The Money and Bond Markets in October

Short-term interest rates changed little on balance during October. The rate on Federal funds fluctuated from week to week, averaging somewhat above the September level. Other short-term rates rose early in October, but some later retreated to the levels prevailing at the beginning of the month. Average member bank borrowings from the Federal Reserve Banks were little changed from September, while the monetary aggregates grew at relatively moderate rates.

Yields on Treasury securities were affected by plans for meeting the large cash needs of the Federal Government. After raising $2 billion through an auction of notes early in October, the Treasury disclosed that it expected to need to raise an additional $12 billion through the early weeks of January. Part of this need was met by the sale of $3 billion of intermediate-term notes at the beginning of November. In addition, the Treasury began adding $200 million to its weekly bill auctions starting on October 30. Rates on bills due within three months rose during most of the month, but those on longer term bills and coupon issues edged downward.

The bond market responded to increased diplomatic activity directed toward settlement of the Vietnam conflict, and prices edged higher. Underwriters encountered some investor resistance to higher prices, however. Sales of new corporate and municipal issues were slow in many cases, and dealer inventories increased substantially. Toward the end of the month, a more confident tone gradually emerged throughout the securities markets, and the rally gained momentum early in November.

BANK RESERVES AND THE MONEY MARKET

Money market conditions fluctuated irregularly during October. The average effective rate on Federal funds was 5.04 percent, up 17 basis points from the level in September. The supply of nonborrowed reserves was sufficient to meet the growth in required reserves over most of the month, and member bank borrowings from the Reserve Banks declined slightly to an average level of $543 million in the four weeks ended October 25. Net borrowed reserves averaged $323 million during this period (see Table I), compared with $332 million in the four preceding weeks. Reserves available to support private nonbank deposits (RPD) increased at an annual rate of 4 percent in October.

The money market tightened appreciably late in the first statement week of October, as some banks sought to cover accumulated reserve deficiencies. Federal funds traded as high as 6 percent on the settlement day, and banks borrowed heavily at the discount window. In the next two weeks, banks managed reserve positions more cautiously, but reserve deficiencies occurred again in the fourth statement week. These were run over the Veterans Day weekend and not covered until the weekly reserve settlement day, October 25. On that day, member bank borrowings from the Reserve Banks rose to a record $3.2 billion and Federal funds traded up to 8 percent.

Most short-term interest rates moved irregularly higher early in October, but some declines were recorded in the final week of the month. The rate on 90- to 119-day commercial paper sold through dealers was raised ⅛ percentage point in the first week of October but returned to a level of 5⅛ percent at the end of the month (see Chart I). Rates on most other maturities of commercial paper were unchanged to ⅛ percentage point higher, while those on bankers' acceptances were raised by ¼ percentage point. Two large banks with floating prime lending rates linked to the cost of funds raised their rates ⅛ percentage point to 5⅞ percent, effective October 16. The rest of the industry, however, retained the 5¾ percent rate established at the beginning of the month, and the banks with floating prime rates returned to that level early in November.

According to preliminary estimates, the narrowly defined money supply (M_1)—adjusted private demand deposits plus currency outside banks—increased at a seasonally adjusted annual rate of about 5 percent during the three months ended in October (see Chart II). This was markedly below the rate of growth of M_1 over the third quarter, which had been inflated by an unusually sharp rise in July. Over the twelve months that ended in October, M_1 grew by a relatively moderate 6½ percent.

The growth of the broad money supply (M_2)—defined as M_1 plus time deposits at commercial banks other than large negotiable certificates of deposit (CDs)—continued in October at about the same pace as in the two preceding months. This brought the growth rate of M_2 to about 8 percent over the three months ended in October and to 10 percent over the twelve months ended then.

The adjusted bank credit proxy—which consists of daily average member bank deposits subject to reserve requirements and certain nondeposit liabilities—also advanced in October at roughly the same pace as in the two preceding months. For the three-month period ended in October, the growth rate of the adjusted proxy was about 10 percent. Over the past twelve months, the adjusted proxy rose by 11½ percent.

On October 24, the Board of Governors of the Federal Reserve System announced that the amendments to Regulations D and J would be put into effect beginning November 9.[1] Implementation had been scheduled for September 21 but was delayed by court action. On October 19, however, the United States District Court for the District of Columbia denied a motion for a preliminary injunction sought by some nonmember banks. The new effective date was selected in order to give commercial banks time to make necessary adjustments to the revised regulations. The net release of reserves will occur in phase with seasonal reserve needs. The change in Regulation D, which restructures reserve requirement ratios, is expected to reduce member bank required reserves by about $3½ billion in two steps. The change in Regulation J, which governs the payment schedule for users of Federal Reserve check-clearing facilities, is expected to withdraw about $2 billion from the reserves of the banking system. The revisions are intended to be neutral with respect to monetary policy.

THE GOVERNMENT SECURITIES MARKET

Yields on Government securities responded to varied pressures during October. Treasury decisions about the timing and methods of finance affected rates on shorter term issues, which ended with mixed changes. Persistent rumors of progress in the Vietnam peace negotiations encouraged optimism on the part of dealers and investors, and prices of most coupon issues rose over the month.

Market rates on short-term Treasury bills rose sharply at the beginning of October. Part of this movement was caused by uncertainty about the Government's financing plans. Dealers attempted to reduce inventories of outstanding bills to prepare for a possible increase in the

Table I

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

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

Factors	Changes in daily averages— week ended				Net changes
	Oct. 4	Oct. 11	Oct. 18	Oct. 25	
"Market" factors					
Member bank required reserves	— 485	+ 149	— 635	+ 584	— 387
Operating transactions (subtotal)	— 287	— 508	+ 833	— 722	— 684
Federal Reserve float	— 372	+ 227	+ 840	— 25	+ 670
Treasury operations*	+ 287	— 188	+ 490	— 427	+ 162
Gold and foreign account	+ 6	—	— 7	— 22	— 23
Currency outside banks	— 75	— 493	— 571	— 199	—1,338
Other Federal Reserve liabilities and capital	— 133	— 54	+ 81	— 49	— 155
Total "market" factors	— 772	— 359	+ 198	— 138	—1,071
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 993	+ 337	— 428	— 180	+ 716
Outright holdings:					
Treasury securities	+ 558	+ 620	— 269	— 379	+ 530
Bankers' acceptances	+ 4	+ 7	+ 1	+ 1	+ 13
Federal agency obligations	— 8	— 11	—	— 1	— 20
Repurchase agreements:					
Treasury securities	+ 384	— 269	— 115	+ 181	+ 181
Bankers' acceptances	+ 28	— 3	— 25	+ 10	+ 10
Federal agency obligations	+ 27	— 7	— 20	+ 2	+ 2
Member bank borrowings	— 114	+ 99	— 102	+ 334	+ 217
Other Federal Reserve assets†	+ 86	+ 52	+ 83	+ 66	+ 287
Total	+ 965	+ 487	— 447	+ 213	+1,218
Excess reserves	+ 193	+ 128	— 249	+ 75	+ 147

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash	33,731	33,710	34,096	33,587	33,781‡
Required reserves	33,501	33,352	33,987	33,403	33,561‡
Excess reserves	230	358	109	184	220‡
Borrowings	436	535	433	767	543‡
Free, or net borrowed (—), reserves	— 206	— 177	— 324	— 583	— 323‡
Nonborrowed reserves	33,295	33,175	33,663	32,820	33,238‡
Net carry-over, excess or deficit (—)§	44	107	183	68	101‡

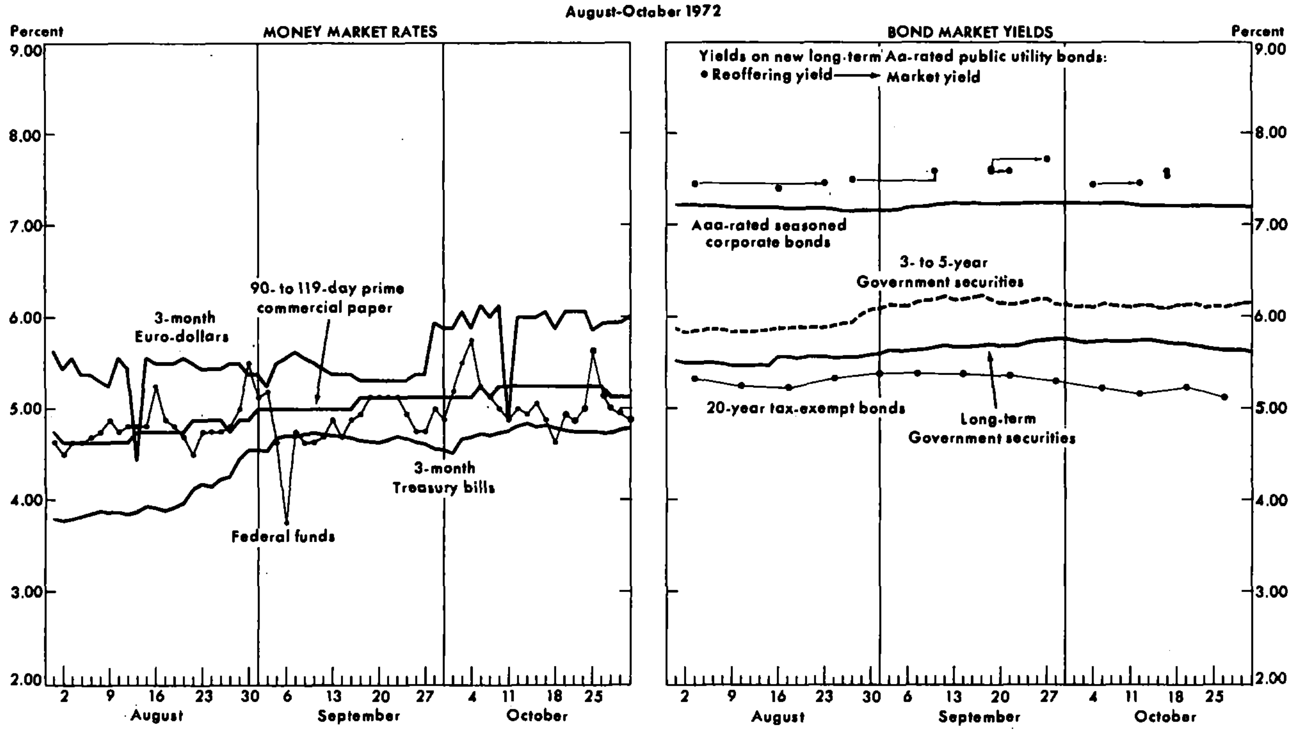
Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ Average for four weeks ended October 25.
§ Not reflected in data above.

[1] A summary of the amendments to Regulations D and J appeared in this *Review* (July 1972), page 154. For a discussion of the issues involved, see this *Review* (August 1972), pages 201-7.

Chart I

SELECTED INTEREST RATES

August-October 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 four 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 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 Bond Buyer.

supply of new issues. On October 5, the Treasury announced the sale at auction of $2 billion in 6 percent notes maturing on September 30, 1974. This decision removed immediate supply pressure from the bill sector, but lack of investor interest pushed rates on short-term bills higher over most of the month.

Investor behavior also influenced the results of the weekly bill auctions. The average issuing rate on new three-month bills rose from 4.60 percent on October 2 to 4.82 percent on October 16 (see Table II). At the next auction, advanced to October 20 because of the Veterans Day holiday, the rate declined. However, this movement was reversed after the Treasury announced, on October 24, plans to increase offerings of new three- and six-month bills by $100 million each. The first such increment was sold at the October 30 auction, and the average issuing rate on the three-month bills was 4.77 percent, 13 basis points higher than at the end of September.

Market yields on longer maturities of Treasury bills edged lower during most of October, and this pattern was little affected by the announcement of new supplies. At the regular monthly auction, the average issuing rate on the 52-week bill was 5.32 percent, 21 basis points below the rate set in the previous month.

The auction of the two-year notes was held on October 11. It represented the second recent action by the Treasury to raise new cash, and a favorable response by investors produced an average issuing rate of 5.86 percent. Commercial banks were permitted to pay in full for their awards by crediting Treasury Tax and Loan Accounts and therefore bid aggressively. The Treasury contemplates further issues of two-year notes, timed to mature at quarterly intervals.

On October 25 the Treasury announced the terms of its November financing. In accordance with this plan, an additional \$3 billion of 6¼ percent notes maturing November 15, 1976 was sold at auction on November 1. Aggressive bidding produced an average yield of 6.20 percent. Payment will be made on November 15, and \$1.3 billion of the proceeds will be used to pay off notes maturing on that date. Commercial banks were permitted to pay for up to 75 percent of accepted tenders by credit to Treasury Tax and Loan Accounts. This auction provided one quarter of the \$12 billion that the Treasury expects it will need to raise through early January. The \$200 million weekly addition to the bill auctions will also fill part of the Treasury's cash needs. In addition, the Treasury indicated that it expects to sell about \$2 billion more of notes in December or early January and that at least the bulk of its remaining near-term cash needs will be met by sales of tax anticipation bills maturing in April and June 1973.

Government agency financing was quite active during October. The pricing of many of the issues offered competitively was somewhat aggressive in relation to market appetites. For example, \$225 million of Government-guaranteed bonds of the Washington Metropolitan Area Transit Authority, D.C., sold slowly when reoffered on October 10 to yield 7.30 percent. One week later, a \$150 million issue of Tennessee Valley Authority bonds priced to yield 7.37 percent also encountered a cool reception from investors. However, both issues eventually sold out and rose to slight premiums when the underwriting syndicates disbanded late in the month. During the week of October 30 to November 3, the General Services Administration auctioned a total of \$196.6 million of thirty-year participation certificates in five segments to finance construction of Federal buildings in various cities. The issues, which are guaranteed by the Federal Government, were well received at declining yields ranging from 7.40 percent to 7.19 percent.

OTHER SECURITIES MARKETS

Prices of corporate and municipal securities were greatly affected during October by the prospects for a Vietnam settlement. Dealers raised prices when the political outlook improved and made some reductions when peace negotiations seemed stalled. The calendar of new issues was moderately heavy, but the near-term supply appeared to be small. Underwriters were therefore willing to retain the inventories left by selective investor demand.

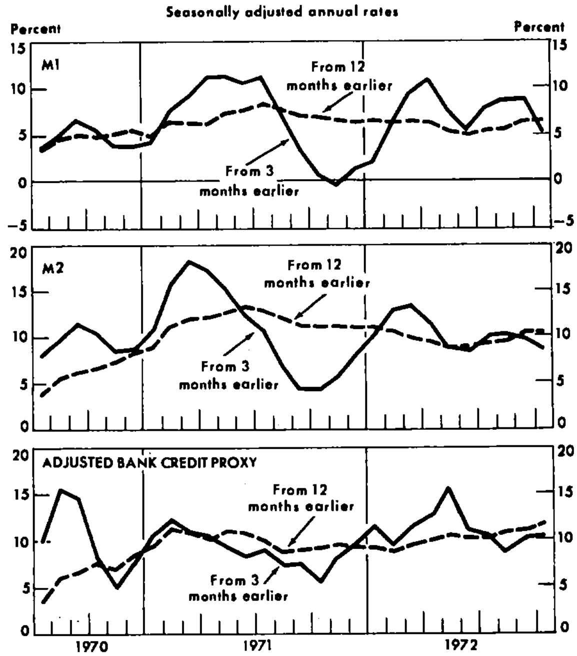
The market opened the month at the end of one rally based on rumors of progress toward peace. The first Aa-rated utility bond was reoffered on October 4 to yield 7.45 percent. This was about 15 basis points below the return established in September, and initial sales were slow. When the issue was released from syndicate on October 12, its yield rose 4 basis points. One week later, comparable issues were priced to yield 7.54 percent and 7.60 percent. Their reception was better, reflecting both the higher returns and the effects of renewed diplomatic activity.

These developments and a lighter calendar encouraged the aggressive pricing of a new telephone debenture rated Aaa by one service and AA by another. On October 24,

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for October 1972 are preliminary estimates.

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.

Sources: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates — October 1972				
	Oct. 2	Oct. 6	Oct. 16	Oct. 20	Oct. 30
Three months	4.601	4.743	4.818	4.712	4.767
Six months	5.082	5.159	5.127	5.105	5.141

Maturities	Monthly auction dates — August-October 1972		
	Aug. 24	Sept. 26	Oct. 24
Nine months	5.040	5.346	5.223
Fifty-two weeks	5.178	5.529	5.318

*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.

this issue was reoffered to yield 7.40 percent. Its reception was cool, since this was about 3 basis points below the returns obtainable on similar securities in the secondary market. However, this issue and several other slow-moving offerings sold out and rose to a premium in the early-November rally.

Prices of seasoned tax-exempt securities rose on balance over the month. The Bond Buyer index of twenty municipal bond yields declined from 5.30 percent on September 28 to 5.13 percent on October 26 and then fell further to 5.04 percent on November 2. The month's largest municipal bond flotation occurred on October 11, when New York City sold $304 million of bonds at a net interest cost of 5.74 percent. Although the cost was well below the 6.17 percent the City paid last July, the bonds sold out quickly. As offering yields declined, sales of other new issues slowed during the month and the Blue List of advertised inventories increased by a substantial $306 million over the month to $922 million.