The Money and Bond Markets in October

In October, most short-term interest rates continued the decline that had begun in mid-September. Longer term interest rates, on the other hand, leveled off after falling since mid-August. As in September, participants were highly sensitive to indications of changes in monetary policy. During October, rates on bankers' acceptances fell by 1 percentage point, while rates on large negotiable certificates of deposit (CDs) also declined significantly. The effective rate on Federal funds averaged 9.90 percent in the statement week ended October 31, 94 basis points below the average of the final week of September. In the second half of October, most major commercial banks lowered their prime lending rate for large business borrowers to 9¾ percent, and in the last week of the month a few banks set their prime rate at 9½ percent.

The optimism that had been building in the Government securities market since mid-August was undermined somewhat in October by uncertainty about the future course of monetary policy, by the hostilities in the Mideast, and by the resignation of Vice President Agnew. Rates on short-term Treasury bills stabilized, while those on longer dated bills continued to decline. On the other hand, prices of Treasury coupon securities fell slightly. Federal agency financing remained heavy, and yields in this sector edged higher. Similarly, prices of seasoned corporate and municipal bonds sagged as the supply of new issues expanded substantially.

The narrow money supply (M_1)—demand deposits adjusted plus currency outside banks—grew modestly in October after contracting in the two previous months. The broad money supply (M_2), which includes time and savings deposits other than CDs, expanded more rapidly during the month than in September. In October, the financial regulatory agencies imposed interest rate ceilings on consumer-type deposits with maturities of four years or more; such deposits had not been subject to interest rate ceilings since early July. The seasonally adjusted volume of CDs outstanding decreased in October for the second successive month. Partially as a result, the growth of the adjusted bank credit proxy slowed.

BANK RESERVES AND THE MONEY MARKET

Interest rates on most short-term instruments moved irregularly lower during October, extending the decline that had begun in mid-September (see Chart I). Rates on most maturities of commercial paper fell 1 percentage point or more. The effective rate on Federal funds averaged 10.01 percent in October, 77 basis points below the average of September. At the same time, member banks further reduced their reliance on the discount window. Borrowings from the Federal Reserve averaged $1.5 billion in October (see Table I), in comparison with $1.9 billion in September and a very substantial $2.1 billion in August.

The reliance by large banks on CDs as a source of funds also continued to diminish in October. In September, the Federal Reserve raised the reserve requirement applicable to CDs, in effect making these instruments more expensive to the issuing banks. Also, with spreading expectations that interest rates would decline further, banks became less aggressive sellers of CDs. Rates on CDs fell sharply in October, and the volume of CDs outstanding at weekly reporting banks decreased sizably over the month.

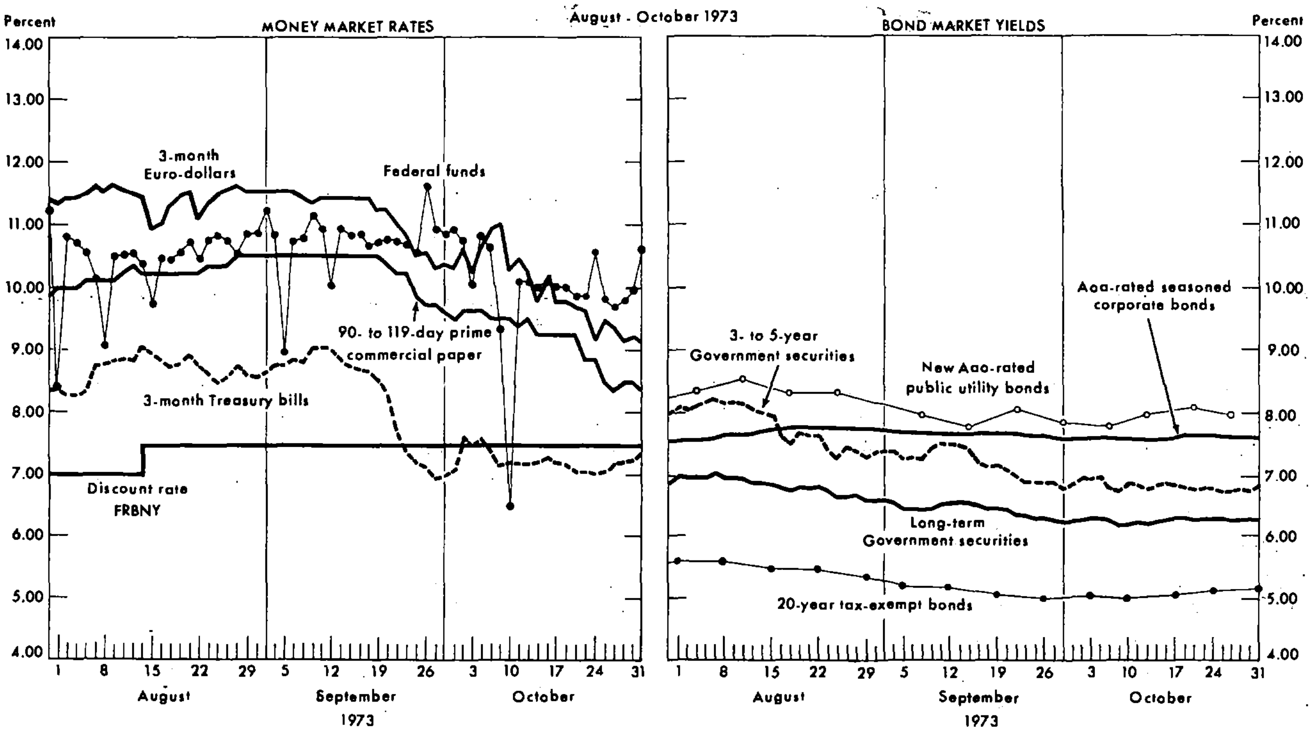
Most major commercial banks lowered their prime lending rate for large business borrowers from 10 percent to 9¾ percent late in October, and by early November several banks reported a further decrease to 9½ percent. Commercial paper rates declined by a considerably greater magnitude, however, restoring the positive spread between the prime rate and commercial paper rates. This realignment led to a substantial rise in the volume of dealer-placed nonbank-related commercial paper outstanding. The amount of such paper outstanding climbed to $11.5 billion at the end of October, up $2.6 billion from the end of September.

Both the narrow and the broad money supply advanced at a faster rate in October than in the two preceding months. Preliminary data indicate that M_1 expanded at a seasonally adjusted annual rate of about 4½

Chart I

SELECTED INTEREST RATES

August - October 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-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.

percent in October, after contracting in September at a 2¼ percent rate. Over the twelve months ended in October, M_1 expanded 5 percent (see Chart II). The growth of commercial bank time and savings deposits other than CDs was more rapid in October than the 9½ percent pace of the previous month, and growth of M_2 accelerated considerably from September's 3¾ percent rate, bringing the expansion in M_2 over the three months ended in October to about 7 percent at an annual rate. In October, the Board of Governors of the Federal Reserve System, the Federal Home Loan Bank Board, and the Federal Deposit Insurance Corporation imposed interest rate ceilings on consumer-type deposits with four or more years' maturity. The new ceilings are 7.25 percent at commercial banks and 7.50 percent at savings and loan associations and mutual savings banks. While placing limits on the rates paid on these deposits, the regulatory authorities removed the restrictions on the amounts of these deposits that the financial institutions can issue. Previously, such deposits had been limited to 10 percent of total deposit liabilities at savings and loan associations and 5 percent of total time and savings deposits at insured commercial banks and mutual savings banks.

The adjusted bank credit proxy—which consists of daily average member bank deposits subject to reserve requirements and certain nondeposit liabilities—grew slowly in October, restrained by the decline in CDs outstanding. Despite the recent moderation in proxy growth, it still expanded 12 percent over the year ended in October. Reserves available to support private nonbank de-

Table I

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

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

Factors	Changes in daily averages— week ended					Net changes
	Oct. 3	Oct. 10	Oct. 17	Oct. 24	Oct. 31	
"Market" factors						
Member bank required reserves	— 150	— 175	— 703	+ 352	— 97	— 773
Operating transactions (subtotal)	— 303	+ 800	— 332	—1,145	+ 498	— 482
Federal Reserve float	— 11	+ 545	+ 351	— 427	— 755	— 297
Treasury operations*	— 455	+ 431	— 66	—1,287	+ 298	—1,079
Gold and foreign account	+ 121	— 18	— 6	+1,179	— 25	+1,251
Currency outside banks	+ 107	— 427	— 458	— 321	+ 784	— 315
Other Federal Reserve liabilities and capital	— 64	+ 267	— 153	— 288	+ 195	— 43
Total "market" factors	— 453	+ 625	—1,035	— 793	+ 401	—1,255
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+1,491	— 559	+ 632	+ 351	— 95	+1,820
Outright holdings:						
Treasury securities	+ 216	— 162	+1,332	+ 419	— 192	+1,613
Bankers' acceptances	+ 2	+ 5	+ 1	+ 4	— 2	+ 10
Federal agency obligations	—	+ 19	—	+ 156	— 3	+ 172
Repurchase agreements:						
Treasury securities	+1,018	— 435	— 449	— 176	+ 104	+ 62
Bankers' acceptances	+ 71	— 23	— 46	— 19	+ 1	— 16
Federal agency obligations	+ 184	+ 37	— 206	— 33	— 3	— 21
Member bank borrowings	— 680	— 168	— 183	+ 746	— 459	— 744
Seasonal borrowings†	— 6	— 13	— 11	+ 5	— 6	— 31
Other Federal Reserve assets‡	+ 48	+ 50	+ 68	+ 89	—	+ 255
Total§	+ 831	— 677	+ 517	+1,186	— 553	+1,304
Excess reserves‡	+ 378	— 52	— 518	+ 393	— 152	+ 49
	Daily average levels					Monthly averages
Member bank:						
Total reserves, including vault cash‡	34,672	34,795	34,980	34,989	34,966	34,880‖
Required reserves	34,220	34,395	35,098	34,746	34,843	34,660‖
Excess reserves§	452	400	— 118	275	123	226‖
Total borrowings	1,519	1,351	1,168	1,914	1,455	1,481‖
Seasonal borrowings†	144	131	120	125	119	128‖
Nonborrowed reserves	33,153	33,444	33,812	33,075	33,511	33,399‖
Net carry-over, excess or deficit (—)#	47	222	247	100	153	154‖

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.

§ Adjusted to include $84 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, $279 million from December 28, 1972 through March 28, 1973, $172 million from March 29 through June 27, 1973, and $112 million from June 28 through September 26, 1973.

‖ Average for five weeks ended October 31.

Not reflected in data above.

posits, adjusted to eliminate the effects of changes in reserve requirement ratios, were little changed in October.

Late in the month, the United States Treasury monetized the increase in the value of the nation's gold stock resulting from the change in the official gold price. Consequently, the Federal Reserve's holdings of gold certificates increased by $1.2 billion to $11.5 billion, and the Treasury's account increased by the same amount.

THE GOVERNMENT SECURITIES MARKET

Rates on Treasury bills of more than three-month maturity generally declined during October, while rates on the shorter term issues increased somewhat. Throughout the month, participants remained highly sensitive to indications of a shift in monetary policy. At the outset of the period, bill rates were in the final stages of a precipitous slide that carried the three-month bill rate down nearly 200 basis points in about two weeks. Given the high cost of financing dealer inventories, a technical correction was inevitable and bill rates rose early in the month. The market was affected to some extent also by concern over the war in the Mideast and the resignation of the Vice President. However, the rate advance halted before midmonth when newly published data were interpreted as being consistent with a move toward less monetary restraint. Rates on longer term bills decreased over much of the remainder of October to finish about 24 to 53 basis points below their opening levels. Meantime, yields on shorter term bills, which had increased considerably early in the month, retraced part of their advance. The three-month bill rate closed the month about 30 basis points above its opening level.

The results of the weekly bill auctions for the most part reflected these fluctuations in market rates. After rising to 7.32 percent on October 5, the average issuing rate on the three-month bill fell to 6.96 percent in the auction of October 19 before increasing in the final auction of the month (see Table II). The issuing rate for the six-month bill declined continuously over the month until the auction of October 29. At the auction of 52-week bills on October 17, an average issuing rate of 7.13 percent was set, 93 basis points below the level established at the previous such auction. Early in the month, the Treasury sold $1.8 billion of 294-day bills at an average rate of 7.70 percent. The issue completed the transition from a monthly cycle of one-year bills maturing on the last day of each month to a four-week cycle of 52-week bills maturing on every fourth Tuesday. On October 25, $2.0 billion of tax anticipation bills maturing April 19, 1974 was auctioned at a yield of 6.77 percent.

Prices of Treasury coupon securities fluctuated narrowly in October, edging slightly lower on balance. In part, this reflected a technical consolidation of the sharp price gains of the previous six weeks. There was also the prospect of additional supply in the Treasury's November financing and some disappointment over the speed with which the monetary authorities seemed to be moving toward the lower interest rates expected by market participants. Weakness in the corporate bond market during the latter part of the month had a depressing influence on prices of longer term Government securities. For the month as a whole, yields on most three- to five-year issues rose by an average of 6 basis points, while yields on longer term issues increased 4 basis points.

On October 24, the Treasury disclosed its plans for refunding \$3.6 billion of publicly held bonds due to mature November 15. The Treasury announced that it would auction up to \$1.5 billion of 25½-month notes, \$2 billion of six-year notes, and an additional \$300 million of 7½ percent bonds scheduled to mature August 15, 1993. For the bonds, the Treasury utilized the technique of awarding all of the bonds at the price of the lowest accepted bid. The Treasury deferred setting coupon rates for the notes until October 29, when it placed 7 percent coupons on both issues.

There was fairly good professional interest in the six-year notes auctioned October 30 at a 6.82 percent average yield. The December 1975 notes and the bonds, auctioned on October 31, were well received; the average yield on the notes was 6.91 percent, and the bonds sold at a yield of 7.35 percent if held to maturity. On the final day of the month, professionals began to press offerings of the six-year notes and the market atmosphere weakened somewhat.

Prices of Federal agency securities also moved slightly lower in October, as new issue activity remained heavy. Early in the month, the Federal Land Banks offered \$362 million of 7.40 percent two-year bonds, \$550 million of 7.35 percent five-year bonds, and \$300 million of 7.30 percent ten-year bonds. This issue sold out quickly. About a week later, the Federal Home Loan Banks raised \$1.3 billion of new cash by selling bonds with maturities of twenty-two months, forty months, and twenty years. The three maturities were priced to yield 7.15 percent, 7.20 percent, and 7⅜ percent, respectively. Initial demand for the shorter maturities was good, but the twenty-year bonds sold slowly. Around midmonth, the Tennessee Valley Authority offered \$100 million of 7.70 percent 25-year bonds. This financing was fairly well received. Shortly thereafter, offerings of short-term debentures by

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

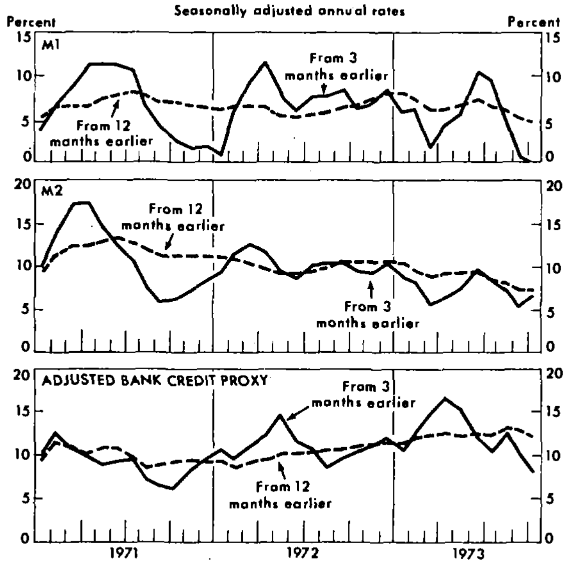
Maturities	Weekly auction dates—October 1973				
	Oct. 1	Oct. 5	Oct. 15	Oct. 19	Oct. 29
Three-month	7.149	7.323	7.188	6.959	7.196
Six-month	7.584	7.259	7.242	6.951	7.263
	Monthly auction dates—August-October 1973				
	Aug. 22	Sept. 19	Oct. 17		
Fifty-two weeks	8.388	8.057	7.132		

* 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

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for October 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.

the Banks for Cooperatives and the Federal Intermediate Credit Banks met favorable receptions.

OTHER SECURITIES MARKETS

After fluctuating within a fairly narrow range over much of the period, prices of corporate and municipal securities finished October somewhat lower than they had begun the month. New issue activity, particularly in the corporate sector, was relatively heavy in comparison with that of preceding months, and many observers thought that this situation would continue in the months ahead. As a consequence, participants became cautious and prices were under light, but steady, pressure throughout the latter half of the month.

In the corporate market, at the outset of the period a major Aaa-rated Bell System offering was marketed at a yield of 7.67 percent, a rate slightly below that on a comparable issue in the secondary market. This financing was afforded only a fair reception. Around midmonth several sizable A-rated corporate issues, priced to return 8 percent or more, generally encountered good receptions. However, late in the month a second Aaa-rated Bell System issue, also forty-year debentures, met an unenthusiastic response from investors when it was priced to yield 7.95 percent.

The volume of new issues in the market for tax-exempt securities was also greater in October than in recent months. The volume of new municipal issues was over $2.2 billion, compared with $1.6 billion in September. Two A-rated issues offered before midmonth were afforded only fair receptions. In the first, $70 million of bonds scaled to yield from 4.60 percent in 1974 to 5.75 percent in 2016 sold well initially but demand subsequently tapered off. Sales of the second A-rated offering—$100 million of 25-year bonds yielding 5.50 percent—were slow. New tax-exempt securities marketed later in the month similarly encountered only limited interest. The Bond Buyer index of twenty tax-exempt bond yields climbed to 5.12 percent on October 25, 12 basis points above the level of September 27. Reflecting the increase in new financing activity, the Blue List of dealers' advertised inventories increased $219 million in October to $931 million.