that excess reserves (adjusted) increased, borrowings from the Federal Reserve fell off from the high level of the previous week, and the Federal funds rate declined, with funds trading as low as ½ percent on the settlement day.

Despite the swings in reserve positions in the statement week ended November 15, most money market rates moved little over the month. Even the average effective

[1] Under the new regulation, the following graduated scale of reserve requirements applies:

Amount of net demand deposits	*Reserve percentages applicable*
First $2 million or less	8 percent
Over $2 million to $10 million	10 percent
Over $10 million to $100 million	12 percent
Over $100 million to $400 million	13 percent
Over $400 million	17½ percent

To smooth the transition, reserve requirements on deposits between $100 million and $400 million were set at 16½ percent during the first week of the new system.

rate on Federal funds, at 5.06 percent, was little changed from the previous month's 5.04 percent rate. Rates on most maturities of dealer-placed commercial paper moved up ⅛ percentage point around midmonth (see Chart I). On the other hand, rates on bankers' acceptances declined ⅛ percentage point on November 3 and remained at the lower level. Three-month Euro-dollar deposit rates drifted downward until late in the month but returned to October levels by the month end. Secondary market rates on large certificates of deposit edged up in the middle of the month but fell off later. Most banks held their prime rate at 5¾ percent throughout the month.

The revision in Regulation J had the effect of increasing demand deposits adjusted, as used in calculating the money supply. However, the resulting increase has been eliminated from current money supply figures in order to avoid a discontinuity in the series. The upward adjustment of the money supply as a result of the revision of Regulation J will be incorporated in the statistics at the time of the annual bench-mark and seasonal adjustment review. At that time, historical figures will be revised to put the series on a consistent basis.

To explain how the demand deposits in the money supply were previously understated requires some examination of the check-clearing process. When one bank receives a check, drawn on a second bank, the first bank credits the account of its customer—a liability item—and also increases cash items in the process of collection (CIPC)—an asset item. Since the deposit is temporarily on the books of both banks, gross demand deposits overstate the true money stock. Therefore, CIPC are deducted from gross demand deposits in calculating the money supply. When the check is to be cleared through the Federal Reserve System, the first bank begins the process by sending the check to its district Reserve Bank, which will in turn send the check on to the second bank. If the actual transfer takes longer than is allowed for in a predetermined collection schedule, the Federal Reserve credits the first bank with reserves. While that bank reduces CIPC, Federal Reserve float increases. This float is also deducted in computing demand deposits in the money supply to avoid double counting. On the day the second bank does receive the check, it will normally write down the account of the customer who wrote the check. Before Regulation J was revised, however, the bank could often delay its payment for the check until the day after the check was presented. This would in turn delay the reduction in CIPC, if the clearing had taken place within the predetermined collection period, or float, if it had extended beyond that period. Inasmuch as the deposits were written down on the day before the CIPC or float that their transfer had generated, the money sup-

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, NOVEMBER 1972

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

Factors	Changes in daily averages— week ended					Net changes
	Nov. 1	Nov. 8	Nov. 15	Nov. 22	Nov. 29	
"Market" factors						
Member bank required reserves	— 94	— 71	+2,224	+ 994	— 39	+3,014
Operating transactions (subtotal)*	+ 198	—1,044	— 952	— 861	+ 269	—2,395
Federal Reserve float	— 234	— 539	—1,309	+ 354	+ 179	—1,549
Treasury operations†	— 103	— 138	+ 539	+ 3	+ 42	+ 343
Gold and foreign account	+ 87	— 3	— 2	— 9	— 14	+ 9
Currency outside banks	+ 550	— 270	— 412	—1,163	+ 112	—1,183
Other Federal Reserve liabilities and capital	— 57	— 94	+ 232	— 47	— 49	— 15
Total "market" factors	+ 99	—1,116	+1,272	+ 138	+ 230	+ 618
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 117	+ 600	— 599	— 307	— 219	— 408
Outright holdings:						
Treasury securities	+ 268	— 52	— 260	— 228	— 138	— 410
Bankers' acceptances	— 2	+ 1	— 4	— 5	— 2	— 12
Federal agency obligations	— 2	— 8	—	+ 24	+ 142	+ 156
Repurchase agreements:						
Treasury securities	— 146	+ 563	— 276	— 112	— 178	— 149
Bankers' acceptances	+ 1	+ 64	— 32	— 10	— 25	— 2
Federal agency obligations	— 2	+ 32	— 27	+ 24	— 18	+ 9
Member bank borrowings	— 210	+ 404	— 465	— 73	+ 151	— 193
Other Federal Reserve assets‡	+ 49	+ 30	+ 4	— 395	+ 50	— 262
Total	— 44	+1,034	—1,060	— 777	— 18	— 865
Excess reserves	+ 55	— 81	+ 662	— 644	+ 212	+ 204

Member bank:	Daily average levels					Monthly averages
Total reserves, including vault cash*	33,704	33,694	32,132	30,494	30,745	32,154§
Required reserves	33,499	33,570	31,346	30,352	30,391	31,832§
Excess reserves*	205	124	786	142	354	322§
Borrowings	555	959	494	421	572	600§
Free, or net borrowed (—), reserves	— 350	— 835	292	— 279	— 218	— 278§
Nonborrowed reserves	33,149	32,735	31,638	30,073	30,173	31,554§
Net carry-over, excess or deficit (—)#	75	127	56	302	58	124§

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

* Adjusted to include $450 million of certain reserve deficiencies on which penalties can be waived for a transition period in connection with bank adaptation to Regulation J as amended, beginning November 9, 1972.

† Includes changes in Treasury currency and cash.

‡ Includes assets denominated in foreign currencies.

§ Average for five weeks ended November 29.

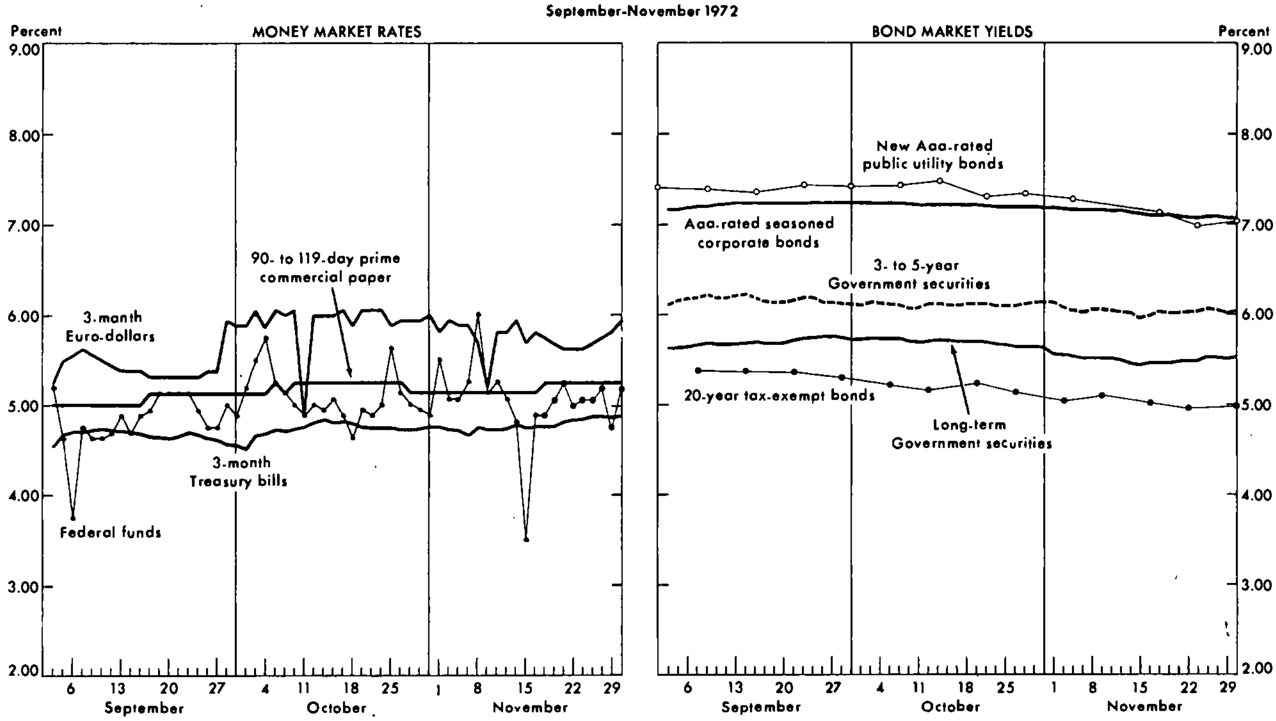
\# Not reflected in data above.

ply was being understated by the amount of the excess CIPC and float being deducted. Since the November 9 revision in the regulation requiring banks to pay on the same day as the check is presented to them for collection, the timing discrepancy and understatement in the money supply arising from this source can be eliminated.

Because of uncertainties stemming from the regulatory changes, the measurement of the monetary aggregates in November was more difficult than usual. On the whole, however, the monetary aggregates appear to have risen at relatively moderate rates in the month. M_1 grew at an estimated 6 percent seasonally adjusted annual rate in November and at a rate of about 5 percent in the three months ended in November (see Chart II). M_2 has grown at an annual rate of about 8 percent in the same three months. The adjusted bank credit proxy, on the other hand, has continued to expand at about the same generous pace over most of the year. In the latest three-month period, it advanced at an annual rate of about 10 percent.

Estimates of reserves available to support private nonbank deposits (RPD) have also been rendered more tenuous than usual because of the changes in regulations. Allowance must be made for Regulation D changes in order to calculate a meaningful growth rate. Accordingly, the reserves released by the reduction in requirements have been added to the actual levels of RPD to compute growth rates. With this adjustment, RPD advanced at an annual rate of about 13 percent in November and at a rate of about 10 percent in the three months ended in November.

Chart I
SELECTED INTEREST RATES
September-November 1972



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.

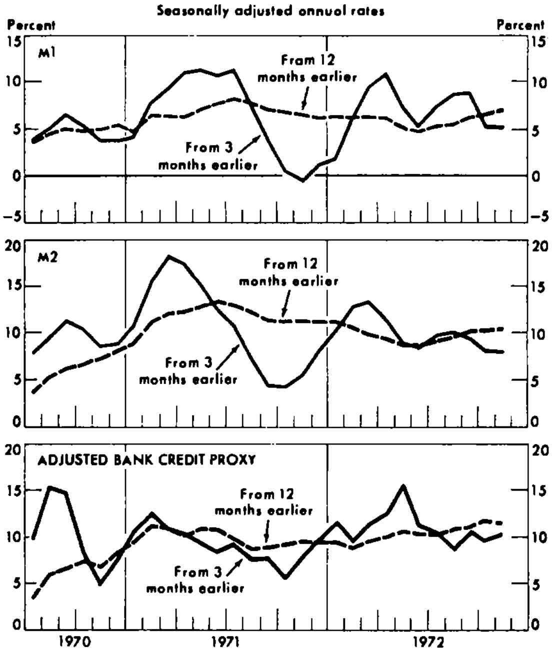
BOND MARKET YIELDS QUOTED: Yields on new Aaa-rated public utility bonds are based on prices asked by underwriting syndicates, adjusted to make them equivalent to a standard Aaa bond of at least twenty years' maturity; daily averages of yields on seasoned Aaa-rated corporate bonds; daily averages of yields 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, Inc., and The Bond Buyer.

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for November 1972 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.

Sources: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York.

THE GOVERNMENT SECURITIES MARKET

November witnessed a flattening of the yield curve for Treasury bills, perhaps reflecting a downward revision of interest rate expectations. After declining early in the period, the three-month bill rate edged upward, closing the month at 4.88 percent bid or 12 basis points higher than at the end of October. In contrast, the upward drift in the 52-week bill rate in late November did not offset the early declines, and the closing bid of 5.22 percent was 12 basis points lower than at the end of October.

In the weekly bill auctions, results were mixed. In the November 6 auction, the issuing rate on three-month Treasury bills declined about 10 basis points from the week before to 4.668 percent. In the next week, however, the issuing rate moved up again to about 4.78 percent and remained there in the succeeding week's auction (see Table II). A further 11 basis point increase in the average issuing rate of three-month bills at the November 27 auction raised rates to the highest level since August 1971.

The monthly auction of 52-week bills, held on November 22, resulted in an average issuing rate of 5.226 percent, 9 basis points below the previous month's auction. In accord with the Treasury's previously announced policy of phasing out nine-month bills, this monthly auction did not include that maturity.

On November 10, the Treasury announced that it would auction $2 billion of tax anticipation bills (TABs) on November 17 with payment on November 24, and a further $2.5 billion of TABs on November 29 with payment on December 5. Banks were allowed to make payment in full for their allotments of both issues by credit to Treasury Tax and Loan Accounts. The first $2 billion of TABs will mature April 20, 1973, while the TABs sold at the second auction are due June 22, 1973. Bidding was active in the former TAB auction, and the average issuing rate was set at 4.722 percent. By November 29, interest rates on outstanding bills had moved up but the second TAB auction still elicited strong interest, with the average issuing rate being set at 5.089 percent.

The market for Treasury coupon securities was buoyed at the beginning of the month by the active bidding for the $3 billion of additional 6¼ percent four-year notes auctioned November 1.[2] Prices increased on outstanding issues following the auction and, by the November 15 payment date, the 6¼ percent notes were trading at a premium. The Treasury announcement of the TAB auctions gave further stimulation to the coupon sector of the market by removing the threat of any further note issues in November. After midmonth, prices fell back a bit as profit taking set in. However, the major part of the early price increase was sustained, and intermediate-term and long-term Treasury securities yields ended the month about 10 basis points below late-October levels.

Several Federal agencies marketed large new issues in November. Most of these new securities sold very well. They benefited from the very aggressive pricing in the corporate sector during the month which made agency yields seem generous by comparison. The principal offering was on November 29, when the Federal National Mortgage Association sold three issues totaling $1 billion to raise $400 million of new cash and replace $600 million of securities

[2] For details of the November refunding announcement, see this *Review* (November 1972), page 285.

Table II

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates — November 1972			
	Nov. 6	Nov. 13	Nov. 20	Nov. 27
Three months	4.668	4.775	4.776	4.886
Six months	4.957	5.070	5.050	5.178

Maturities	Monthly auction dates — September-November 1972		
	Sept. 26	Oct. 24	Nov. 22
Nine months	5.346	5.223	†
Fifty-two weeks	5.529	5.318	5.226

* 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.

† Discontinued.

maturing December 11. The offerings included a 25-year bond priced to yield 7.10 percent, an eight-year note yielding 6.60 percent, and a four-year note yielding 6.25 percent. The issues were well received, and the debentures were selling at a premium before the day was over.

OTHER SECURITIES MARKETS

Prices rose sharply in the corporate and municipal bond markets beginning in early November. Many of the same forces that fueled the rally in the Government bond market were at work. In addition, expectations developed that strong corporate cash positions would reduce the amount of corporate borrowing in the capital markets in the months ahead. Late in the month, prices dropped off as potential buyers of corporate bonds resisted the aggressive pricing of some new issues.

Corporate bond prices benefited from a light calendar early in the month. A Bell Telephone System issue, rated Aaa by one rating service and AA by another, had been poorly received at a 7.40 percent yield when it was issued on October 24, but sold out quickly in the first three days of November and moved to a premium in the resale market. Prices of seasoned issues continued to advance during the week that included Election Day, as no major new corporate issues were marketed. Because of the dearth of new high-grade utilities and the sharp advances in other issues, underwriters were encouraged to place an aggressive price on a utility rated Aa and marketed November 14. These bonds were priced to yield 7.17 percent, the lowest yield on such an issue in ten months. The rate offered was 37 basis points below the most recent comparable issue that had been placed on the market almost a month earlier. Sales were relatively slow, as market participants hesitated to accept such greatly reduced rates.

Even more resistance greeted a $75 million offering by a Bell System subsidiary on November 20. The debentures, which carried an Aaa rating from both major services, were priced to yield 7.075 percent in 40 years. This yield represented the lowest return on a long-term Bell System issue since February 1971. Reflecting the slow sales of these securities, the parent company's huge $500 million issue on November 30 of notes and debentures was priced less aggressively. The $350 million of 31-year debentures was priced to yield 7.145 percent, while the eight-year notes were priced to yield 6.43 percent. The debentures were well received, while the notes got off to a fairly slow start.

A new series giving yields on new issues of Aaa-rated public utility bonds has been plotted in the second panel of Chart I. The series tracks the yield of a standard straight debt long-term utility bond rated Aaa by Moody's Investors Service, carrying five-year call protection and underwritten through competitive bidding. New issues that do not fit these characteristics are adjusted by a formula to derive equivalent yields.[3] This series shows the relatively sharp decline in new-issue yields until the final week of November.

In contrast to the corporate sector, the volume of tax-exempt issues was relatively large throughout the month. In addition, the Blue List of dealers' advertised inventories, already swollen when the month began, climbed to $1,088 million on November 9, the highest level of the year. Even so, prices on tax-exempt securities moved up, reflecting the declines in long-term interest rates generally as well as optimism that borrowing needs of municipalities will slacken somewhat in 1973. This view was stimulated by reports of increased state and local government tax receipts and the passage of the Federal revenue-sharing program. The Bond Buyer index of twenty municipal bonds declined to 4.96 percent in the Thanksgiving week, 17 basis points below its late-October level and the lowest it has been since February 1969. The index edged up to 4.99 percent by the end of November.

[3] For a discussion of the derivation of this new series, see the *Federal Reserve Bulletin* (September 1972), pages 783-84.