The Money and Bond Markets in January

A further reduction in short-term credit demands by businesses and an increased availability of nonborrowed reserves resulted in sharp declines in short-term interest rates during January. Recent actions by the Board of Governors of the Federal Reserve System also fostered rate declines. In early January, the Board approved a reduction in the discount rate from 7¾ percent to 7¼ percent at six Federal Reserve Banks and the others followed suit as the month progressed. Effective February 5 the discount rate was again reduced at nine banks, including New York, to 6¾ percent. In addition, the Board announced a lowering of reserve requirements against net demand deposits on January 20. This action will provide over $1 billion of reserves to the banking system. (Details of the change are discussed on page 33.) The Board noted that the change should facilitate moderate growth in the monetary aggregates.

Treasury bill rates moved down sharply in concert with other money market rates. Yields in the intermediate-term Government sector, however, fell only slightly over the course of the month as market participants showed concern about the potential for sizable Treasury cash borrowing in the months ahead and prepared for the quarterly refunding operation. Yields on long-term Government bonds were initially under some upward pressure but turned down later in the month and ended generally lower.

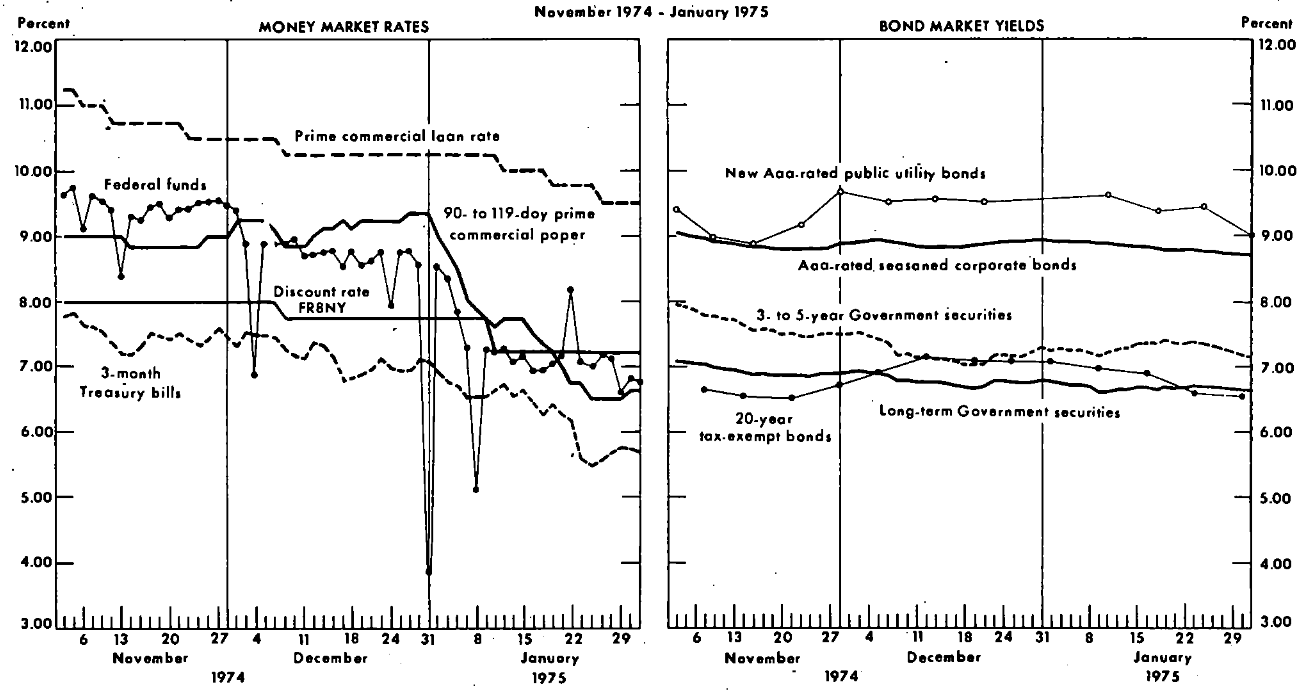
Business continued its drive to bolster liquidity, and borrowing demands in the corporate bond market were consequently very heavy. Still, the decline in short-term rates prompted investors to lengthen maturities in their portfolios, and demand for new issues proved strong enough to raise prices in this sector over the course of the month. Interest in tax-exempt securities remained sluggish, but the financing calendar was light and some price gains occurred in this sector as well.

Preliminary data indicate that the narrowly defined money stock (M_1) contracted substantially during the first several weeks of January following a rather small increase in the previous month. Declines in market rates of interest fostered strong inflows of consumer time and savings deposits to commercial banks, however, so that the more broadly defined money stock (M_2) and the adjusted bank credit proxy did rise in January though apparently at rather slow rates reflecting the weak growth in demand deposits.

THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

Money market rates moved downward sharply in January (see Chart I), as banks found nonborrowed reserves in more ample supply and loan demand slackened. Dur-

Chart I
SELECTED INTEREST RATES
November 1974 - January 1975



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Prime commercial loan rate at most major banks; 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-rated 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.

ing January the effective rate on Federal funds averaged 7.13 percent, 140 basis points below its average over the preceding month and at its lowest level since April 1973. Most banks reduced their prime rates by ½ point to ¾ point during the month, and the range in the industry at the close was 9 to 9½ percent. This rate remained well above rates on other sources of funds to businesses, so that commercial and industrial loans at the weekly reporting New York City banks displayed a somewhat larger than seasonal decline of about $2 billion over the four-week period ended January 29. Banks withdrew from active bidding to issue certificates of deposit (CDs) and even sustained some runoff during January. The rate on three-month CDs in the secondary market fell over the course of the month by more than 2½ percentage points to 6.78 percent. The volume of CDs outstanding at New York City weekly reporting banks dropped by $1,130 million over the four weeks ended January 29. Member banks reduced their borrowings from the Federal Reserve Banks over the five weeks ended January 29 by $519 million (see Table I).

The easing in money market conditions was also reflected by a fall in the rates on commercial paper, with the rate on 90- to 119-day dealer paper declining by 2¾ percent to a level of 6⅝ percent by the end of the month. The wide spread between the prime rate and the commercial paper rates induced businesses to shift some of their borrowing toward the commercial paper market, and the volume of nonfinancial commercial paper rose over the five weeks ended January 29 by \$2.1 billion.

According to preliminary estimates M_1—which includes private demand deposits adjusted plus currency outside banks—declined at an annual rate of 9.6 percent in the four-week period ended January 29 over the average of the four weeks ended January 1. The unusually large decrease was entirely attributable to a fall in demand deposits, whereas currency continued to increase. But short-term movements in money stock growth are often quite volatile and may not reflect underlying trends. In January 1974 the money stock also declined but then went on to rise significantly the following month. As market interest rates fell this January, time deposits other than large CDs grew rapidly over the same period. This offset the demand deposit decline, and M_2—which consists of M_1 plus these other time deposits—expanded at a 3 percent annual rate. The adjusted bank credit proxy—which includes demand deposits of member banks subject to reserve requirements plus certain nondeposit liabilities—increased by 3.4 percent over the same period, slow by previous standards. The growth rates from a longer perspective are shown in Chart II.

The reduction in reserve requirements announced by the Board of Governors on January 20 incorporated the following changes. Reserve requirements for the first \$400 million of net demand deposits held by a member bank were reduced by ½ percentage point and for demand deposits in excess of \$400 million by 1 percentage point. Specifically, the requirements were reduced to 7.5 percent on the first \$2 million of demand deposits, to 10 percent on deposits above \$2 million but below \$10 million, to 12 percent on deposits above \$10 million but below \$100 million, to 13 percent on deposits above \$100 million but below \$400 million, and to 16.5 percent on deposits above \$400 million. Reserve requirements on time and savings deposits were unaffected by the change.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1975

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

Factors	Changes in daily averages—week ended					Net changes
	Jan. 1	Jan. 8	Jan. 15	Jan. 22	Jan. 29	
"Market" factors						
Member bank required reserves	— 584	— 156	—1,091	+ 183	+ 901	— 747
Operating transactions (subtotal)	+ 977	+1,761	+1,454	— 685	— 880	+2,627
Federal Reserve float	+1,062	+ 108	— 824	— 501	— 144	— 299
Treasury operations*	— 119	+ 762	+ 517	— 262	—1,380	— 482
Gold and foreign account	+ 12	+ 9	— 122	+ 167	— 10	+ 56
Currency outside banks	+ 94	+ 704	+1,919	+ 11	+ 652	+3,380
Other Federal Reserve liabilities and capital	— 72	+ 178	— 36	— 100	+ 2	— 28
Total "market" factors	+ 393	+1,605	+ 363	— 502	+ 21	+1,880
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	— 102	—1,918	— 864	+ 665	+ 315	—1,905
Outright holdings:						
Treasury securities	— 15	— 145	— 206	— 190	+ 257	— 299
Bankers' acceptances	+ 50	+ 21	+ 18	+ 24	+ 32	+ 145
Federal agency obligations	—	— 14	—	—	—	— 14
Repurchase agreements:						
Treasury securities	— 396	— 862	— 380	+ 673	+ 28	— 937
Bankers' acceptances	+ 187	— 353	— 85	+ 56	+ 47	— 148
Federal agency obligations	+ 72	— 565	— 211	+ 102	— 49	— 651
Member bank borrowings	— 101	— 249	+ 296	— 14	— 451	— 519
Seasonal borrowings†	— 7	— 3	— 6	— 1	— 2	— 19
Other Federal Reserve assets‡	+ 63	+ 86	+ 18	+ 134	+ 48	+ 349
Total	— 140	—2,081	— 550	+ 785	— 91	—2,077
Excess reserves‡	+ 253	— 476	— 187	+ [illegible]33	— 70	— 197
	Daily average levels					Monthly averages§
Member bank:						
Total reserves, including vault cash‡	37,661	37,341	38,245	38,345	37,374	37,793
Required reserves	37,011	37,167	38,258	38,075	37,174	37,537
Excess reserves	650	174	— 13	270	200	256
Total borrowings	561	312	608	594	143	444
Seasonal borrowings†	22	19	13	12	10	15
Nonborrowed reserves	37,100	37,029	37,637	37,751	37,231	37,350
Net carry-over, excess or deficit (—)‖	243	204	150	— 15	88	134

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Included in total member bank borrowings.
‡ Includes assets denominated in foreign currencies.
§ Average for five weeks ended January 29, 1975.
‖ Not reflected in data above.

THE GOVERNMENT SECURITIES MARKET

Treasury bill rates declined substantially while yields on coupon securities moved only slightly lower during January. Expectations that fiscal policy would become more stimulative to counteract the current economic slowdown made market participants increasingly aware of the possibilities that Treasury financing needs could become quite large in the months ahead. In addition, the approach of the quarterly refunding operation prompted dealers to lighten their inventories. As a result, prices of intermediate maturity issues moved downward over most of the month but rose toward the close.

In the market for Treasury bills, demand generally favored shorter maturities and, over the month as a whole, Treasury bill rates in the secondary market fell by 84 to 149 basis points. Rates set at Treasury bill auctions moved successively lower over the four weeks of January (see Table II). At the final auction of the month, on January 27, the average issuing rate set on three-month bills was 5.61 percent while the average rate on six-month bills was set at 5.83 percent, for respective declines of 151 and 128 basis points from the final auction in December. At the regular monthly auction of 52-week bills, the average issuing rate was set at 6.38 percent, down from 6.63 percent set at the previous month's sale. On January 2, the Treasury held an auction of $750 million in additional 8 percent notes due in March 1976 on which an average yield was set at 7.24 percent.

In mid-January, proposals for a tax rebate to stimulate the economy caused estimates of the Treasury's cash needs to be revised upward. The Treasury announced plans for raising an additional $19 billion by June 30 to cover the currently estimated deficit. According to these plans, part of this amount will be raised after January by increasing the regular weekly bill offerings, by offering $100 million more at the next 52-week-bill auction, and by offering in February two note issues totaling $3 billion. Finally, the Treasury said that it might sell two-year notes each month, rather than just at the end of each quarter. These statements were viewed by the market as indicating that intermediate-term issues would be in greater supply. Yields on intermediate Government maturities rose in the wake of these announcements but, after further drops in short-term rates, strong interest in these issues emerged.

The first stage of these plans involved holding three auctions in late January to refinance $3.6 billion in issues maturing on February 15 and to raise $1.95 billion in new cash. All issues were available in minimum denominations of $1,000. Specifically, $3 billion of 3¼-year notes was auctioned on January 28 at an average yield of 7.21 percent, $1.75 billion of six-year notes was auctioned on January 29 at an average yield of 7.49 percent, and finally on January 30 $750 million in 25-year bonds was auctioned at an average yield of 7.95 percent. For the month as a whole, the yields on intermediate-term coupon issues declined 3 to 21 basis points, while long-term bond yields dropped 7 to 25 basis points.

The market for agency securities turned in a relatively strong performance in January. Investor sentiment reflected the prospects that lower market rates would continue to improve the position of thrift institutions and therefore reduce borrowing by the housing-related agencies. In the first week of the month, the Federal Land Banks raised $593.4 million in new cash by selling $713.4 million in bonds due April 1978 at a yield of 7.6 percent and $400 million in seven-year bonds at a yield of 7.8 percent. At midmonth the Banks for Cooperatives (COOP) and the Federal Intermediate Credit Banks (FICBs) offered $1,228 million in a coordinated sale. Both the $474 million in the six-month COOP bonds, which were used to help retire $580.5 million in maturing obligations, and the $754 million in the nine-month FICB bonds, which raised $65 million in new money, were sold at a yield of 7.05 percent. In December a similar FICB sale was made at a 7.35 percent yield.

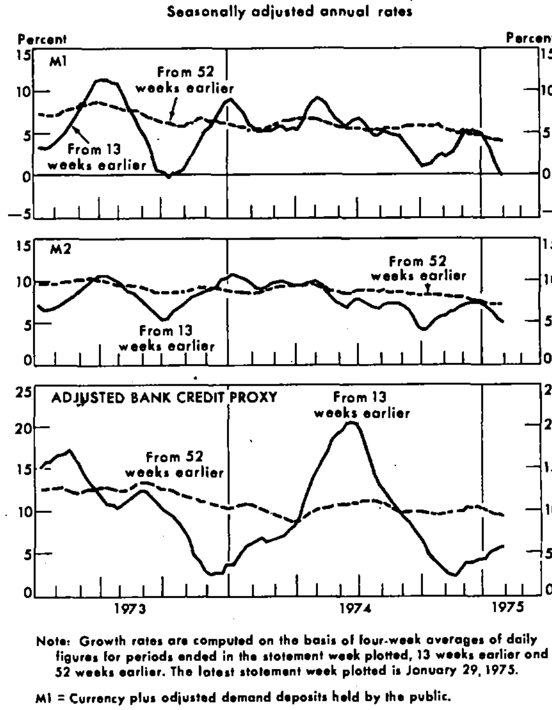
THE OTHER SECURITIES MARKETS

Yields moved down in the corporate sector despite a near record calendar of offerings. Some investor hesitancy was shown toward the middle of the month, as concern

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Growth rates are computed on the basis of four-week averages of daily figures for periods ended in the statement week plotted, 13 weeks earlier and 52 weeks earlier. The latest statement week plotted is January 29, 1975.

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.

over the size of the Federal deficit developed. In view of the heavy supplies reaching the market, new offerings were priced to yield a bit more than usual, relative to issues in the secondary market, in order to spur quick distribution. Improvements in the long-term municipal market lagged those in other sectors, though yields on short-term tax-exempt securities fell substantially as traditional buyers began to show some interest.

Early in the month, an Aaa-rated Bell Telephone subsidiary experienced a sellout of its negotiated sale of $150 million of forty-year debentures priced to yield 9.3 percent and $100 million of seven-year notes yielding 8.2 percent. These yields were in marked contrast to the last sale of a similarly rated Bell subsidiary in October when forty-year debentures carried a yield of 10.03 percent. Investors continued in January to display a preference for quality industrial offerings over similarly rated utility obligations. At midmonth, an Aa-rated industrial concern sold $300 million of thirty-year debentures at a yield of 8.5 percent, while at the same time a similarly rated utility offered a yield of 9 percent on its $60 million in mortgage bonds of the same maturity. Both issues were well received. A somewhat tighter market situation existed at midmonth, especially for lower rated debt. For example, an A-rated industrial found it necessary to provide a yield of 8.83 percent on a midmonth offering of $100 million of ten-year notes; this represented a concession to the market in that a similar offering made early in the month carried a yield of 8.45 percent. Prices rebounded later in the month when all sectors did better. On January 28, the American Telephone & Telegraph Company sold $600 million divided evenly between seven-year notes priced to yield 7¾ percent and debentures due in 2007 with a yield of 8⅝ percent. Both issues, which were rated Aaa, had been offered to the public in November but were withdrawn at that time. The yield on the shorter maturity was 42 basis points lower than on the original financing, and the other was down by only 4.5 basis points.

A lightened supply of new tax-exempt issues plus the impressive performance in the corporate sector contributed to some improvement in selling conditions in the tax-exempt market as the month progressed. The state of Minnesota in an early-January offering was accorded a sellout of its $33.8 million of Aaa-rated bonds maturing in 1976 to 1994 and yielding 4.2 percent to 6.5 percent, respectively. These rates were below the 4.7 percent to 7.25 percent yields that a similarly rated locality posted in December on maturities from 1976 to 1990. On January 31, The Bond Buyer index of twenty municipal bond yields stood at 6.54 percent, 54 basis points below its level at the end of December. The Blue List of dealers' advertised inventories declined over the month by $159 million to a level of $561 million on January 31.

Short-term financing by municipalities was large, but the rates in this area fell with those on other money market instruments. New York City offered a large volume of one-year revenue-anticipation notes on January 7. The $620 million offering provided investors with a return of 9 percent but was yielding only 7½ percent at the end of the month.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—January 1975			
	Jan. 6	Jan. 13	Jan. 20	Jan. 27
Three-month	6.698	6.678	6.369	5.606
Six-month	6.682	6.646	6.373	5.825
	Monthly auction dates—November 1974-January 1975			
	Nov. 13	Dec. 11	Jan. 8	
Fifty-two weeks	7.362	6.625	6.878	

* 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.