The Money and Bond Markets in November

Interest rates in the money and bond markets stabilized in November after dropping sharply in the previous month. Although slightly easier conditions prevailed in the Federal funds market, reports of very large weekly increases in the money stock produced doubts that the monetary authorities would promote further declines in interest rates in the near term. As a result, rate declines early in the month were generally offset by subsequent increases.

Substantial new corporate borrowing weighed heavily on the bond market in November, as the calendar of new issues for December increased. The Treasury continued to borrow through large increases in the regular bill auctions but not through coupon issues during the month. Government agency financing activity was also heavy.

Yields on high-grade tax-exempt securities declined modestly in November, but lower rated issues continued to encounter market resistance. Throughout the period, uncertainty revolved around the prospect of finding a means of avoiding a New York City default. Optimism was revived in midmonth when a three-year moratorium on the payment of certain New York City notes, with the option of exchanging them into long-term Municipal Assistance Corporation (MAC) bonds, was passed by the New York State legislature and enacted into law. The moratorium, however, is being challenged in the courts. By the end of November, the legislature had passed a broad plan designed to help avert a default by New York City, which included the raising of certain taxes. Subsequently, President Ford indicated that he would propose Federal legislation to provide the city with up to $2.3 billion in short-term loans.

According to preliminary data, the narrowly defined money stock (M_1) rebounded strongly in November from its decline in October. With consumer-type time deposits continuing to advance, the more broadly defined money stock (M_2) expanded rapidly as well. The bank credit proxy also experienced relatively strong growth in comparison with previous months.

THE MONEY MARKET AND THE MONETARY AGGREGATES

Interest rates on most money market instruments fluctuated narrowly in November, after having fallen in the previous month (see Chart I). The effective rate on Federal funds averaged 5.22 percent during the month, down 60 basis points from October. With the rate of Federal funds averaging over ¾ percentage point below the discount rate, member banks continued to make little use of the discount window (see Table I). Rates on 90- to 119-day dealer-placed commercial paper closed the period at 5.75 percent, down ⅛ percentage point from the end of October, and rates on ninety-day bankers' acceptances fell 5 basis points to 5.75 percent. At the month end, large negotiable certificates of deposit (CDs) maturing in ninety days were trading in the secondary market at 6.30 percent, a decline of 10 basis points over the period.

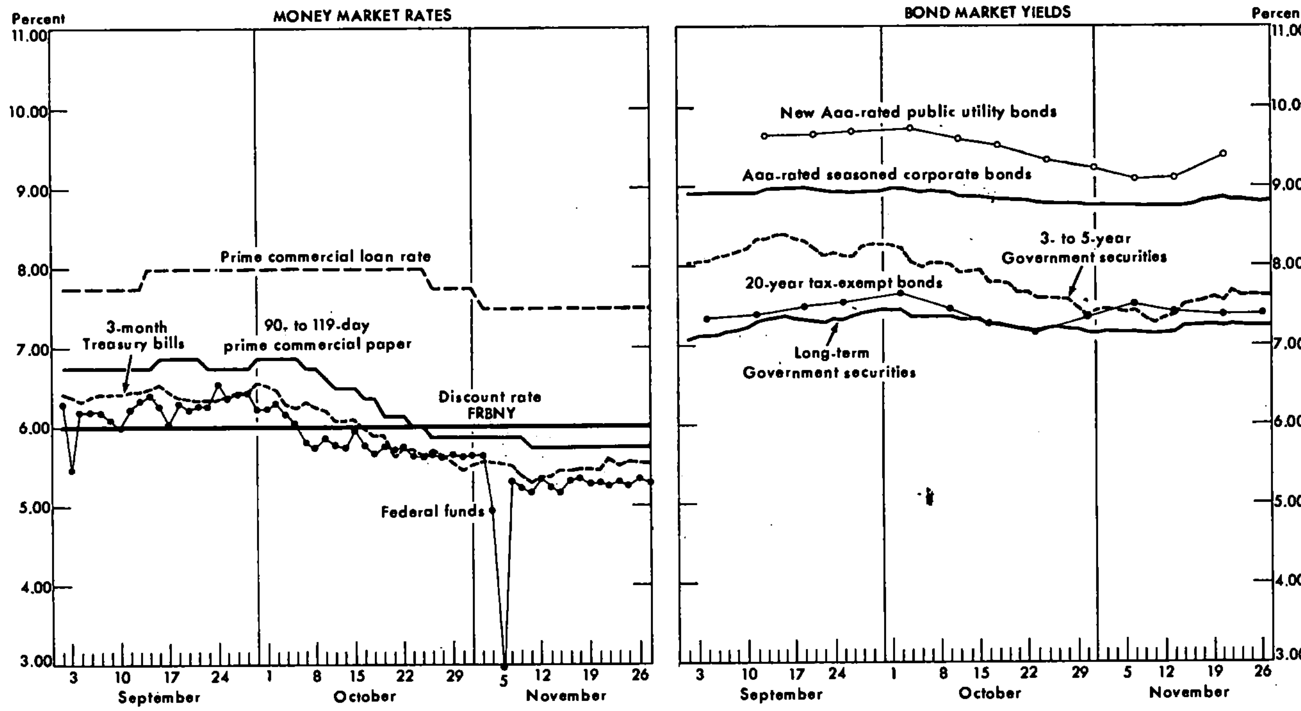
Business demand for bank loans remained weak in November. Over the first four statement weeks of the month, business loans at large commercial banks rose by $642 million; however, a portion of this reflects a rise in holdings of bankers' acceptances. Business loans excluding bankers' acceptances declined by $519 million. Over comparable periods in the preceding three years, these loans showed an average increase of $877 million. One large bank lowered its prime lending rate ½ percentage point in two steps to 7 percent. A few other money center banks reduced their prime rates ¼ percentage point to 7¼ percent, and at the beginning of December this became the prevailing rate at most money center banks.

Preliminary data indicate that, after experiencing sluggish growth over the previous four months, the monetary aggregates grew at rapid rates in November. During the four-week period ended November 26, seasonally adjusted M_1—private demand deposits adjusted plus currency outside commercial banks—advanced at a 13.7 percent annual rate from its average level during the preceding four statement weeks. This rapid expansion raised the growth

Chart I

SELECTED INTEREST RATES

September-November 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.

rate of M_1 over the past thirteen weeks to 3.3 percent (see Chart II). Consumer-type time and savings deposits at commercial banks in November expanded at a relatively strong rate. Consequently, M_2—M_1 plus time deposits other than large negotiable CDs—also registered a sizable gain. During the first four statement weeks of the month, these deposits advanced at a 12.8 percent annual rate from their average during the four statement weeks ended October 29. Over this same period, M_2 increased at a 13.2 percent annual rate. After rising at a rapid rate in the preceding month, the average level of CDs declined slightly in November. The adjusted bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—rose at a 12.8 percent average rate.

THE GOVERNMENT SECURITIES MARKET

Yields on most Government securities ended higher on balance in November. The interest rate declines that typified the previous month continued during the first week of November. Easier conditions prevailed in the Federal funds market, and increased investor preference for safety supported demand. Toward the middle of the month, however, investor preference for safety eased somewhat with the appearance of progress in resolving New York City's fiscal crises. At the same time, published data indicating that the money stock measures had expanded sharply during the first two statement weeks of the month fostered market expectations that the recent easing in monetary policy could halt and possibly reverse.

Sizable increases in the wholesale and consumer price index added to the concern of market participants, while supplies of fixed income investments grew through enlarged regular bill auctions and corporate debt financings. Against this background, yields in all maturity ranges moved higher.

Treasury bill rates declined modestly early in November in response to good investor demand and lower dealer financing costs. At the second weekly auction of the month on November 10, the average issuing rate on three-month bills was 5.28 percent (see Table II), 41 basis points below the average rate at the last weekly auction in October. At the same time, the average yield on six-month bills was 5.48 percent, 49 basis points lower than two auctions previous. In the auction of 52-week bills held on November 13, the average issuing rate was 6.01 percent, 59 basis points below the average yield in the corresponding monthly auction in mid-October. Around mid-November, however, considerable concern emerged about the future course of monetary policy. Dealer financing costs stabilized, and the substantial additions to the available supply of bills through increases in the bill auctions began to weigh on the market. The Treasury raised approximately $2.8 billion of new cash in the four regular weekly auctions in November and about $1 billion in the auction of 52-week bills. Following these developments, the average yields on three- and six-month bills at the weekly auction of November 24 rose to 5.52 percent and 5.93 percent, respectively.

At the end of the month, the Treasury announced plans to raise $3.2 billion of new money in the Treasury bill market. An auction of $2 billion of 139-day bills due April 22, 1976, representing an addition to the outstanding series, was scheduled for December 2. Auctions for $600 million of ten-day bills due December 18 and $600 million of eighteen-day bills due December 26, both of which represent additions to the outstanding series, were scheduled for December 5. The terms of the financing were generally in line with market expectations and had little effect on bill rates. The average yield on the 139-day bills auctioned on December 2 was 5.82 percent, and in the auctions held on December 5 the average yield was 5.22 percent on the ten-day bills and 5.14 percent on the eighteen-day bills. Over the month as a whole, bill rates were about 2 basis points lower to about 40 basis points higher.

Developments in the market for Government coupon issues followed a similar pattern. November was the first month in 1975 in which there was not an auction for new cash borrowing through coupon issues by the Treasury. While this was a positive factor, supply considerations

Table I

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

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

Factors	Changes in daily averages— week ended				Net changes
	Nov. 5	Nov. 12	Nov. 19	Nov. 26	
"Market" factors					
Member bank required reserves	+ 303	+ 362	— 788	+ 54	— 69
Operating transactions (subtotal)	— 214	+3,419	—1,022	—2,680	— 497
Federal Reserve float	+ 457	+ 10	+ 587	— 577	+ 477
Treasury operations*	— 591	+3,933	— 389	—1,677	+1,276
Gold and foreign account	— 23	+ 15	— 42	+ 88	— 12
Currency outside banks	— 60	— 849	—1,104	— 215	—2,228
Other Federal Reserve liabilities and capital	+ 5	+ 310	— 76	— 250	— 11
Total "market" factors	+ 89	+3,781	—1,810	—2,020	— 560
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 408	—4,582	+2,242	+2,997	+1,065
Outright holdings:					
Treasury securities	— 962	—2,305	+2,016	+1,527	+ 276
Bankers' acceptances	+ 14	— 10	— 7	+ 3	—
Federal agency obligations	—	— 1	—	—	— 1
Repurchase agreements:					
Treasury securities	+1,104	—1,930	+ 184	+1,232	+ 590
Bankers' acceptances	+ 170	— 232	+ 44	+ 118	+ 100
Federal agency obligations	+ 82	— 104	+ 5	+ 117	+ 100
Member bank borrowings	— 28	— 27	+ 19	+ 15	— 21
Seasonal borrowings†	— 10	— 16	— 1	—	— 27
Other Federal Reserve assets‡	+ 48	+ 37	— 278	— 359	— 552
Total	+ 428	—4,572	+1,983	+2,053	+ 492
Excess reserves‡	+ 517	— 791	+ 173	+ 27	— 74

	Daily average levels				Monthly averages§
Member bank:					
Total reserves, including vault cash‡	34,943	33,790	34,751	34,724	34,552
Required reserves	34,140	33,778	34,566	34,512	34,249
Excess reserves	803	12	185	212	303
Total borrowings	67	40	59	74	60
Seasonal borrowings†	43	27	26	26	31
Nonborrowed reserves	34,876	33,750	34,692	34,650	34,492
Net carry-over, excess or deficit (—)‖	160	267	86	88	138

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 four weeks ended November 26, 1975.
‖ Not reflected in data above.

continued to be an issue as corporate and agency financing was sizable. The uncertain outlook for interest rates and inflation encouraged trimming of dealer positions, and some profit taking followed October's rally. Over the month as a whole, the index of yields on intermediate-term Government securities rose 19 basis points to 7.62 percent. The index of long-term bond yields rose 9 basis points to 7.24 percent.

Yields on Government agency issues reflected the same influences during November. Early in the month, the Federal Home Loan Banks successfully sold $1.8 billion of bonds. Rates of return on this three-part financing were 7.25 percent on $800 million of 27-month bonds, 7.75 percent on $600 million of five-year bonds, and 8.10 percent on $400 million of ten-year bonds. In concurrent issues just before midmonth, refinancings by the Federal Intermediate Credit Banks (FICB) and the Banks for Cooperatives (BC) were well received, as the redeemed securities totaled $232 million more than the two new issues sold. The FICB sold $714 million of nine-month bonds yielding 6.20 percent, and the BC sold $449 million of six-month bonds yielding 6 percent. These returns were 70 and 75 basis points, respectively, below similar financings in October. In addition to the previously mentioned factors depressing the market later in the month, the Federal National Mortgage Association unexpectedly included $600 million of new cash borrowing in an auction on November 25. In that $1.4 billion financing, $450 million of 21-month debentures was sold at a 7⅜ percent yield, $650 million of five-year debentures was sold at an 8 percent yield, and $300 million of eight-year debentures was sold at an 8.4 percent yield.

OTHER SECURITIES MARKETS

Yields on corporate securities edged downward early in November, but they reversed course following increased concern about monetary policy, a very sizable influx of new issues, and a growing calendar of scheduled financings for December. Large price declines were recorded when dealers sought to reduce inventories by removing price restrictions on issues in syndicate, and a number of new offerings were postponed. In the market for state and municipal obligations, yields on high-quality issues outside New York State stabilized, while developments in Albany and Washington were the primary influence on the prices of debt instruments which carried low ratings or were located in New York State.

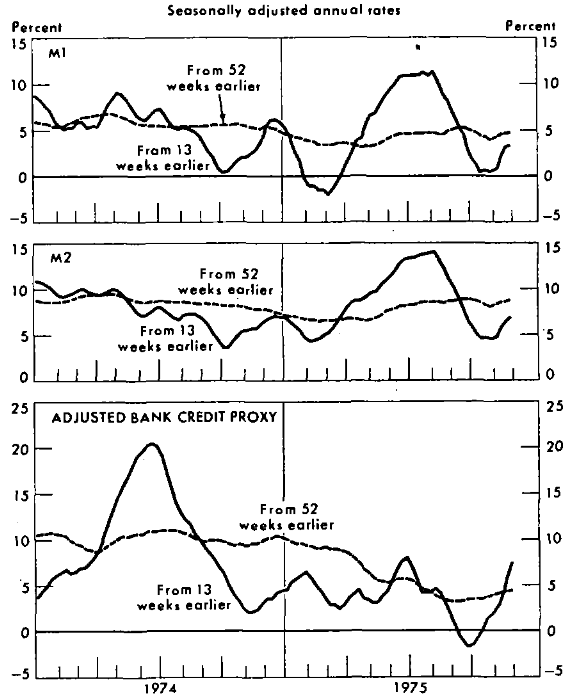
Following the improvement in market tone of the previous month and anticipating sizable demand on the credit markets by the United States Treasury in early 1976, underwriters brought a substantial amount of new corporate issues to market in November and added more to the schedule for December. This financing activity included an appreciable new supply of medium-term notes as well as long maturity issues.

Reflecting the improvement in market conditions, a $50 million A-rated utility offering of thirty-year bonds was priced in the first week of November to yield 9.75 percent, a full percentage point below a similar issue offered two months earlier. However, after the market retreated somewhat, a yield of 10 percent was set on $100 million of A-rated thirty-year utility bonds. In two 25-year industrial financings, $250 million of Aa-rated debentures was priced to yield 8⅞ percent and $100 million of

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 lastest statement week plotted is November 26, 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.

Aa-rated debentures returned 9⅛ percent. Market sentiment shifted while the larger issue was still in syndicate, and the yield rose sharply when price restrictions on the undistributed portion were lifted.

New issues of Aaa-rated state bonds were distributed at lower interest rates in November. The State of Wisconsin sold $102 million of bonds yielding from 3.50 percent in 1976 to 6.50 percent in 2005, while returns on $100 million of State of Oregon bonds ranged from 5 percent in 1981 to 6.15 percent in 1990. A similar Oregon issue yielded 5.25 percent in 1981 to 6.70 percent in 1993 when offered at the beginning of October.

As in recent months, the financial problems of New York City continued to dominate the market for lower grade tax-exempt securities. Developments around mid-November rekindled optimism over the prospect of some form of Federal aid to New York City, and prices on MAC issues rose. Another municipality in New York State as well as certain state agencies, however, experienced financial difficulties. At midmonth the New York State legislature averted default by Yonkers, the fourth largest city in the state, and by the Housing Finance Agency (HFA). Yonkers was able to redeem $21 million of maturing notes on schedule through a plan passed by the legislature providing for the creation of an emergency control board to oversee the city, similar to the one for New York City. The legislature also appropriated $80 million as part of a package to prevent the HFA from defaulting on its maturing notes. Although rated Aaa by Moody's and Aa by Standard & Poor's, a $37 million issue of Westchester County bonds was offered at yields ranging from 4.5 percent in 1976 to 6.8 percent in 1990, between 50 and 90 basis points higher than on a similar issue of bonds by a municipality outside the state.

At the end of the month, prices of MAC issues rose following the passage by the New York State legislature of a plan designed to avoid a New York City default. The legislature voted a $200 million increase in New York City taxes, which includes increases in the personal income tax, the bank tax, and the cigarette tax. The city sales tax is to be extended to cover personal services, and the minimum corporation tax is to be raised. In addition, an estate tax is to be levied and a minimum personal income tax is to be imposed. In a subsequent speech, President Ford stated that he would propose legislation to provide short-term loans to New York City to allow for adjustments to the uneven cash flow pattern during the year. The direct Federal loans, to be available through June 30, 1978, would not exceed $2.3 billion at any one time. To qualify for new loans for the next fiscal year, the city would be required to pay back all outstanding loans by the end of each fiscal year. The loans would be administered by the Treasury and made at a rate of 1 percentage point above the Treasury borrowing rate. If the city failed to keep up its efforts to achieve a balanced budget, the loans could be discontinued.

The Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds rose 3 basis points from the end of October to 7.39 percent on November 26. The Blue List of dealers' advertised inventories declined by $53 million and closed the month at $631 million.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—November 1975			
	Nov. 3	Nov. 10	Nov. 17	Nov. 24
Three-month	5.602	5.279	5.471	5.520
Six-month	5.792	5.483	5.796	5.933
	Monthly auction dates—September-November 1975			
	Sept. 17	Oct. 15	Nov. 13	
Fifty-two weeks	7.338	6.601	6.010	

* 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.