The Money and Bond Markets in December

Interest rates generally moved higher in December. The cumulating evidence of gathering momentum in the expansion of economic activity—which seemed to many to portend both greater demands for credit and, quite possibly, intensified upward pressure on prices—tended to prompt caution among participants in the credit markets. Of even more immediate concern was the belief that a shift to a somewhat less expansionary monetary policy might be under way, in view of the firming of conditions in the money market. Around midmonth, moreover, confidence was shaken by the frustration of hopes for an early end to hostilities in Vietnam. To be sure, there were some constructive developments, such as the Administration's announced intention to seek extension of wage and price controls and the reaffirmation of its determination to keep a tight lid on Federal Government spending. On balance, however, the forces tending to push yields higher prevailed during December.

In the money market, banks seeking to cover their growing reserve requirements bid up the Federal funds rate and turned increasingly to the Federal Reserve discount window. Since the major banks posted higher rates on loans to Government securities dealers, the dealers found it increasingly burdensome to carry their inventories, which were swollen by additions to the supply of Treasury bills in November and December. As market professionals attempted to limit their commitments, Treasury bill rates were pushed upward, and rates on competing instruments registered similar increases. Yields in the capital markets also rose during December. Investors resisted aggressively priced new corporate and municipal bond issues, and underwriters attempted to reduce their sizable inventories by releasing a number of recent issues from syndicate price restrictions and, at the same time, paring prices on older issues.

The United States Treasury raised a substantial amount of new cash in December. In addition to the continuing $200 million increase in each of the weekly bill auctions and the receipt of payment for the $2.5 billion of tax anticipation bills (TABs) auctioned in late November, the Treasury sold at auction a $2 billion issue of two-year notes in accordance with its program of issuing such securities maturing at quarterly intervals. Near the month end, the Treasury announced that it would auction in early January $625 million of twenty-year bonds, the longest maturity to be offered by the Treasury since 1965.

BANK RESERVES AND THE MONEY MARKET

Money market conditions grew increasingly firm during most of December. The effective rate on Federal funds climbed steadily to about 5⅜ percent in the last two weeks of the year. Over the month as a whole, the effective Federal funds rate averaged 5.31 percent, 25 basis points above the average for November and the highest level since September 1971. As the Federal funds rate rose, member banks borrowed increasing amounts from the Federal Reserve Banks (see Table I). Such borrowings averaged $934 million during the four weeks ended December 27, compared with $600 million in the five preceding weeks. This increase in borrowed reserves accounted for most of the growth of reserves available to support private nonbank deposits (RPD), which rose at an estimated seasonally adjusted annual rate of 15½ percent in December.

Conditions also firmed in the other short-term markets (see Chart I). Rates on dealer-placed prime commercial paper were raised ⅜ to ⅝ percentage point. Dealers in bankers' acceptances also increased their rates ¼ percentage point. In the secondary market, rates on large negotiable certificates of deposit (CDs) rose about 25 to 45 basis points during December. Late in the month, most major money center banks raised their prime lending rate to 6 percent from 5¾ percent.

The monetary aggregates increased sharply in December. Preliminary estimates indicate that the narrow money supply (M_1)—adjusted private demand deposits plus currency outside banks—rose at a seasonally adjusted annual rate of about 15½ percent in December. This followed four successive months of relatively moderate M_1 growth.

For the fourth quarter, M_1 grew at an annual rate of about 8½ percent, and the growth over 1972 as a whole was 8 percent (see Chart II).

Table I

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

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

Factors	Changes in daily averages—week ended				Net changes
	Dec. 6	Dec. 13	Dec. 20	Dec. 27	
"Market" factors					
Member bank required reserves	— 285	— 151	— 416	— 40	— 892
Operating transactions (subtotal)*	— 459	+ 250	— 661	+ 995	+ 125
Federal Reserve float	— 402	+ 513	+ 171	+1,534	+1,816
Treasury operations†	+ 82	— 252	— 31	— 289	— 490
Gold and foreign account	— 29	— 11	— 26	— 2	— 68
Currency outside banks	+ 46	— 140	— 839	— 185	—1,118
Other Federal Reserve liabilities and capital	— 156	+ 141	+ 64	— 63	— 14
Total "market" factors	— 744	+ 99	—1,077	+ 955	— 767
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 671	— 428	+ 507	— 790	— 40
Outright holdings:					
Treasury securities	+ 143	— 235	+ 475	— 495	— 112
Bankers' acceptances	+ 4	— 1	+ 3	+ 4	+ 10
Federal agency obligations	—	— 6	— 8	+ 127	+ 113
Repurchase agreements:					
Treasury securities	+ 499	— 195	+ 28	— 364	— 32
Bankers' acceptances	+ 20	— 2	+ 15	— 41	— 8
Federal agency obligations	+ 5	+ 11	— 6	— 21	— 11
Member bank borrowings	+ 17	+ 216	+ 418	— 103	+ 548
Other Federal Reserve assets‡	+ 52	+ 21	+ 61	+ 42	+ 176
Total	+ 740	— 191	+ 986	— 851	+ 684
Excess reserves	— 4	— 92	— 91	+ 104	— 83
	Daily average levels				**Monthly averages**
Member bank:					
Total reserves, including vault cash*	31,009	31,068	31,393	31,537	31,252§
Required reserves	30,673	30,824	31,240	31,280	31,004§
Excess reserves*	336	244	153	257	247§
Borrowings	589	805	1,223	1,120	934§
Free, or net borrowed (—), reserves	— 253	— 561	—1,070	— 863	— 687§
Nonborrowed reserves	30,420	30,263	30,170	30,417	30,318§
Net carry-over, excess or deficit (—)‡	156	145	128	124	138§

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 four weeks ended December 27.

‡ Not reflected in data above.

Time deposits other than large negotiable CDs at commercial banks grew at an annual rate of about 12½ percent in December, which was slightly above its rate of advance over the final quarter of the year but slightly below the 13 percent increase in these deposits during all of 1972. The combined effect of the growth of these time deposits and M_1 resulted in expansion of the broad money supply (M_2) at an annual rate of about 14 percent in December. In the fourth quarter, M_2 rose at about a 10 percent rate, and over the calendar year the growth rate was 10½ percent.

The adjusted bank credit proxy—which consists of daily average member bank deposits subject to reserve requirements and certain nondeposit liabilities—also grew rapidly in December. The December rate of advance in the proxy was about 14 percent, compared with about 11½ percent during the fourth quarter and over all of 1972.

THE GOVERNMENT SECURITIES MARKET

Climbing money market interest rates and resultant increases in costs of financing dealers' inventories in the face of increased supplies of Treasury bills drove bill rates higher. Projections of rapid economic expansion contributed to expectations of greater demands for credit and continued inflation, which depressed bond market prices. At midmonth, a breakdown in Vietnam peace negotiations and renewed bombing of North Vietnam led to additional downward pressure on prices.

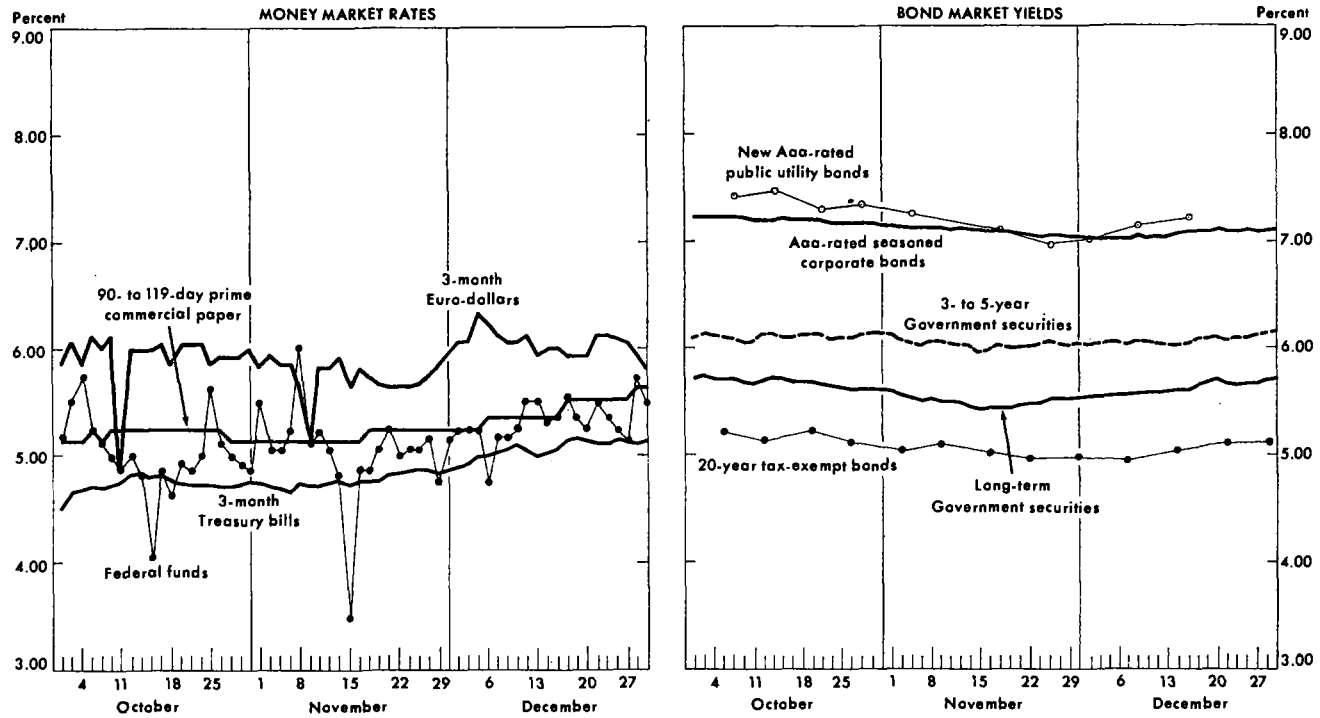
Bidding at the weekly Treasury bill auctions and rate movements in the secondary markets displayed a general movement toward higher yields for short-term Treasury issues. The average issuing rate for three-month bills rose 27 basis points from the 4.89 percent of the last auction in November to 5.16 percent at the December 29 auction (see Table II). That was the highest new-issue rate on the three-month Treasury bills since the auction of August 9, 1971, just prior to the inauguration of the new economic program. In the secondary market, Treasury bill rates generally rose 3 to 35 basis points during December.

The increased supply of bills stemmed from a variety of sources. Beginning on October 30, 1972, the Treasury increased the weekly bill auction by $200 million. Dealer inventories also reflected the $2 billion and $2.5 billion issues of TABs that had been marketed for payment on November 24 and December 5, respectively. In addition, some foreign central bank holdings of Treasury bills were reduced after mid-November, partly reflecting some switching from bills to coupon-bearing issues. Moreover, total marketable Government securities held in custody

Chart I

SELECTED INTEREST RATES

October-December 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 five 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.

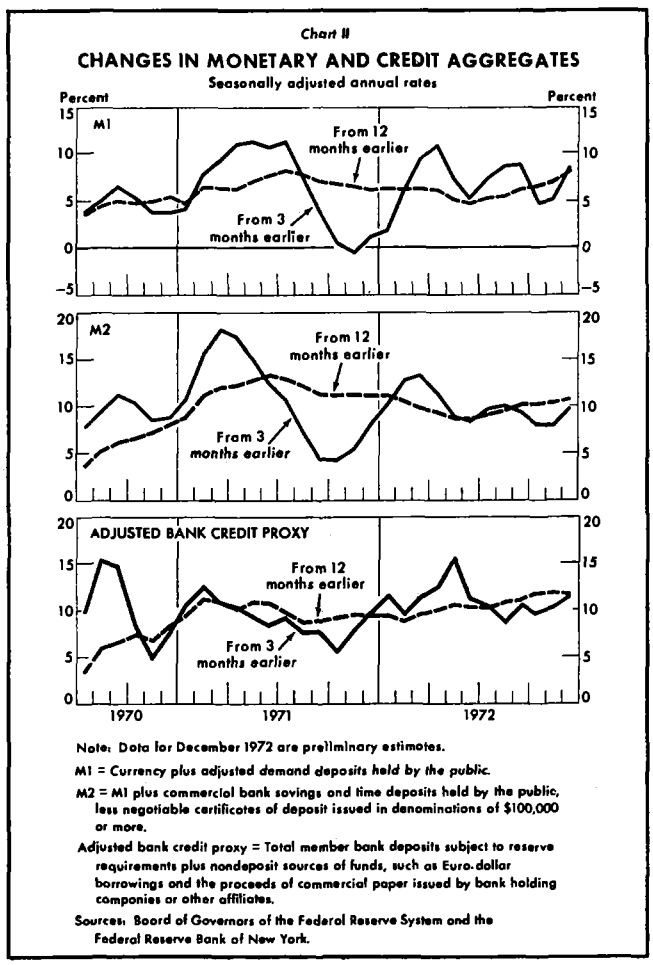
by the Federal Reserve Banks for foreign and international accounts fell $1.2 billion from November 22 to $30.8 billion on January 3, 1973.

In part, the higher bill rates also reflected lower than expected investor demand for bills. Dealers had expected state and local governments to invest temporarily the proceeds of their first revenue-sharing instalment. The first checks of the $2.7 billion amount were mailed December 8, and these governments were expected to purchase Treasury bills directly or deposit the checks in commercial banks which must in large part collateralize them with United States Government securities. However, this demand did not materialize in the projected proportions. Consequently, faced with sizable inventories at the beginning of the month and increasing costs of bank financing for them, dealers offered higher yields on these obligations.

Prices of Treasury coupon issues generally drifted lower over the month, with the larger declines occurring on the longer term obligations. On December 14, the Treasury announced the sale at auction of $2 billion of 5⅞ percent notes maturing December 31, 1974. This sale was part of the program announced by the Treasury last October for issuing two-year notes maturing at quarterly intervals. The auction was held on December 20, 1972 for payment on December 28, and commercial banks were allowed to

pay for their awards by credit to Treasury Tax and Loan Accounts. Banks bid aggressively for the issue since the late-December payment date allowed expanded Government securities holdings and deposits for year-end statement purposes. The average price of the issue was 100.09, which is equivalent to a 5.83 percent yield. Of the total, $300 million was accepted at the average price on a noncompetitive basis. The high price was 100.29 or 5.72 percent, and the low price was 100.05 or 5.85 percent.

The Treasury announced on December 15 its intention to issue between $500 million and $750 million of twenty- to thirty-year bonds in early January. The purpose of the issue is to lengthen the maturity structure of Treasury debt. The Congress has authorized the issuance of up to $10 billion of long-term bonds outside the 4¼ percent statutory interest ceiling on bonds. The Treasury had previously sold $7.1 billion of bonds under this provision.



The details of the latest offering were revealed on December 27. It was announced that the Treasury would auction $625 million of 6¾ percent twenty-year bonds on January 4, 1973. These bonds, which are the longest maturity to be offered by the Treasury since 1965, are dated January 10, 1973 and will mature February 15, 1993. While auctions have been used successfully for many years in marketing Treasury bills and more recently in marketing medium-term coupon issues with maturities up to nine years and nine months, this sale extended the use of the auction method to the marketing of longer term bonds. The procedure under which awards were made in this auction differed from that used in auctions of shorter term securities, however. The difference was that all accepted tenders were awarded at a single price—that of the lowest one accepted—rather than at their respective bid prices. This was intended to reduce risks to bidders and thereby to encourage more confident bidding in view of the market's unfamiliarity with auctions of long-term Treasury securities. The Treasury received $1,668 million of competitive tenders and accepted the $546 million which specified prices at 99.50 and higher for an interest rate of about 6.79 percent. About $72 million of noncompetitive tenders was received and accepted.

In the Federal agency market, the General Services Administration offered, on December 13, $200 million of participation certificates due in thirty years. The initial investor response to a reoffering price providing a yield of 7.15 percent was moderate. The certificates were subsequently freed from syndicate price restrictions, and their yield rose about 15 basis points. The farm credit agencies raised $71 million of new money on December 14 through the sale of $347 million of new six-month bonds by the Banks for Cooperatives at a 5.60 percent rate and the sale of $591 million of new nine-month bonds by the Federal Intermediate Credit Banks at a 5.70 percent rate.

OTHER SECURITIES MARKETS

Prices of corporate and municipal securities fell during December. The corporate and municipal calendars of new issues were concentrated in the beginning of the month because many investors typically close their books about midmonth for year-end accounting purposes. A thin market and a sizable overhang of securities in dealer inventories followed in the second half of the month. Unfavorable Vietnam war news affected buyers, and dealers reduced prices on their inventories of older issues. In the first week of the month, six corporate issues were released from syndicate price restrictions, but most of them incurred only modest reductions in price. American Tele-

phone and Telegraph's $500 million of debentures and notes was priced somewhat ahead of the market and, as the month opened, investors initially resisted prices at this level but later purchased virtually the entire issue at syndicate prices. The 31-year debentures were priced to yield 7.145 percent, and the seven-year notes were priced to return 6.433 percent.

Duke Power Company held a competitive sale of $75 million of thirty-year bonds on December 5. These bonds had recently been downgraded from AA to A by Standard and Poor's. They were reoffered to yield 7.33 percent and moved slowly. After six corporate issues were freed from syndicate restriction, investors largely ignored the Duke Power offering. Finally, underwriters had to mark prices down significantly as the corporate market steadily eroded. At the lower levels, investor reception was strong for $150 million of A-rated first mortgage bonds offered by Georgia Power Company and priced to yield 7.50 percent in thirty years.

Underwriters encountered investor resistance in placing two $100 million issues of eight-year bank holding company notes. The first was offered on December 12 at a yield of 6.70 percent, and the second followed a week later at a yield of 6.80 percent. Investors found both issues too richly priced. When syndicate price restrictions were lifted, prices fell and yields rose about 10 to 20 basis points.

Early in the month, the tax-exempt market witnessed on top of an already bulky backlog of state and city bonds a $294 million offering by New York City which was well received. The interest cost to the City of 4.98 percent was the lowest in four and one-half years. By the end of the day only $40 million remained unsold. Another key issue was the sale of $268.2 million of tax-free housing bonds by the Department of Housing and Urban Development. The prime-grade bonds resulted in a net interest cost of 4.88 percent, and good market demand developed.

In the second week, Los Angeles Department of Water and Power brought a $116.2 million revenue issue to market. Although it was priced in line with the market, investors responded weakly, and prices were cut substantially after the securities failed to move. The Blue List of advertised inventories of municipal bonds soared in the first two weeks to a 1972 high of nearly $1.2 billion. Over the remainder of the month, dealers were able to pare these inventories to $934 million by cutting prices. The Bond Buyer index of twenty municipal bond yields rose by 12 basis points over the month to close at 5.11 percent.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates — December 1972				
	Dec. 4	Dec. 11	Dec. 15	Dec. 22	Dec. 29
Three months	4.945	5.099	5.087	5.111	5.163
Six months	5.230	5.309	5.297	5.313	5.396
	Monthly auction dates — October-December 1972				
	Oct. 24		Nov. 22		Dec. 26
Nine months	5.223		†		†
Fifty-two weeks	5.318		5.226		5.337

*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.