The Money and Bond Markets in January

During January, investor optimism regarding the future course of interest rate movements generated a resurgence and acceleration of the bond market rally that had waned in the latter half of December. Yields on intermediate-term Treasury securities declined as much as a full percentage point over the month, and long-term Treasury bond yields were down by as much as half a percentage point (see Chart I). At the same time, yields on newly issued high-grade corporate bonds declined more than a full percentage point during the month to their lowest level in more than two years. *The Weekly Bond Buyer's* index of yields on twenty municipal bonds fell 42 basis points to 5.16 percent, almost 2 percentage points below its record high of 7.12 percent posted in May 1970.

While this historic performance was taking place in the nation's bond markets, sluggish demand for short-term loans sent virtually all money market rates tumbling downward. The commercial bank prime rate was lowered from 6¾ percent to 6 percent in a series of three ¼ percentage point reductions, and two ¼ percentage point reductions of the Federal Reserve discount rate brought it to 5 percent. The bid rate on three-month Treasury bills declined 70 basis points to 4.15 percent, down nearly 4 percentage points from its peak level at the end of 1969. Similarly, rates on bankers' acceptances and commercial paper were reduced by ¾ to 1⅛ percentage points over the month.

Preliminary figures indicate that the money supply—private demand deposits plus currency outside banks—grew at an annual rate of about 3 percent in January, in line with the 3.4 percent rate of growth in the fourth quarter of 1970 but down from the 5.4 percent growth achieved in all of 1970. In contrast, the growth of the adjusted bank credit proxy, a more comprehensive measure of commercial bank liabilities, accelerated to an annual rate of about 10 percent in January from 8.3 percent over the previous quarter and for all of 1970. The divergence between the growth rates of these two aggregates was largely attributable to continued rapid growth of time deposits (see Chart II).

THE GOVERNMENT SECURITIES MARKET

The focal point of attention in the Government securities market was the Treasury's February refinancing, the terms of which were announced on January 20. The Treasury took advantage of the buoyant tone of the market to prerefund several maturities. It offered to exchange the notes and bonds maturing February 15, March 15, and November 15, 1971 and February 15, 1972 for a 5⅞ percent note due in four and one-half years or a 6¼ percent note due in seven years. Public holdings[1] of the issues eligible for the exchange totaled $19.5 billion. Preliminary results indicate that by the time the subscription books closed on January 27 holders of $10.8 billion of these issues had elected to make the exchange. "Attrition" of the February 1971 issues—the proportion of publicly held maturing notes to be redeemed for cash—was 17.4 percent, a modest figure in light of there being no short-term issue in the exchange offer. The highly successful operation resulted in a significant lengthening of the average maturity of the privately held Federal debt to about three years eight months from its level of three years five months at the end of 1970.

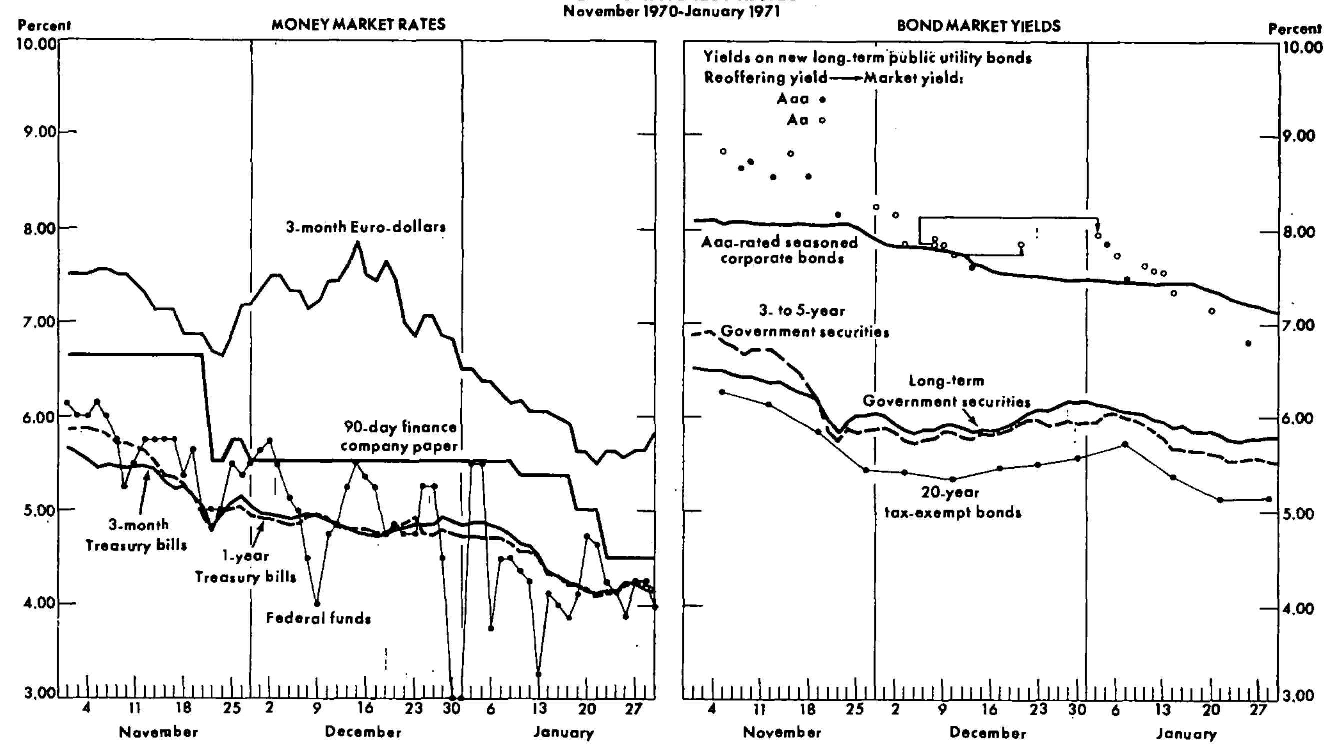
Prices of outstanding Government securities rose sharply during January. The market for intermediate-term issues was initially restrained by dealers' attempts to lighten their positions in anticipation of the refunding. After this initial drift, however, selling pressure subsided and the sizable demand resulting from investor confidence in the downward thrust of interest rates more than offset any lingering sales pressure. The market was also buoyed by the good reception accorded new corporate issues. Coupon issues due within one year were rapidly bid up to prices reflecting their anticipated "rights" value in the refunding. By the

[1] Other than those of the Federal Reserve Banks and United States Government investment accounts.

Chart I

SELECTED INTEREST RATES

November 1970-January 1971



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.

time the announcement of the refunding was made, the February 15 and March 15, 1971 notes and bonds had been bid up to prices generating negative yields. After the refunding terms became known, investor and dealer satisfaction with the Treasury's offer generated strong initial demand for the new issues, the rights issues, and the outstanding intermediates. There was particular interest in the February 1972 issues which had not been expected to be included in the refunding. Though weakness developed toward the end of the month, the new issues closed trading well above par, and the outstanding intermediates showed price appreciation of about 1 to 1½ points for the month. Prices of long-term Treasury bonds posted even larger gains, with price appreciation ranging from 2 to 4 points.

Treasury bill rates declined substantially over the month. Rates rose in the first few days of trading, largely in reaction to a reversal of window-dressing operations undertaken before the end of the year. But trading was relatively light and little selling pressure materialized, despite sizable dealer inventories. A better tone developed after the first reduction in the prime rate was announced on January 6, and yields proceeded to decline steadily, although there was some occasional profit taking. Activity became dull as the announcement of the Treasury's refinancing plans approached, with participants in this sector hesitating in the event the new offering contained a short-term issue. Rates declined sharply the day after the terms of the refunding became known, but demand was disappointing during the rest of the month. None-

Table I
FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1971

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

Factors	Changes in daily averages— week ended				Net changes
	Jan. 6	Jan. 13	Jan. 20	Jan. 27	
"Market" factors					
Member bank required reserves	— 657	— 144	— 705	+1,008	— 498
Operating transactions (subtotal)	— 237	+ 148	+ 666	— 640	— 63
Federal Reserve float	— 250	— 676	+ 170	— 835	—1,591
Treasury operations*	+ 188	— 63	+ 108	— 275	— 42
Gold and foreign account	— 377	— 4	—	— 1	— 382
Currency outside banks	+ 319	+ 601	+ 456	+ 538	+1,914
Other Federal Reserve liabilities and capital	— 117	+ 289	— 66	— 68	+ 38
Total "market" factors	— 894	+ 4	— 39	+ 368	— 561
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 801	— 404	— 131	— 86	+ 180
Outright holdings:					
Government securities	+ 537	+ 19	— 236	— 65	+ 255
Bankers' acceptances	+ 2	+ 3	+ 2	— 1	+ 6
Repurchase agreements:					
Government securities	+ 185	— 327	+ 83	— 16	— 75
Bankers' acceptances	+ 26	— 40	+ 7	— 4	— 11
Federal agency obligations	+ 51	— 59	+ 13	—	+ 5
Member bank borrowings	+ 137	— 132	+ 196	— 117	+ 84
Other Federal Reserve assets†	+ 67	+ 17	+ 40	+ 34	+ 158
Total	+1,005	— 517	+ 103	— 169	+ 422
Excess reserves	+ 111	— 513	+ 64	+ 199	— 139

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash	30,611	30,242	31,011	30,202	30,517‡
Required reserves	30,066	30,210	30,915	29,907	30,275‡
Excess reserves	545	32	96	295	242‡
Borrowings	407	277	471	354	377‡
Free, or net borrowed (—), reserves	138	— 245	—375	— 59	— 135‡
Nonborrowed reserves	30,204	29,965	30,540	29,848	30,139‡
Net carry-over, excess or deficit (—)§	210	249	63	— 12	128‡

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 four weeks ended January 27.
§ Not reflected in data above.

theless, rates on most bills declined by about ½ to ¾ percentage point over the month. The average issuing rate on the three-month bill fell to 4.20 percent in the final weekly bill auction of January (see Table II). This was 63 basis points below the rate set in the auction four weeks earlier and the lowest such rate since August 1967.

OTHER SECURITIES MARKETS

The strong demand for securities that prevailed throughout the money and capital markets enabled the corporate and municipal bond markets to absorb large volumes of new securities at rapidly declining rates. The yield on newly issued prime corporate bonds declined more than a full percentage point to the lowest level in more than two years, and a record volume of tax-exempt bonds was marketed at declining yields until late in the month. *The Weekly Bond Buyer's* twenty-bond index of municipal bond yields closed at 5.16 percent, 42 basis points below its level at the beginning of the month.

As the new year opened, there was some concern among corporate traders regarding the New York Telephone issue which had originally been awarded on December 14 and was still largely unsold. Pricing the securities to yield 7.60 percent in thirty-six years, the syndicate marketing the issue had refused to disband during the last week of the year—when bond trading is normally sluggish. A Northwestern Bell Telephone Aaa issue sold well on January 5 when priced to yield 7.85 percent, making it appear that the syndicate handling the New York Telephone issue would have to remove its price restrictions. But, on Thursday, January 7, after the prime rate cut had been announced, a Commonwealth Edison Aaa-rated issue was successfully reoffered at a yield of 7.45 percent, causing the New York Telephone yield to appear generous and the issue was rapidly sold out and rose to a premium.

In the municipal bond market there was evidence of investor hesitancy regarding poorer quality issues. At midmonth New York City, which has a Baa-1 rating, was forced to award $237 million of bonds at a net interest cost greater than the one it had incurred in October, despite the improvement in general market conditions. Yields on top quality tax-exempt issues declined substantially, however, as illustrated by the $121.3 million New Housing Authority issue which was awarded at a net interest cost of 4.95 percent on January 27. The last similar issue had carried a net interest cost of 5.84 percent two months earlier.

Investor resistance to rate declines began to appear toward the end of the month. A $200 million Southwestern Bell issue was only about one-quarter sold when priced to yield 6.80 percent on January 26. This left the corporate market with a formidable supply of unsold telephone bonds as it awaited a $500 million American Telephone and Telegraph Company offering scheduled for early February. In the municipal bond market, new issues also sold slowly late in the month, and the Blue List of advertised dealer inventories rose to nearly $1 billion from a midmonth low of about $600 million.

THE MONEY MARKET

Conditions in the money market were comfortable in January, as loan demand continued weak and System open market operations provided reserves generously. Reflecting this comfortable tone, member bank borrowings at the Federal Reserve averaged $377 million, up slightly from the December level but well below the average level of $803 million for all of 1970. The Federal funds rate averaged 4.14 percent, down 76 basis points from December, and the commercial bank prime rate was lowered from 6¾ percent to 6 percent. To bring it into alignment with other money market rates, the Federal Reserve discount rate was lowered in two steps to 5 percent, a level it had last seen in April 1968.

Largely reflecting slow growth of private demand deposits, the money supply increased at an annual rate of about 3 percent in January, compared with 3.4 percent in the fourth quarter of 1970 and 5.4 percent for all of 1970. Time deposits continued to surge upward at about the same rapid rate as in the fourth quarter of 1970. In the four weeks ended January 27, large negotiable certificates of deposit rose by about $1 billion (not seasonally adjusted) to a record $27.1 billion. Liabilities to foreign branches were reduced by about $1 billion (not seasonally adjusted) to $6.7 billion. This decline, however, approximately matched a sale of 6 percent three-month notes by the Export-Import Bank. Such notes purchased by a bank's foreign branches may be counted in the bank's reserve-free base. The runoff in bank-related commercial paper slowed considerably in January. Such paper declined by about $300 million (not seasonally adjusted) to $2.0 billion. Total member bank deposits plus nondeposit liabilities—the adjusted bank credit proxy—increased at an annual rate of about 10 percent in January, according to preliminary figures. This compares with the 8.3 percent rate of growth achieved in the previous quarter and over all of 1970.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

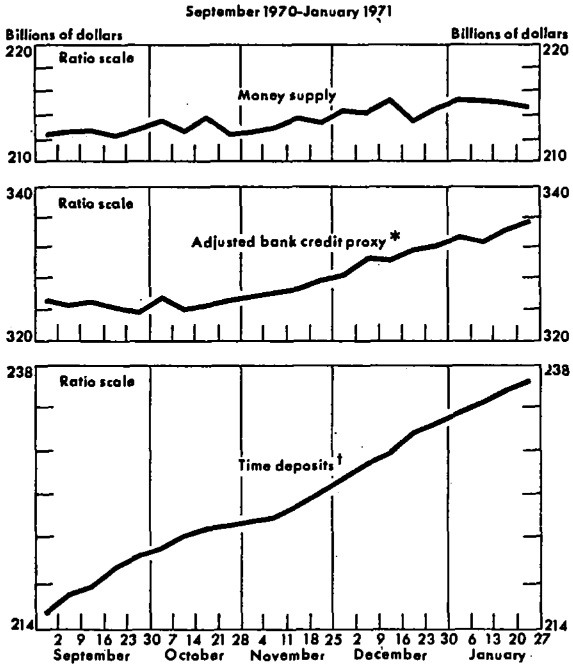
Maturities	Weekly auction dates—January 1971			
	Jan. 4	Jan. 11	Jan. 18	Jan. 25
Three-month	4.921	4.640	4.213	4.201
Six-month	4.927	4.638	4.243	4.235
	Monthly auction dates—November 1970-January 1971			
	Nov. 24	Dec. 23	Jan. 26	
Nine-month	5.088	4.949	4.268	
One-year	5.009	4.886	4.248	

* 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.

Chart II

CREDIT AND MONETARY AGGREGATES

Seasonally adjusted weekly averages
September 1970-January 1971



Note: Data for January 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.