# The Money and Bond Markets in January

A rally late in January pushed most interest rates down sharply from their midmonth levels. Treasury bill rates had backed up earlier in the month in response to a heavy volume of sales by foreign central banks. However, when the Federal funds market showed signs of easing in the final week of January, this was interpreted by participants as indicative of a less restrictive monetary policy and touched off the rally. Rates on money market instruments had begun to move downward early in the month, and the declines accelerated in the wake of the rally. By the end of the month, rates on commercial paper were as much as a full percentage point lower while other rates posted more modest declines. In addition, toward the end of the month, most major commercial banks reduced their prime lending rate to large borrowers by ¼ percentage point to 9½ percent.

End-of-the-month declines in yields on Treasury coupon issues were more modest than those on bills, and most rates closed above their levels at the end of December. The rising yields in the United States Government securities market resulted from a number of factors. The selling of foreign holdings occurred because of the strength of the dollar relative to certain other currencies and the consequent attempt of foreign central banks to support these currencies. Dealers were also concerned with the high cost of financing inventories in view of the relatively weak investor demand and prospects of additional supplies that would be forthcoming from the Treasury's February refunding. The termination on January 29 of United States restrictions on foreign investments by United States residents contributed to an improved tone in the securities market at the close, since the move was expected to reduce some of the pressure on foreign currencies.

Faced with the largest monthly calendar in two and one-half years, the corporate bond market posted rates on new issues in January at the highest levels since last summer. The yield on new Aaa-rated utility bonds, as measured by the Board of Governors of the Federal Reserve System, climbed to 8.27 percent from the 7.98 percent registered late in December, before declining to 8.13 percent at the close of January. (On one utility issue the yield dropped back to 7.98 percent.) Rates on municipal bonds also rose, as dealers began the period with heavy inventories and the prospects of a sizable supply of new issues.

Preliminary data indicate that the narrow money supply ($M_1$)—private demand deposits adjusted plus currency outside banks—declined on average for the four weeks ended January 23, following a large increase during the preceding four-week period. There was further expansion both in $M_2$, which includes time and savings deposits other than large negotiable certificates of deposit (CDs), and in the adjusted bank credit proxy, which consists of daily average member bank deposits subject to reserve requirements plus certain nondeposit liabilities.

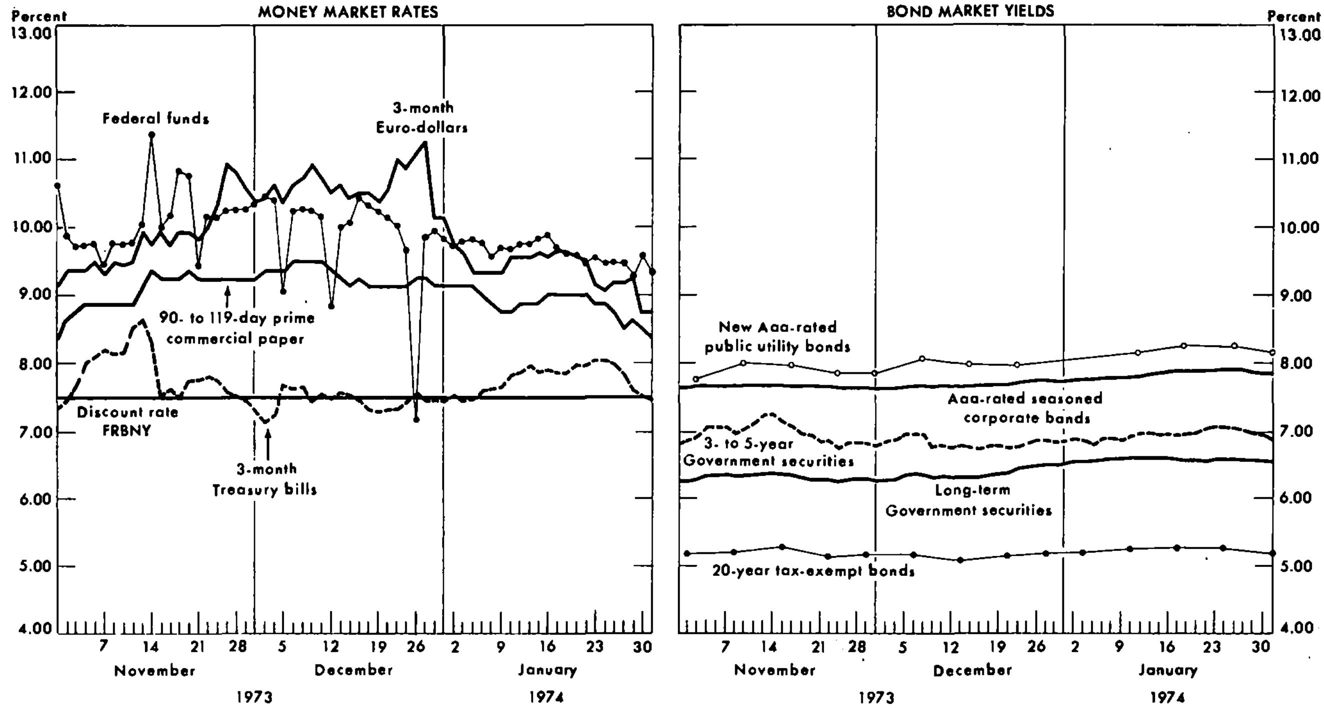
On January 25, the Board of Governors of the Federal Reserve System sent to the Congress draft legislation to implement its recommendations for uniform reserve requirements. The proposals were drawn in such a way as to achieve more precision in monetary control and more equity in competition without altering the diversified banking and financial structure that now serves the country. The basic underlying principle is that equivalent cash reserve requirements should apply to all deposits that effectively serve as a part of the public's money balances, regardless of the type of institution in which the balances are held. Thus, there would be reserve requirements against demand deposits at nonmember commercial banks and at foreign-owned banking institutions located in the United States as well as against those interest-bearing deposits at savings and loan associations and mutual savings banks from which withdrawals by negotiable instrument are permitted in some states. The proposal would provide a four-year transition period and no reserves would be required against the first $2 million of deposits.

### BANK RESERVES AND THE MONEY MARKET

Interest rates on most money market instruments declined in January and by larger amounts than had occurred in the preceding month (see chart). All categories of dealer-placed commercial paper registered decreases;

**SELECTED INTEREST RATES**

November 1973 - January 1974




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.

these ranged from ¾ percentage point on paper maturing in ninety days or more to 1 percentage point on paper due in less than ninety days. Bid rates on bankers' acceptances were lowered by ⅜ percentage point. The effective rate on Federal funds averaged 9.65 percent in January, 30 basis points less than in December when the rate also fell. For the fifth consecutive month, member banks reduced their reliance on the discount window. Consequently, the average level of borrowings fell $251 million in January to $1,076 million (see Table I).

The secondary market yield on large negotiable CDs also moved lower in January. The rate on CDs of three months' maturity closed the month at 8.87 percent, down 36 basis points over the period. At the same time, the volume of CDs outstanding increased by about $2.5 billion in this, the first month following the reduction in the marginal reserve requirement on large CDs and certain other commercial bank liabilities.* The reduction had been made in recognition of the slowing of bank credit growth during October and November, a pattern which had continued in December. In line with the deceleration of credit growth and the decline in short-term rates, several commercial banks reduced their prime lending rate ¼ per-

* For details concerning this change in reserve requirements, see this *Review* (January 1974), pages 7-8.

centage point to 9½ percent effective late in January.

Following the pattern of the last several years, $M_1$ appears to have been weak in January after rapid growth in December. Preliminary data indicate a decline in seasonally adjusted $M_1$ for the four weeks ended January 23. (The money supply series have been revised to reflect bench-mark adjustments for nonmember banks and new seasonal adjustment factors.) From its average for the four weeks ended thirteen weeks earlier to its average for the four weeks ended January 23, $M_1$ rose at a seasonally adjusted annual rate of 5.1 percent. The increase from the average for the four weeks ended fifty-two weeks earlier was also at a 5.1 percent rate.

The growth of commercial bank time and savings deposits other than large CDs remained strong in January, and as a result the advance in the broad money supply ($M_2$) slowed very little from its December pace. $M_2$ expanded at an 8.5 percent annual rate between its four-week average thirteen weeks earlier and its average for the four weeks ended January 23.

The adjusted bank credit proxy grew strongly during the four weeks ended January 23, continuing the pickup which had begun in December. The rise in the proxy during this most recent period was at a seasonally adjusted annual rate of 6 percent, compared with the four-week average ended thirteen weeks earlier. Substantial growth in CDs, as well as in other time and savings deposits, and a large increase in United States Government deposits were the major factors in the proxy's expansion following two months of contraction. Reserves available to support private nonbank deposits also increased in January, though more moderately than their average growth in 1973.

### THE GOVERNMENT SECURITIES MARKET

Rates on Treasury bills were pushed steadily higher during the first half of January, when this sector of the market experienced heavy sales by foreign central banks. Investor demand was modest, and Government securities dealers were generally reluctant to incur the high cost of financing inventories in the absence of signs of a Federal Reserve move to a less restrictive monetary policy. Rates began to drift lower in the third week, and sentiment improved dramatically as the month closed. A decline in the Federal funds rate during the final week was interpreted as a sign of a relaxed policy stance, and rates fell sharply. By the end of the month, shorter rates were only a touch above their end-of-December levels while rates on bills maturing in more than three months were 6 to 24 basis points lower on balance.

Early in the period, the market had responded favor-

Table I

**FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1974**

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

| Factors | Changes in daily averages— week ended | | | | | Net changes |
|---|---|---|---|---|---|---|
| | Jan. 2 | Jan. 9 | Jan. 16 | Jan. 23 | Jan. 30 | |
| **"Market" factors** | | | | | | |
| Member bank required reserves | — 316 | — 924 | —1,129 | + 646 | + 800 | — 923 |
| Operating transactions (subtotal) | — 741 | + 983 | +1,418 | — 859 | —1,330 | — 529 |
| Federal Reserve float | — 723 | + 202 | — 674 | — 418 | —1,028 | —2,641 |
| Treasury operations* | — 27 | — 73 | + 161 | — 162 | — 741 | — 842 |
| Gold and foreign account | + 200 | — 213 | + 226 | — 80 | — 96 | + 37 |
| Currency outside banks | + 4 | + 571 | +1,786 | — 94 | + 571 | +2,838 |
| Other Federal Reserve liabilities and capital | — 196 | + 496 | — 81 | — 105 | — 37 | + 77 |
| Total "market" factors | —1,057 | + 59 | + 289 | — 213 | — 530 | —1,452 |
| **Direct Federal Reserve credit transactions** | | | | | | |
| Open market operations (subtotal) | + 705 | — 23 | — 158 | — 458 | + 803 | + 869 |
| Outright holdings: | | | | | | |
| Treasury securities | + 879 | + 428 | + 21 | — 486 | + 498 | +1,340 |
| Bankers' acceptances | + 9 | — 4 | — 1 | — | + 3 | + 7 |
| Federal agency obligations | + 117 | + 5 | — 2 | — 2 | + 13 | + 131 |
| Repurchase agreements: | | | | | | |
| Treasury securities | — 195 | — 338 | — 95 | + 28 | + 226 | — 374 |
| Bankers' acceptances | — 68 | — 48 | — 39 | — 5 | + 21 | — 139 |
| Federal agency obligations | — 37 | — 66 | — 42 | + 7 | + 42 | — 96 |
| Member bank borrowings | + 172 | — 434 | + 213 | + 193 | + 39 | + 183 |
| Seasonal borrowings† | — 4 | — 12 | + 1 | — 7 | + 4 | — 18 |
| Other Federal Reserve assets‡ | + 92 | + 7 | — 21 | + 62 | + 58 | + 198 |
| Total | + 969 | — 449 | + 34 | — 202 | + 900 | +1,252 |
| Excess reserves‡ | — 88 | — 390 | + 323 | — 415 | + 370 | — 200 |

| | Daily average levels | | | | | Monthly averages§ |
|---|---|---|---|---|---|---|
| **Member bank:** | | | | | | |
| Total reserves, including vault cash‡ | 35,656 | 36,190 | 37,642 | 36,581 | 36,151 | 36,444 |
| Required reserves | 35,268 | 36,192 | 37.321 | 36,675 | 35,875 | 36,266 |
| Excess reserves | 388 | — 2 | 321 | — 94 | 276 | 178 |
| Total borrowings | 1,210 | 776 | 989 | 1,182 | 1,221 | 1,076 |
| Seasonal borrowings† | 31 | 19 | 20 | 18 | 17 | 20 |
| Nonborrowed reserves | 34,446 | 35,414 | 36,653 | 35,399 | 34,930 | 35,368 |
| Net carry-over, excess or deficit (—)‖ | 229 | 152 | 64 | 171 | — 31 | 117 |

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.
§ Average for five weeks ended January 30, 1974.
‖ Not reflected in data above.

ably to a move by several major banks to reduce the prime rate to 9¾ percent. However, in the cautious atmosphere that prevailed at that time, the improvement was short-lived. When rates approached the 8 percent level around midmonth, some participants felt investors would be attracted, and bidding at the regular auction on January 14 was stronger than anticipated. Investor demand did emerge and rates moved lower over the rest of the week. At the auction on January 21, bidding was once again strong; the rate on the new six-month bill was down 5 basis points from the week before, while the three-month bill was only 1 basis point higher (see Table II). Sales by the Federal Reserve for customer accounts depressed the market soon after that, but a firm tone developed during the final week of January in response to the additional ¼ percentage point reduction in the prime rate to 9½ percent by most major banks. When the Federal Reserve executed repurchase agreements shortly before the weekly auction on January 28, bill rates plummeted and the average issuing rates were down about ¼ percentage point from the previous week's auction rates. The removal of restrictions on investments abroad helped buoy sentiment causing rates to continue falling over the final days of the month.

Table II

**AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS***

In percent

| Maturity | Weekly auction dates—January 1974 | | | |
|---|---|---|---|---|
| | Jan. 7 | Jan. 14 | Jan. 21 | Jan. 28 |
| Three-month | 7.615 | 7.983 | 7.995 | 7.778 |
| Six-month | 7.560 | 7.867 | 7.819 | 7.516 |
| | Monthly auction dates—November 1973-January 1974 | | | |
| | Nov. 14 | Dec. 12 | Jan. 9 | |
| Fifty-two weeks | 7.708 | 6.881 | 6.948 | |

* 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.

Yields on Treasury coupon issues also rose over the first half of January, and the rate on long-term securities held steady at that level during the rest of the period. The rate on three- to five-year issues, however, continued its increase over the next week, and then declined. For the month as a whole, the rate on intermediate-term issues rose 7 basis points and that on long-term issues 5 basis points.

The coupon market was also influenced by many of the factors which operated in the bill market during the first half of the month. In addition, there was concern over continued inflation and the dim prospects for sustained long-term rate declines. In the face of relatively limited demand, dealers became increasingly anxious about the addition to supply that would result from the Treasury's February refunding, and a cautious tone prevailed as participants awaited the Treasury's January 30 announcement. At the beginning of the final week, the coupon market reacted favorably to the reductions in short-term rates and a firmer tone developed despite the impending Treasury sale.

In its February refunding, the Treasury will provide funds for retiring the $4.5 billion of publicly held notes and bonds maturing on February 15 by auctioning three issues to the public. These consist of up to $2¼ billion of 3¼-year notes, up to $1½ billion of seven-year notes, and up to $300 million of 19½-year bonds. The last is an addition to an issue of 7½ percent bonds initially offered last August. Coupon rates on the 3¼- and seven-year notes were set at 6⅞ percent and 7 percent, respectively. Market reaction to the terms of the refunding was generally quite favorable.

Yields on Federal agency securities also increased on balance. There were large offerings by each of the three major farm agencies during January. The first of these was a two-part sale by the Federal Land Banks that included $360 million of thirty-month bonds yielding 7.05 percent and $300 million of five-year bonds yielding 7.10 percent. Later in the month the Banks for Cooperatives and the Federal Intermediate Credit Banks also marketed two bond issues, both of which were priced at par. The former consisted of $556 million of 8.15 percent bonds due August 1, 1974, while the latter comprised $753.5 million of 8 percent bonds maturing November 4, 1974. All of these issues were well received.

## OTHER SECURITIES MARKETS

Yields on corporate and municipal securities moved somewhat higher during January, when more than $3 billion in new securities was marketed. The corporate calendar of more than $2 billion represented the heaviest monthly volume in two and one-half years. In view of the large supply, investors were quite selective and rates moved steadily higher until late in the month, when they declined.

At the start of the month, prior to the marketing of any new offerings, syndicates were terminated on the unsold portions of several recent corporate issues, resulting in upward yield adjustments of as much as 21 basis points. Investors gave a rather cool reception to the year's first large new issue, $75 million of power company bonds offered on January 7. Utility bonds were in plentiful supply, and several offerings had recently encountered investor resistance. On the following day, however, investors responded with strong interest to two attractively priced offerings. The larger of these issues, $100 million of Singer Company A-rated debentures, was almost completely sold by the close of the first day, a result of its 8.1 percent yield and the relative scarcity of new industrial bonds. Although the smaller issue was again a utility issue (Oklahoma Gas and Electric Company), it was priced to yield 8¼ percent, the highest return on Aa-rated utility bonds in about six months, and sold rapidly.

Investor response to new offerings of bonds from industrial corporations remained favorable throughout the month. Shortly after the Singer Company sale, two other industrial issues totaling $150 million were successfully marketed in one day. The largest offering of the month, a $160 million package from Ford Motor Company on January 16, was also in good demand. This negotiated package included $100 million of six-year notes and $60 million of twenty-year debentures, yielding 7.40 percent and 7.85 percent, respectively. Investor response to new utility bonds, on the other hand, remained, as at the beginning of the month, quite mixed. The year's first Bell System issue, $100 million of Aaa-rated Wisconsin Telephone Company bonds priced to yield 8.05 percent, was given a good reception, and a $125 million Aa-rated offering by the Florida Power and Light Company was a first-day sellout on January 17 at a yield of 8.44 percent. Several other large issues, however, met with investor resistance, and one syndicate disbanded after two days. In addition to attractiveness of price, a factor cited by some observers in determining the reception to new utility issues was the impact that investors thought possible fuel shortages would have on the companies selling the bonds. At the close of the month, two issues—one of industrial debentures and the other of utility bonds—were successfully marketed at yields just under 8 percent.

While the January calendar of new state and local government bonds was somewhat smaller than the corporate calendar, dealers began the month with heavy inventories, and rates moved higher in this market as well. The Bond Buyer index of yields on twenty tax-exempt bonds climbed 10 basis points over the first three and one-half weeks to 5.26 percent and then eased back to 5.20 percent on January 31 for a net gain of 4 basis points over the month. The largest issue sold during the month was $349.1 million of New York City bonds, the city's first offering since being restored to an A rating by both bond-rating houses. The city was able to sell the bonds at an average interest cost several basis points below The Bond Buyer index, in contrast to its previous sale when the average cost was higher than the index. The bonds, which are exempt from New York City, New York State, and Federal taxes, were well received, with a balance of only $25 million remaining after the first day. Another large offering during the month was a $302 million package of New Jersey Sports and Exposition Authority Baa-rated bonds. This consisted of $218.2 million of term bonds yielding 7.5 percent and $83.8 million of serial bonds with rates from 5¼ percent to 7 percent. The term bonds sold well, but the others moved more slowly. By the end of the month, dealers had made some progress in reducing their inventories and the Blue List of stocks on hand had declined $97 million to $1,034 million.