The Money and Bond Markets in October

Virtually all interest rates fell in October, as the modest easing in the financial markets that began in September prevailed for most of the month. The declines were generally largest on short-term money market instruments. Notably, the average effective rate on Federal funds dropped 128 basis points from its September level, while the rate on most maturities of dealer-placed commercial paper fell 1⅝ percentage points. The decline in interest rates came amid signs of a weakening economy which fostered expectations of a diminution in credit demands. In addition, market participants concluded that the continued drop in the Federal funds rate in October indicated some relaxation in Federal Reserve policy. The statement by Federal Reserve Board Chairman Arthur F. Burns on October 10, indicating that he desired moderate growth in the money supply, provided some confirmation of this view. However, the persistence of inflationary expectations served to temper the improvement.

Developments in the United States Government securities market paralleled for the most part those in other markets, although rates on short-term Treasury bills experienced large increases. In a reversal of the situation in September, rates on three-month bills moved up by about 170 basis points. The volume of noncompetitive tenders at the weekly bill auctions diminished in October, while at the same time the supply of new bills was increased. Investor interest was light in the market for longer term Treasury obligations, but yields dropped somewhat in response to falling money market rates and the sluggish economy.

The corporate and municipal bond markets were also aided by falling short-term rates and, despite one of the heaviest corporate calendars in recent years, the markets rallied at midmonth. Subsequently, more large offerings were announced, including several by industrial corporations, and the rally halted temporarily but resumed around month end. High inflation rates continued to weigh on the capital markets, and investors displayed a preference for shorter term issues.

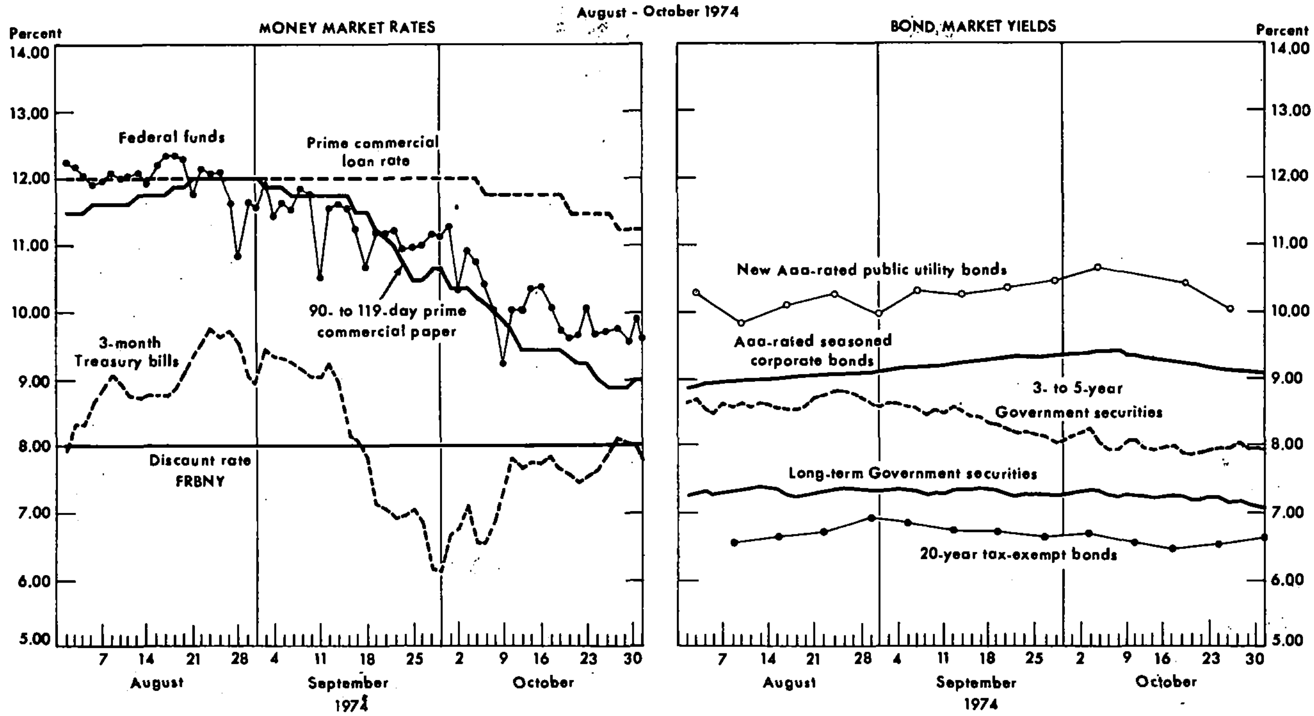
According to preliminary estimates, the growth of the monetary aggregates picked up substantially in the first several weeks of October, lifting the growth rate of M_1 over the most recent thirteen-week period to 2.7 percent at an annual rate. The growth of M_2 also accelerated. However, the volume of large negotiable certificates of deposit (CDs) dropped in October after rising sharply in September.

THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

Most short-term interest rates dropped in October, continuing the experience of September (see Chart I). The average effective rate on Federal funds was 10.06 percent, the lowest average rate since last March. Rates on 90- to 119-day dealer-placed commercial paper fell by about 1⅝ percentage points during the month to close at 9 percent. The rates on three-month CDs in the secondary market showed a similar decline, falling from the 10.60 to 10.90 percent range at the beginning of the month to around 9.15 to 9.30 percent at the end of the interval. Heavy trading continued in the market for bankers' acceptances, where dealers' offering rates declined by about 1 to 1¼ percentage points to the 8.60 to 9.25 percent range at the close of the month.

The commercial banks' prime lending rate, which had remained at a record-high 12 percent from early in July until late in September, worked its way down from a split 11¾ to 12 percent rate at the beginning of October to the 11 to 11¼ percent range by the end of the month. Business loans at large banks in New York City were exceptionally volatile in October, increasing sharply early in the month and then dropping late in the period. Outside New York City, business loan growth was generally sluggish throughout the month. At the same time, the volume of nonfinancial commercial paper outstanding showed some large increases in October, probably reflecting the efforts of borrowers to switch from bank borrowing to the commercial paper market where rates had dropped more sharply. During the four weeks ended October 23, non-

Chart I
SELECTED INTEREST RATES
August - October 1974



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Prime commercial loan rate at most major banks; 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.

financial commercial paper outstanding increased by $1,280 million.

Preliminary data indicate that the money stock measures advanced at a fairly rapid pace in the first several weeks of October, after growing slowly during the previous three months. M_1—demand deposits adjusted plus currency outside banks—advanced at a 6.5 percent seasonally adjusted annual rate in the four-week period ended October 23 over the average of the four weeks ended September 25. The growth rate of time deposits other than CDs was 12.1 percent for the same period, thus boosting the growth of M_2—which includes these time deposits plus M_1—to a 9.5 percent rate. Taking a somewhat longer term perspective, the growth rate of M_2 from the corresponding period thirteen-weeks earlier to the four weeks ended October 23 was 5.8 percent (see Chart II). CDs declined at a 3 percent rate from the four weeks ended September 25 to the four weeks ended October 23, reflecting the subdued growth of business loans.

The failure of Franklin National Bank, at one time the nation's twentieth largest bank, distorted several monetary aggregates and bank reserves series in October, in particular the adjusted bank credit proxy and member bank borrowings. On October 8, Franklin National Bank, a member bank, was declared insolvent and a substantial portion of its assets and liabilities was assumed by European-American Bank & Trust Company, at the time a nonmember bank. The credit proxy is a series based upon

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, OCTOBER 1974

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

Factors	Changes in daily averages— week ended					Net changes
	Oct. 2	Oct. 9	Oct. 16	Oct. 23	Oct. 30	
"Market" factors						
Member bank required reserves	— 197	+ 415	— 430	+ 492	+ 25	+ 305
Operating transactions (subtotal)	+ 106	+1,007	+ 844	— 535	— 71	+1,351
Federal Reserve float	— 275	+ 249	— 274	+ 656	— 615	— 259
Treasury operations*	— 121	+ 572	+1,866	— 356	— 124	+1,837
Gold and foreign account	+ 256	+ 68	+ 17	—	— 41	+ 300
Currency outside banks	+ 349	— 402	— 726	— 679	+ 787	— 671
Other Federal Reserve liabilities and capital	— 103	+ 521	— 39	— 156	— 78	+ 145
Total "market" factors	— 91	+1,422	+ 414	— 43	— 46	+1,656
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 563	—1,357	— 767	— 122	+ 160	—1,523
Outright holdings:						
Treasury securities	+ 140	—1,424	— 882	+ 874	— 254	—1,546
Bankers' acceptances	+ 22	+ 3	+ 16	— 115	+ 1	— 73
Federal agency obligations	+ 148	—	—	—	—	+ 148
Repurchase agreements:						
Treasury securities	+ 87	+ 32	+ 138	— 517	+ 209	— 51
Bankers' acceptances	+ 143	— 21	— 109	— 112	+ 50	— 49
Federal agency obligations	+ 23	+ 53	+ 70	— 252	+ 154	+ 48
Member bank borrowings	— 313	— 973	— 501	— 422	+ 316	—1,893
Seasonal borrowings†	+ 1	— 8	— 12	— 15	— 3	— 37
Other Federal Reserve assets‡	+ 232	+ 398	+1,234	+ 108	— 12	+1,960
Total	+ 482	—1,932	— 34	— 436	+ 465	—1,455
Excess reserves‡	+ 391	— 510	+ 380	— 479	+ 419	+ 201

	Daily average levels					Monthly averages§
Member bank:						
Total reserves, including vault cash‡	37,560	36,635	37,445	36,474	36,868	36,996
Required reserves	37,081	36,666	37,096	36,604	36,579	36,805
Excess reserves	479	— 31	349	— 130	289	191
Total borrowings	3,218	2,245	1,744	1,322	1,638	2,033
Seasonal borrowings†	142	134	122	107	104	122
Nonborrowed reserves	34,342	34,390	35,701	35,152	35,230	34,963
Net carry-over, excess or deficit (—)‖	48	177	56	188	— 46	85

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 October 30, 1974.
‖ Not reflected in data above.

member bank liabilities, and consequently the absence of Franklin National's data contributed to the large decline in the week ended October 9. This decline is reflected in the slow growth of the credit proxy in Chart II. On October 31, the European-American Bank & Trust Company became a member of the Federal Reserve System, and its liabilities will be included in the credit proxy beginning in the week ended November 6. In addition, the large volume of lending by the Federal Reserve to Franklin National Bank (which had reached approximately $1.75 billion early in October) was assumed by the Federal Deposit Insurance Corporation. This arrangement produced a large decline in member bank borrowings for the month of October to an average of $2 billion (see Table I).

THE GOVERNMENT SECURITIES MARKET

Interest rates on United States Government securities were mixed in October, with yields on notes and bonds falling while some Treasury bill rates increased. As the month began, rates on three-month bills were roughly 4 percentage points below the rates on large CDs and dealer-placed commercial paper of comparable maturity. Market participants questioned the viability of the relatively low bill rates and, by midmonth, rates had moved closer to the more normal spread of roughly 1½ percentage points. Bill rates moved up during the month partially in response to a diminution in the volume of noncompetitive tenders at the weekly auctions in comparison with the September level. At the same time, the Treasury raised a total of $1 billion in new cash in October at the regular weekly and monthly bill auctions. As a consequence of these developments, the average volume of three- and six-month bills available for competitive bidding at the October auctions was roughly double the amount in September. In addition, the supply of new bills was augmented by $1.5 billion of 7½-month bills auctioned on October 29 as part of the Treasury's $2.5 billion cash financing.

Moreover, a special demand factor impinged on the three-month bill rate. Throughout the month, the rate on the bill maturing December 26, 1974 was substantially below that on the bill maturing one week later, reflecting investors' end-of-year window-dressing practices. Thus, in moving from September to October, the three-month bill rates rose in part because of the shift from December to January maturities. However, even the rates on the December maturities rose in response to supply pressures.

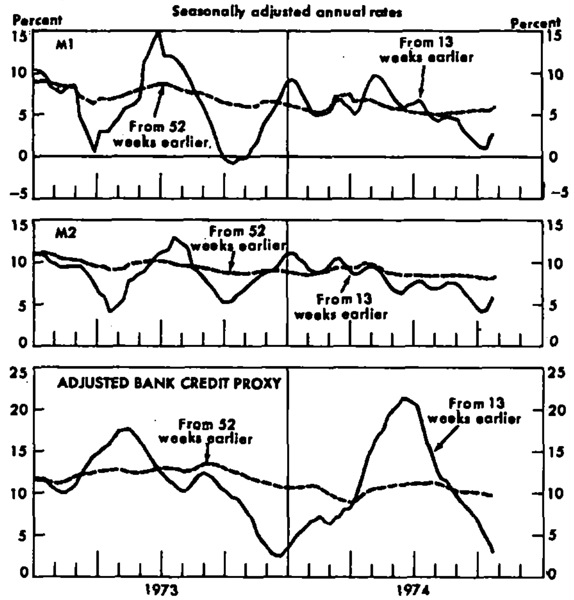
At the first weekly bill auction on October 7, bidding favored the six-month bill, since rates on three-month bills had fallen far below dealers' financing costs. As a result, the rate on the three-month bill was set at 6.70 percent (see Table II), 31 basis points above the rate at the previous auction, while the six-month bill rate dropped slightly. At the next auction—advanced to Friday, October 11, because of the Columbus Day holiday—the three-month bill rate rose by over 100 basis points, owing largely to an overhang of unsold awards from the Monday auction. Bidding at the final two weekly auctions was routine and rates changed little. The average issuing rate at the special auction of 7½-month bills on October 29 was 7.93 percent, roughly in line with the prevailing rates on similar maturities.

Despite the upsurge in short-term bill rates, yields on Treasury coupon securities edged down in October. In a market that was dominated by professional trading, buying interest favored intermediate- rather than long-term issues. President Ford's anti-inflation program and Treasury Secretary Simon's statement that further reductions in short-term rates were likely promoted a constructive tone, but the distressingly high rate of inflation made investors wary of longer term securities. For the month as a whole, yields on intermediate-term Treasury securities fell by 6 to 39 basis points, while long-term yields declined by 1 to 44 basis points. A portion of the Treasury's cash needs was met by an auction of $1 billion of 4½-year notes on October 23. Bidding on the notes was on a yield basis, as was the case in the auction of two-year notes in September. However, the minimum denomination on the notes was lowered to $1,000 from the $10,000 minimum set in September's auction. The note issue drew good interest, with the average yield established at 7.89 percent.

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Growth rates are computed on the basis of four-week averages of daily figures for periods ended in the statement week plotted, 13 weeks earlier and 52 weeks earlier. The latest statement week plotted is October 23, 1974.

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.

Source: Board of Governors of the Federal Reserve System.

On October 30, the Treasury announced its plans to refund $4.3 billion of publicly held notes and bonds maturing on November 15 as well as to raise $550 million in new cash. The Treasury will use the yield-auction method to sell $2.5 billion of three-year notes and $1.75 billion of seven-year notes, while $600 million of 8½ percent bonds due in 1999 will be auctioned on a price basis. The minimum denomination for the three-year notes will be $5,000 in order to reduce pressures on the nation's thrift institutions, and the minimum denomination for the other securities will be $1,000. The Treasury also indicated that it will need to raise an additional $4.5 billion of new cash by mid-December.

Prices of United States Government agency issues were buoyed by the improvement in the market for Treasury coupon issues. New issues were well received at rates significantly below those on comparable issues in September. On October 9, the Federal Home Loan Banks raised $1.5 billion of new capital by selling $600 million of 8.60 percent bonds maturing November 1976, $500 million of bonds due May 1979, and $400 million of November 1981 bonds yielding 8.65 percent. In the middle of the month, two farm credit agencies issued $1.4 billion of short-term securities at rates that were 100 to 115 basis points below those on similar issues in September. The offering raised about $340 million of new cash.

THE OTHER SECURITIES MARKETS

The corporate and municipal bond markets suffered from some congestion of new offerings early in the month before rallying at midmonth. Investors continued to show preference for short- and intermediate-term offerings. As recently issued bonds moved well above par, prices of older issues increased as well. Moody's index of Aaa-rated seasoned corporate bonds, which had risen rather steadily over most of the year, finished the month at 9.07

percent, 26 basis points below the level prevailing at the end of September.

The preference for shorter maturities was typified by the receptions afforded two Bell System offerings. An $80 million issue of forty-year Aaa-rated debentures priced to yield 10.03 percent met investor resistance on October 1 and was only 60 percent sold at the end of the second day. In contrast, at midmonth a $300 million issue consisting of seven- and ten-year notes, rated Aaa by Moody's and AA by Standard and Poor's, was quite attractive to small investors and sold out quickly when priced to return 9.05 percent and 9.10 percent, respectively. Investor reluctance to purchase longer term issues was also evident in the offering rates on two well-received Aa-rated utility bonds. A thirty-year $100 million bond issue sold early in the month was priced to yield 12 percent, while an eight-year $150 million issue was sold later in the month with a yield of 9.85 percent.

In a market where utility companies were generally marketing shorter maturities, several large industrial borrowers sold long-term debt that was well received. At midmonth, Abbott Laboratories issued $100 million of Aa-rated 25-year sinking-fund debentures priced to yield 9.20 percent. On the next day, Exxon Pipeline Company, a subsidiary of Exxon Corporation, sold $250 million of Aaa-rated thirty-year debentures. The securities were priced to yield 9.07 percent, well below the average rate for new Aaa-rated public utility bonds shown in Chart I. On the last day of the month, Weyerhaeuser Company sold $200 million of Aa-rated thirty-year debentures priced to yield 8.9 percent, the lowest such yield since last April.

The tax-exempt market was again dominated by New York City's offerings. At midmonth, New York City sold $476 million of A-rated various-purpose bonds. The bonds were priced to yield from 6.50 percent in 1976 to 7.90 percent in 2015. At a sale in July, New York City's bonds due in 1976 were priced to yield 7 percent, while the 2015 bonds were priced to yield 7.50 percent. The other major tax-exempt financing of the month was a $125 million competitive offering of Aa-rated bonds reoffered at yields of 4.80 percent in 1975 to 6.10 percent in 1994. The yields proved to be unattractive, and the bonds sold very slowly. The Bond Buyer index of twenty municipal bond yields rose by 3 basis points over the month to reach 6.65 percent on October 31. The Blue List of dealers' advertised inventories rose by $254 million to $834 million.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—October 1974			
	Oct. 7	Oct. 11	Oct. 21	Oct. 25
Three-month	6.698	7.722	7.524	7.892
Six-month	7.364	7.829	7.398	7.766

	Monthly auction dates—August-October 1974		
	Aug. 21	Sept. 18	Oct. 16
Fifty-two weeks	9.564	8.341	7.629

* 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.