The Money and Bond Markets in December

Interest rates continued to decline on a broad front until about mid-December, and then generally leveled off or rose somewhat over the latter half of the month. On balance, most interest rates were little changed for the month, following the sharp declines of November (see Chart I). Over the fourth quarter as a whole, however, both short- and long-term rates declined considerably and in several instances fell to their lowest levels in a year and a half or more. Thus, the average issuing rates on new three- and six-month bills reached their lowest point since late 1967, while *The Weekly Bond Buyer's* index of yields on twenty municipal bonds fell to its May 1969 level by the close of 1970.

Both the money supply and the adjusted bank credit proxy[1] rebounded in December following two months of relatively slow growth. Over the fourth quarter as a whole, the money supply apparently grew at about a 3½ percent annual rate and the adjusted credit proxy at about an 8 percent rate. Over the year 1970 the money supply increased by about 5½ percent, compared with 3 percent during 1969. The adjusted bank credit proxy grew by about 8¼ percent over 1970 after virtually no growth during the previous year.

THE MONEY MARKET

Conditions in the money market eased further during December, when the effective rate on Federal funds averaged 4.90 percent, some 50 basis points lower than in the preceding month. Reflecting in part the substantial provision of reserves by System open market operations, as well as continued sluggishness of loan demand, member bank borrowings from the Federal Reserve Banks declined further in December. Such borrowings averaged $348 million for the month (see table), down $61 million from the November average and the lowest monthly level since January 1968.

Business loan demand at weekly reporting banks continued in the sluggish pattern which began in mid-September. During the week containing the December 15 corporate tax payment date, business loans (adjusted for sales to affiliates) grew by only $1.2 billion, compared with an increase of $1.6 billion in the same period last year when bank reserve positions were under considerably more pressure. Moreover, for the fourth quarter as a whole, repayments of business loans exceeded new borrowing at weekly reporting banks. Consequently, outstanding loans fell by $1.4 billion, whereas during the comparable periods of 1968 and 1969 they rose by $4.4 billion and $3.1 billion, respectively. In response to the contraseasonal slackening of loan demand, commercial banks had reduced their prime lending rate by ½ percentage point in two steps during November. Then, following the mid-December corporate tax date experience, major banks lowered their prime rate an additional ¼ percentage point to 6¾ percent, compared with the high of 8½ percent earlier in the year. The prime rate was again reduced by ¼ percentage point to 6½ percent in early January.

Preliminary data indicate that the money supply grew at about a 6 percent annual rate during December following gains of only 1.1 percent and 2.8 percent in October and November when economic activity was depressed by the strike in the automotive industry. Over the three months as a whole, the money supply grew at about a 3½ percent rate. The adjusted bank credit proxy showed an even greater rise in December, growing at an annual rate of about 15 percent compared with increases of 1.1 percent and 7.0 percent in the preceding two months. This brought the growth rate of the adjusted proxy over the fourth quarter to about 8 percent. Continued heavy inflows of time deposits (see Chart II), particularly large certificates of deposit, were the primary factor in the substantial rise in the proxy. Large CD's at weekly reporting banks climbed to $26.1 billion at the end of December, surpassing the late-1968 peak by $1.8 billion.

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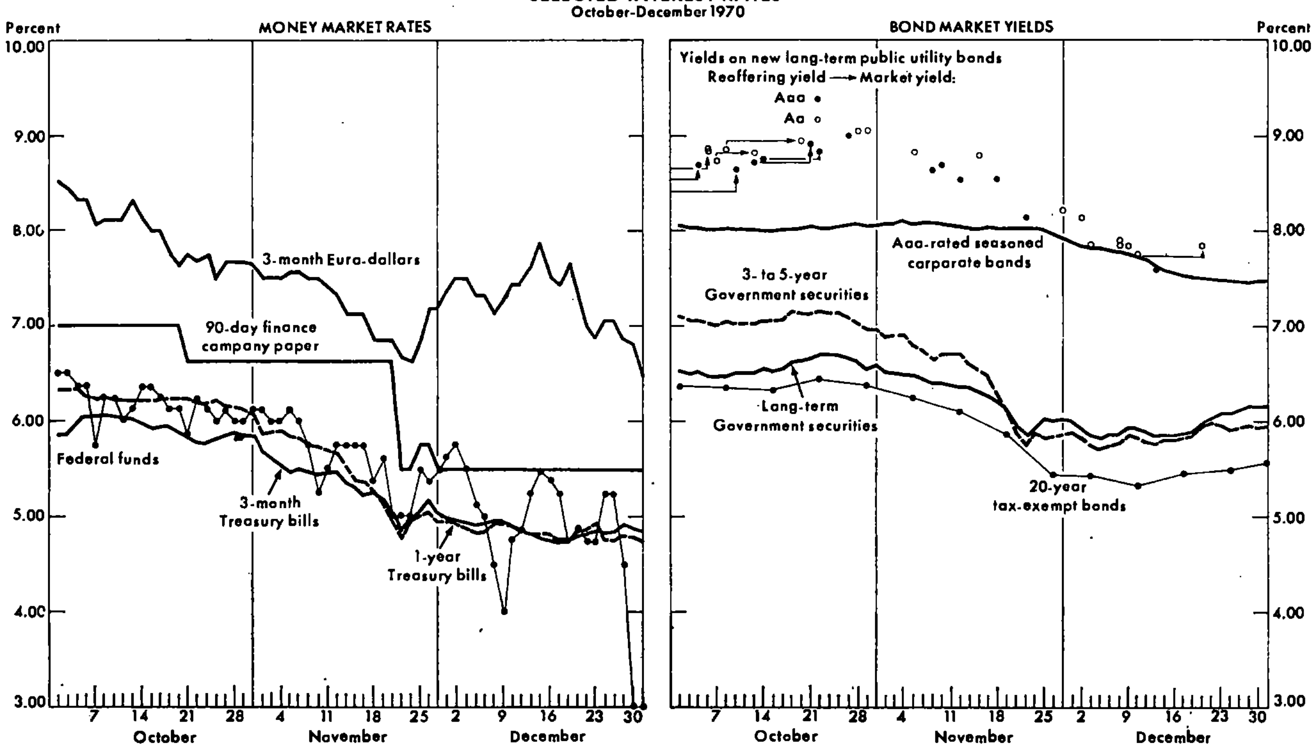
[1] A measure of bank liabilities, which includes deposits subject to reserve requirements and nondeposit items such as Euro-dollar liabilities and bank-related commercial paper.

Chart II

SELECTED INTEREST RATES

October-December 1970



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; offering rates for directly placed finance company paper; 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 and one-year Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new Aaa- and 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.

Nondeposit liabilities of banks declined further during the month, however. Since Euro-dollar rates far exceeded domestic interest rates, banks reduced their Euro-dollar liabilities by an additional $1.1 billion. Outstanding Euro-dollar liabilities of weekly reporting banks totaled $7.7 billion on December 30, just one half of their October 1969 high. Bank-related commercial paper—the other major nondeposit component of the adjusted credit proxy—also declined in December, continuing a trend which has been evident since the late-August announcement of the imposition of reserve requirements on these liabilities. As a result of the accompanying reduction of the reserve requirement on large time deposits to the same level as that on commercial paper, CD's and bank-related paper were placed on a more nearly equal basis. Since both banks and their customers tend to prefer deposits to commercial paper, the volume of bank-related paper outstanding was reduced to $2.4 billion at the end of the year, down from a high of $7.8 billion at the end of July.

THE GOVERNMENT SECURITIES MARKET

The market for United States Treasury issues continued to advance over the first half of December, and yields on all maturities registered additional declines. The rally faltered after midmonth, however, and prices generally declined thereafter, particularly in the coupon sector. As a result of the consolidation in the coupon market, yields on most longer dated securities were higher at the close of December than they were at the start of the month. Yields on intermediate-term issues generally rose 3 to 27 basis points, while those on most long-term coupon issues ranged between 3 and 20 basis points higher.

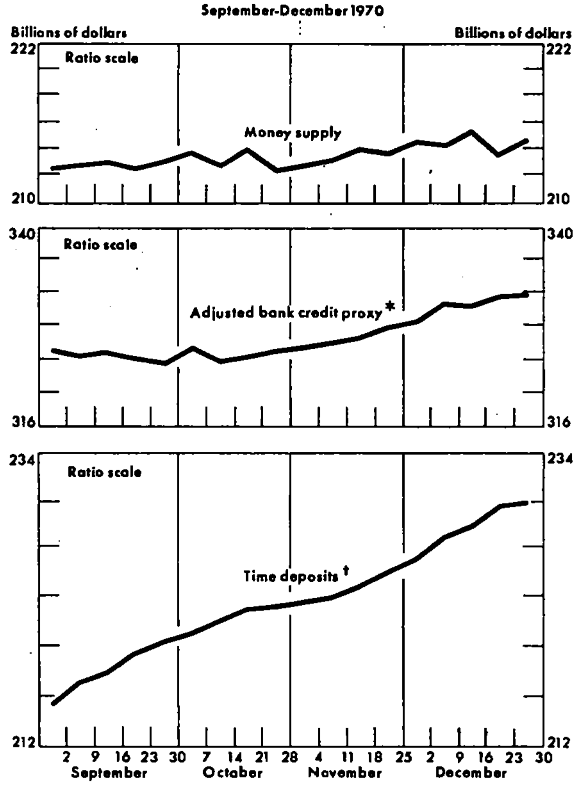
The month-long rally in the bond market was sustained in the first week of December by the reduction in the discount rate on November 30, System purchases of coupon issues on the following day, and active investor demand. Some profit taking then emerged, as participants reflected upon the sizable rise in prices which already had occurred, but after a few days the coupon market resumed its advance. The gains at this time were triggered in large part by the expectation of further reductions in interest rates, particularly in the prime rate in view of the contraseasonal sluggishness of business loan demand at commercial banks. Increased demand for Treasury securities on the part of both investors and professionals was an additional factor in the renewed advance, and over the December 1-14 period yields on most coupon issues showed net declines of 8 to 24 basis points.

The better tone was short-lived, however, and yields on Treasury notes and bonds began to rise on December 15 in reaction to the unenthusiastic response given by investors to a large, aggressively priced new corporate bond issue. On several succeeding days coupon yields continued to rise, as investors and dealers attempted to reduce their holdings. Increasingly as the month progressed there was discussion of the forthcoming Treasury refunding in February, the terms of which will probably be made known late in January, and a reluctance on the part of dealers to add to their already large inventories in the face of the imminent refunding.

An additional factor which weighed upon the coupon market in the latter half of December was the possibility that, after the turn of the year, insurance coverage on Treasury and Federal agency bearer securities held by banks, dealers, and brokers might be drastically curtailed. The Federal Reserve Bank of New York, in cooperation with the financial community, formulated contingency plans to ensure the continued functioning of the market in the event that one or more major banks or dealers curtailed its securities operations. Late in the month, the major insurer in this field made known its intention of extending coverage with respect to banks through the first three months of 1971, thereby removing for the time being the threat of disruption of trading in the Government securities market. Meanwhile, the Federal Reserve Bank is pressing ahead with plans for the further expansion of its Government securities clearing arrangement and of the book-entry procedure for Government securities, as a means of minimizing the physical handling of bearer Government securities by market participants.

Unlike yields on most Government coupon issues, Treasury bill rates declined on balance during December. The bill market was buoyed early in the month by some of the same factors that led to an improvement in coupon issues. At midmonth, when the rally in the capital markets faltered, the bill market performed quite well in the absence of the usual selling pressure in connection with the corporate tax date. In addition, there was steady investor demand for bills much of the time and yields continued working down. As the holidays approached, however, apprehension over the uncertain insurance situation and a slackening of investor interest were felt in this sector as well, and yields edged somewhat higher. Nevertheless, rates on most issues declined by a net of 7 to 19 basis points over the month.

Chart II
CREDIT AND MONETARY AGGREGATES
Seasonally adjusted weekly averages
September-December 1970



Note: Data for December are preliminary.

* Total member bank deposits subject to reserve requirements plus nondeposit liabilities, including Euro-dollar borrowings and commercial paper issued by bank holding companies or other affiliates.

† At all commercial banks.

OTHER SECURITIES MARKETS

In the corporate and municipal bond markets, yields on both new and seasoned issues showed further decreases in the early part of the month, but then some investor resistance developed in the market for tax exempts. Profit taking and investor unwillingness to pay higher prices later extended to the corporate bond market, and by mid-December the approximately six-week-long rally had faltered in both sectors.

Rates on new and seasoned corporate bonds moved lower as the month opened, and on December 3 a long-term Aa-rated utility issue was priced to yield 7.85 percent, the first instance in sixteen months that the return on such a new issue was less than 8 percent. The reception to these bonds was quite favorable, despite the fact that the return was 37 basis points lower than that on a similar issue sold three days earlier, and over the next several days additional Aa-rated offerings were marketed at this same yield. The response of the market was somewhat cooler, however, and these later issues were initially only partially sold. When on December 10 another utility bond was even more aggressively priced to provide investors with a return of only 7¾ percent, however, the remaining 7.85 percent bonds were snapped up. The last large corporate issue to be sold in 1970 was a $200 million offering of New York Telephone Company bonds, which was marketed on December 14. Priced to yield 7.60 percent—56 basis points below the yield offered on the most recent comparable issue on November 23—the bonds moved slowly and the bulk of them remained in the underwriting syndicate's inventory at the end of the year.

Prices of municipal bonds continued to rise during the first week of December, but the rally began to falter during the next week when the market faced one of the heaviest calendars on record. Indicative of the improvement during the rally is the fact that for almost two years the state of Texas had been unable to sell certain bonds because of a 4.5 percent interest ceiling but finally marketed them on December 7 at a net cost of 4.07 percent. On the following day, however, more than $400 million in new tax-exempt securities was offered, and investor interest was decidedly restrained. Yields were raised somewhat on succeeding new offerings, but dealer inventories continued to rise as an unusually heavy December calendar was marketed. The Blue List of advertised inventories climbed to more than $1 billion during the December 10-14 period. Finally in the third week of December, underwriters began pricing new issues more attractively to investors, and several bond offerings were quickly sold out. In the face of such sizable inventories and the success of these new, lower priced bonds, a number of outstanding issues were released from syndicate price restrictions with upward yield adjustments of 20 to 40 basis points. Dealer inventories were reduced, but the Blue List

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, DECEMBER 1970

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

Factors	Changes in daily averages — week ended on					Net changes
	Dec. 2	Dec. 9	Dec. 16	Dec. 23	Dec. 30	
"Market" factors						
Member bank required reserves	− 168	− 109	− 344	− 156	− 331	−1,108
Operating transactions (subtotal)	− 410	+ 100	− 419	+ 395	+ 507	+ 173
Federal Reserve float	− 317	+ 152	− 103	+ 905	+ 741	+1,378
Treasury operations*	+ 34	+ 103	− 107	+ 1	− 376	− 345
Gold and foreign account	+ 5	− 8	+ 3	− 8	− 19	− 27
Currency outside banks	− 6	− 81	− 260	− 665	+ 232	− 780
Other Federal Reserve liabilities and capital	− 126	− 65	+ 47	+ 161	− 70	− 53
Total "market" factors	− 578	− 9	− 763	+ 239	+ 176	− 935
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 967	− 138	+ 588	− 48	− 88	+1,281
Outright holdings:						
Government securities	+ 516	+ 32	+ 328	+ 286	+ 42	+1;204
Bankers' acceptances	− 1	+ 4	+ 6	+ 8	+ 2	+ 19
Repurchase agreements:						
Government securities	+ 337	− 177	+ 258	− 321	− 45	+ 52
Bankers' acceptances	+ 42	+ 33	− 28	− 14	− 23	+ 10
Federal agency obligations	+ 73	− 30	+ 24	− 7	− 64	− 4
Member bank borrowings	+ 18	− 163	+ 108	− 75	− 54	− 166
Other Federal Reserve assets†	− 61	+ 26	+ 28	+ 45	+ 45	+ 83
Total	+ 924	− 275	+ 724	− 80	− 96	+1,197
Excess reserves	+ 341	− 281	− 87	+ 159	+ 80	+ 262

	Daily average levels					Monthly averages
Member bank:						
Total reserves, including vault cash	28,885	28,710	29,015	29,330	29,741	29,136‡
Required reserves	28,463	28,572	28,916	29,072	29,403	28,885‡
Excess reserves	417	136	99	258	338	250‡
Borrowings	455	290	399	324	270	348‡
Free, or net borrowed (—), reserves	− 38	− 154	− 300	− 66	68	− 98‡
Nonborrowed reserves	28,430	28,420	28,616	29,006	29,471	28,788‡
Net carry-over, excess or deficit (—)§	70	204	122	137	117	130‡

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 five weeks ended on December 30.
§ Not reflected in data above.

was still at a very high $937 million on December 31.

An interesting development in the tax-exempt market during December was the sale of some $46 million in bonds by the Vermont Municipal Bond Bank, which in turn will purchase the bonds of several small Vermont communities and school districts that individually would not have ready access to nationwide capital markets. The Aa-rated bonds of the bank were well received and may set a pattern for other states which are considering ways to raise additional funds for financing local governments.