The Money and Bond Markets in January

Short-term interest rates rose considerably in January against the background of the strong economic advance and general apprehension over the future course of prices. The rapid recent growth of the monetary and credit aggregates added to this concern, with market participants expecting the monetary authorities to resist this growth. Indeed, the average effective Federal funds rate rose to 5.94 percent, 61 basis points higher than in December.

The exceptionally rapid increase in wholesale agricultural prices during December underlined the growing concern about inflationary pressures, and announcement of Phase Three in the Economic Stabilization Program engendered further caution stemming from uncertainty about its potential effects. On January 12, the Board of Governors of the Federal Reserve System approved a ½ percentage point increase in the discount rate to 5 percent at all twelve Reserve Banks. The Board explained that this adjustment was undertaken to bring the discount rate into better alignment with short-term market interest rates, which had risen earlier.

Banks experienced increased pressure on their reserve positions during January. Their efforts to cover reserve requirements enlarged by the rapid growth in deposits during December were reflected in higher rates for Federal funds and expanded member bank borrowings at the Federal Reserve discount window. As overnight money became more expensive, Government securities dealers sought to reduce their inventories, putting strong upward pressure on Treasury bill rates. Posted rates on private short-term instruments increased as well. The yields on Government coupon issues also rose appreciably, in part because of the approach of the Treasury's February financing.

Corporate bond yields rose while tax-exempt yields remained relatively steady during most of January. Dealers in corporate bonds met stiff investor resistance to aggressively priced issues. However, most new municipal securities were absorbed comfortably. Later in the month, bank selling of outstanding issues and lackluster investor interest led to a rise in tax-exempt yields.

BANK RESERVES AND THE MONEY MARKET

Money market conditions grew increasingly firmer during January. The average effective rate on Federal funds rose from 5.34 percent in the December 27, 1972 statement week to 6.35 percent in the January 31, 1973 statement week. Average required reserves rose $1.6 billion above December levels, as the large deposit expansion of late December was reflected in January's required reserves (see Table I). (Member banks calculate required reserves on deposit levels of two weeks earlier.) Consequently, reserves available to support private nonbank deposits (RPD) increased sharply in January, at a seasonally adjusted annual rate of 22 percent. Nonborrowed reserves, which are essentially managed by the monetary authorities, rose by only $1.3 billion. Thus, banks bid aggressively for Federal funds and expanded borrowings from Federal Reserve Banks by about $300 million.

With Federal funds trading at markedly higher interest rates, yields on other short-term instruments also rose (see Chart I). Dealers in prime commercial paper increased their rates by ¼ to ⅜ percentage point, and bankers' acceptance dealers adjusted their offering rates upward by ¾ percentage point. In the secondary market, rates on large negotiable certificates of deposit (CDs) rose about 50 basis points. The discount rate boost had been anticipated by most market participants and was not a disturbing influence.

The rapid growth of the narrow money supply (M_1) halted in January. Preliminary estimates indicate that M_1 —adjusted private demand deposits plus currency outside banks—was unchanged on a seasonally adjusted basis from December to January. The M_1 series has been revised to reflect benchmark adjustments for domestic nonmember banks and to incorporate additional international banking institutions, the impact of the revised Regulation J, and new seasonal factors. In spite of the leveling-off in January, M_1 increased at an annual rate of 6.2 percent

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1973

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

Factors	Changes in daily averages—week ended					Net changes
	Jan. 3	Jan. 10	Jan. 17	Jan. 24	Jan. 31	
"Market" factors						
Member bank required reserves	− 792	− 336	−1,319	+1,165	+ 420	− 862
Operating transactions (subtotal)	− 513	+1,094	+ 496	−1,449	−1,091	−1,463
Federal Reserve float	− 590	+ 511	− 811	− 879	−1,226	−2,995
Treasury operations*	− 22	+ 15	+ 32	− 638	− 368	− 981
Gold and foreign account	− 42	+ 35	− 4	− 15	+ 28	+ 2
Currency outside banks	+ 146	+ 409	+1,284	+ 177	+ 620	+2,696
Other Federal Reserve liabilities and capital	− 5	+ 64	− 5	− 93	− 145	− 184
Total "market" factors	−1,305	+ 758	− 823	− 284	− 671	−2,325
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+1,145	− 150	+ 341	+ 141	+ 884	+2,301
Outright holdings:						
Treasury securities	+ 483	+ 423	− 18	—	+ 788	+1,676
Bankers' acceptances	+ 1	+ 5	+ 2	+ 2	+ 1	+ 11
Federal agency obligations	+ 21	—	—	—	—	+ 21
Repurchase agreements:						
Treasury securities	+ 536	− 486	+ 324	+ 153	+ 44	+ 571
Bankers' acceptances	+ 53	− 47	+ 19	− 4	+ 18	+ 39
Federal agency obligations	+ 51	− 45	+ 14	− 10	+ 33	+ 43
Member bank borowings	+ 633	−1,063	+ 613	− 206	+ 216	+ 193
Other Federal Reserve assets†	+ 69	+ 21	+ 35	+ 72	− 9	+ 188
Total‡	+1,676	−1,192	+ 989	+ 7	+1,090	+2,570
Excess reserves‡	+ 371	− 434	+ 166	− 277	+ 419	+ 245

Member bank:	Daily average levels					Monthly averages
Total reserves, including vault cash‡	32,604	32,506	33,991	32,549	32,548	32,840§
Required reserves	32,044	32,380	33,699	32,534	32,114	32,554§
Excess reserves‡	560	126	292	15	434	285§
Borrowings	1,751	688	1,301	1,095	1,311	1,229§
Free, or net borrowed (−), reserves	−1,191	− 562	−1,009	−1,080	− 877	− 944§
Nonborrowed reserves	30,853	31,818	32,690	31,454	31,237	31,610§
Net carry-over, excess or deficit (−) ‖	59	248	105	140	27	116§

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

† Includes assets denominated in foreign currencies.

‡ Adjusted to include $279 million of certain reserve deficiencies on which penalties can be waived for a transition period in connection with bank adaptation to Regulation J as amended effective November 9, 1972. (The adjustment amounted to $450 million from November 9 through December 27, 1972.)

§ Average for five weeks ended January 31.

‖ Not reflected in data above.

over the three months ended in January (see Chart II).

Time deposits other than CDs accelerated slightly to a 14 percent annual growth rate. This component of the broad money supply (M_2) partially offset the deceleration in the M_1 component, resulting in expansion of M_2 at an annual rate of about 7 percent in January. For the three months ended in January, M_2 advanced at a 9 percent annual rate.

The growth of the adjusted bank credit proxy—which consists of daily average member bank deposits subject to reserve requirements and certain nondeposit liabilities —slowed to an annual rate of about 9 percent in January. The deceleration was particularly noticeable in CDs which nevertheless continued to grow rapidly, albeit at a slower pace than in December. For the three months ended in January the proxy posted an 11 percent annual rate of advance.

THE GOVERNMENT SECURITIES MARKET

Increased concern over the course of inflation and expectations of firmer monetary policy dominated sentiment in the Government securities market during January. The exceptionally large advance in gross national product during the fourth quarter of 1972 underscored the strength of the recovery in aggregate demands for goods and services. This suggested to many observers increasing upward pressure on interest rates as credit demands accelerate and on prices as the economy moves rapidly toward full-capacity output. Expectations of higher consumer prices in the months ahead were prompted by the announcement of the enormous increase in wholesale prices of agricultural goods in December.

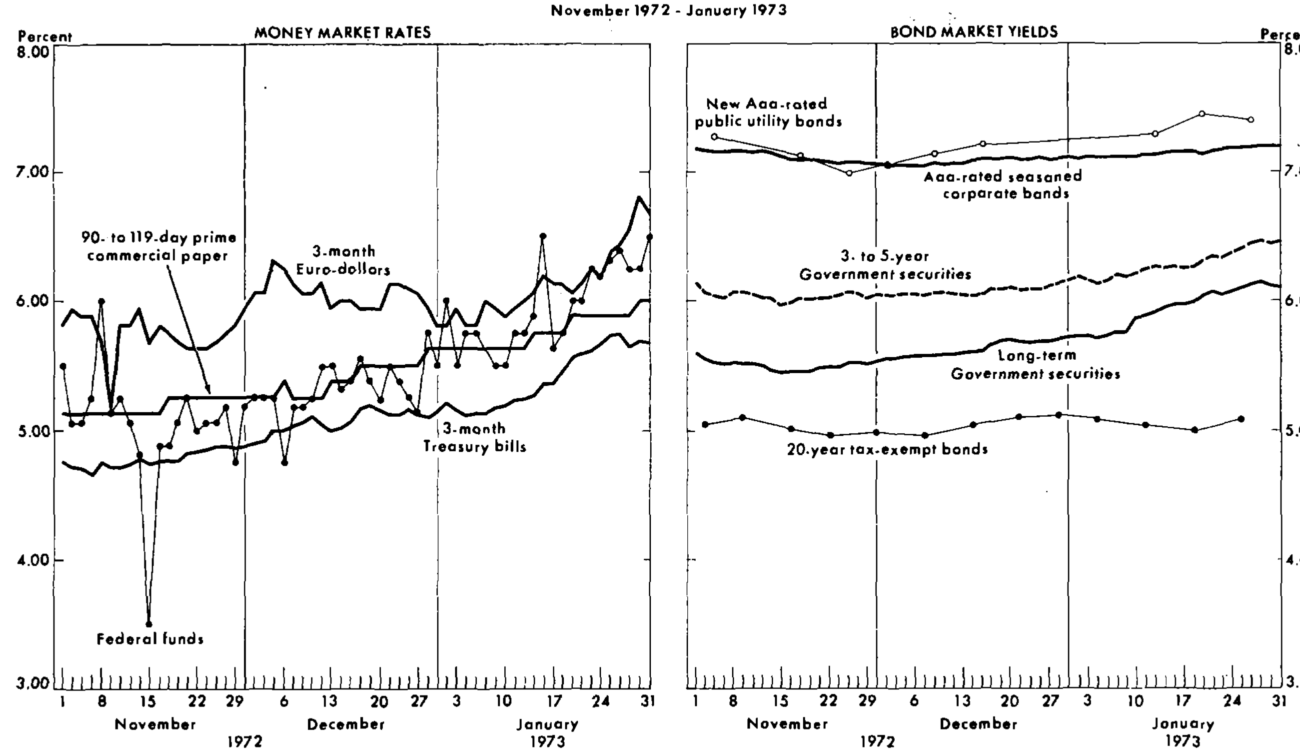
On January 11, the Administration disclosed the details of the Economic Stabilization Program's Phase Three. Some market participants interpreted the increased reliance upon voluntary compliance to wage and price guidelines to be a relaxation in the program's ability to control inflationary pressures. Expectations of a tighter monetary policy posture had been advanced following the rapid M_1 growth in December and the large wholesale price increase. The Phase Three announcement reinforced these sentiments, and the increase in the discount rate was taken as confirmation of the Federal Reserve's position.

The President's budget message, transmitted to the Congress on January 29, somewhat tempered the market's concern over inflation, however, by indicating the Administration's commitment to restraint on Federal spending. The new budget estimates fiscal 1973 outlays at $249.8 billion and receipts at $225 billion for a fiscal 1973 deficit of $24.8 billion on a unified budget basis. For fiscal 1974,

Chart I

SELECTED INTEREST RATES

November 1972 - January 1973



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 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 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.

outlays are projected at $268.7 billion and revenues at $256 billion for a deficit of $12.7 billion.

Expectations of firmer monetary policy combined with higher money market interest rates and a continued increase in the supply of Treasury bills to push bill rates upward. The average issuing rate for three-month bills rose 53 basis points from 5.16 percent at December's last auction to 5.69 percent at the January 29 auction (see Table II). The increased supply of bills came from enlarged Treasury issues and from sales by some foreign and international accounts. In each weekly bill auction through January 22 the Treasury sold an additional $200 million of bills, and in the monthly auction a net addition of $100 million of bills was placed. Although the Treasury discontinued sales of nine-month bills with the October auction, the amount of one-year bills auctioned exceeded the maturing nine-month and one-year bills by $100 million. On balance, foreign and international accounts continued to reduce the amount of marketable Government securities held in custody at the Federal Reserve. These accounts fell $0.6 billion over the four weeks ended January 31 to $30.2 billion. The increased supply of bills applied upward pressure on bill rates in the secondary market, and rates generally rose 30 to 70 basis points during January.

Yields on Treasury coupon securities increased rapidly in January. At the January 4 auction, the new twenty-year

Treasury bond was sold to yield about 6.79 percent. Approximately $472 million of the $627 million of accepted tenders was from the New York Federal Reserve District. This, in addition to the fact that only $81 million of noncompetitive tenders was received, suggested that the bond may have been positioned initially with short-term holders. As the security was distributed to permanent investors, the bond's price declined and the issue closed the month on a bid quotation at a 6.86 percent yield. The weak secondary-market performance of this long-term bond carried over to other coupon issues, and yields on intermediate- and long-term Treasury securities ended the month about 30 basis points above late-December levels.

On January 31 the Treasury announced the terms of its February financing. The Treasury offered a new 6½ percent note of 3½ years in exchange for $6.8 billion of securities maturing on February 15. The new notes due August 15, 1976 will yield about 6.60 percent at a price of 99.70. In addition, the Treasury auctioned on February 7 about $1 billion of 6⅝ percent notes due November 15, 1979.

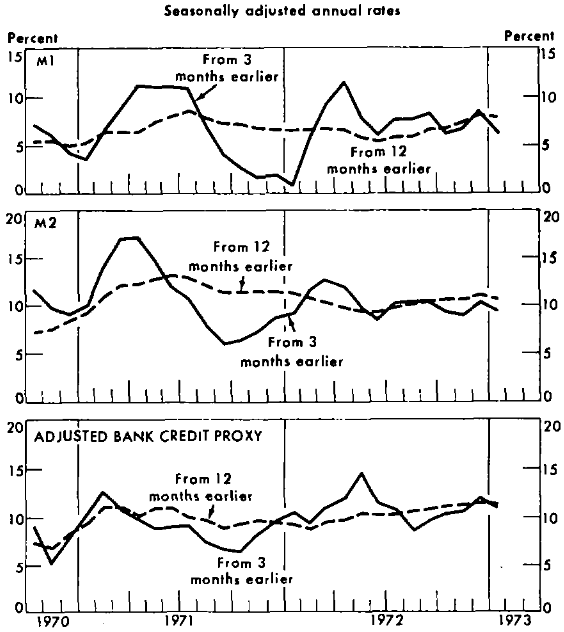
The upward rate movements in longer term issues extended into the Federal agency market. On January 16, $100 million of Tennessee Valley Authority (TVA) 25-year bonds was reoffered at a yield of 7.35 percent and met an enthusiastic reception at those terms. However, just eight days later, a much slower reception was accorded a Washington (D.C.) Metropolitan Area Transit Authority issue bearing an identical yield. The $220 million of bonds carried a Government guarantee and a ten-year call protection in contrast to the five-year protection for the TVA obligations, but bond market investors had increased their yield requirements since the TVA issue. On January 29, syndicate price restrictions were removed from the transit issue and the price initially dropped enough to raise the yield 10 basis points.

In other Federal agency activity, the Federal Land Banks offered, on January 5, $373 million of 6.25 percent bonds due in April 1976 and $300 million of 6.70 percent bonds maturing in January 1980. The issues replaced $407 million of maturing securities and raised $266 million of new money. The farm credit agencies sold $569 million of 5.95 percent six-month Banks for Cooperatives bonds and $544 million of 6 percent nine-month bonds of the Federal Intermediate Credit Banks on January 17. The new issues replaced $934 million of maturing debt and raised $178 million in new money.

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for January 1973 are preliminary.

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.

OTHER SECURITIES MARKETS

Corporate bond prices edged downward during January, as the traditional reinvestment demand from holders of year-end maturing securities failed to develop in the size expected. The market for tax-exempt securities, on the other hand, remained comparatively firm until late in the month. The municipal market was aided by recurring Congressional discussion of possible alternatives to full tax exemption for these securities and by the generally better financial position of these governments.

Investors responded very selectively to new utility issues in January, finding most unattractively priced. Two issues totaling $150 million were the first to test the market. The thirty-year bonds carried a split rating of Aa by Moody's and A by Standard and Poor's. Investors resisted the reoffering terms which specified about a 7.43 percent yield. Subsequently, both issues were released from syndicate and reduced sharply in price. The next major reoffering—$100 million of thirty-year Aa-rated bonds—was also considered to be aggressively priced at a yield of 7.47 percent, and the securities moved slowly. At a 7.50 percent yield, $100 million of 26-year Aa-rated bonds was distributed more easily. However, subsequent attempts to sell securities at lower yields met investor resistance. For example, another Aa-rated issue was poorly received when the $50 million of thirty-year bonds was priced to yield 7.44 percent.

The postponement of $125 million of Richmond, Virginia, expressway revenue bonds from the tax-exempt calendar aided the municipal market before midmonth. Pending litigation regarding environmental considerations was responsible for its removal. The State of Hawaii sold $55 million of A-rated debt priced to yield 3.70 percent in 1976 to 5.30 percent in 1993. On the same day, Wisconsin's $38 million of Aa-rated bonds was reoffered to return 3.10 percent in 1974 to 5.10 percent in 1992-93. Both issues moved well. New York State brought to market $130 million of Aa-rated obligations in the following week. Investors reacted favorably to terms providing a 3.00 percent yield in 1974 to a 5.40 percent yield in 1996-2003. The Blue List of advertised inventories of municipal bonds was reduced slightly to $905 million on January 31. The Bond Buyer index of twenty municipal bond yields rose by 5 basis points to 5.16 percent on February 1.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates — January 1973			
	Jan. 8	Jan. 15	Jan. 22	Jan. 29
Three months	5.155	5.277	5.633	5.689
Six months	5.412	5.540	5.760	5.871

Maturities	Monthly auction dates—November 1972-January 1973		
	Nov. 22	Dec. 26	Jan. 26
Fifty-two weeks	5.226	5.337	5.986

* 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.