The Money and Bond Markets in November

Following two months of decline, interest rates were mixed in November. Short-term rates, which had fallen substantially in previous months, fell somewhat further at the start of November but held steady or increased later on. For the month as a whole, most short-term rates changed little, although commercial banks' prime lending rates were lowered further in November in lagged response to previous declines in other money market rates. After the close of the month the Board of Governors of the Federal Reserve System approved reductions in the discount rates at six Federal Reserve Banks, including New York, from 8 percent to 7¾ percent. The Board announced that it had taken these actions, effective December 9 and 10, in view of lower money market rates and the slackening in the demand for credit.

In the markets for corporate and longer term Government securities, the rally continued through most of November. The halt in the decline in short-term rates and growing supplies of issues in dealer positions, however, caused bond prices to lose some of their gains as the month drew to a close. Moody's Aaa bond-yield average declined 38 basis points over the month. The long-term markets were faced with a heavy volume of new issue activity in November. The Federal Government was in the market often, refinancing maturing obligations and raising new cash. Substantial quantities of corporate issues also came into the market during the month at generally lower yields. However, the absence of investor demand for tax-exempt issues and large current and upcoming supplies kept these securities from joining the bond market rally.

During the month, the Board of Governors of the Federal Reserve System announced several regulation changes. The Board announced on November 13, and later modified slightly on November 18, a restructuring of reserve requirements on member bank demand and time deposits. The new reserve requirements apply to deposits in the week beginning November 28 and affect required reserves in the week beginning December 12. The timing of the change, which was expected to free about $750 million (net) of reserves, was set to coincide with the seasonal need for reserves in December. (Details of the restructuring are discussed below.) On November 22, the Board announced that the limit on outright holdings of bankers' acceptances by the Federal Reserve System had been increased from $500 million to $1 billion. The increase was initially authorized by the Federal Open Market Committee on November 11 to insure a smooth market adjustment following the suspension of the System's guarantee of acceptances purchased by the Federal Reserve Bank of New York for foreign official accounts. Finally on November 26, the Board amended its Regulation Q to permit governmental units to hold savings deposits at member commercial banks. The action was taken in conjunction with new legislation, effective November 27, providing deposit insurance for public time and savings deposits up to $100,000. The Board set the interest rate ceilings for public deposits at member banks at 5 percent on passbook savings deposits and 7.5 percent on other time deposits under $100,000.

The Board also released revised measures of the monetary aggregates, which incorporated new bench-mark data for nonmember banks from the June 30 call report and revised seasonal adjustment factors. The revisions began in 1968 for M_1, in 1964 for M_2, and in 1969 for the adjusted bank credit proxy. Growth rates for these measures computed over periods as short as a quarter are about the same as those derived from the old series. Monthly growth rates in 1974 for the revised series, however, fluctuate over a somewhat narrower range than previously indicated. The growth of seasonally adjusted M_1 in October was revised downward from an annual rate of 5.1 percent to 3.8 percent, while third-quarter growth remained unchanged at a sluggish 1.6 percent. According to preliminary estimates, however, the growth of the monetary aggregates strengthened in November.

THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

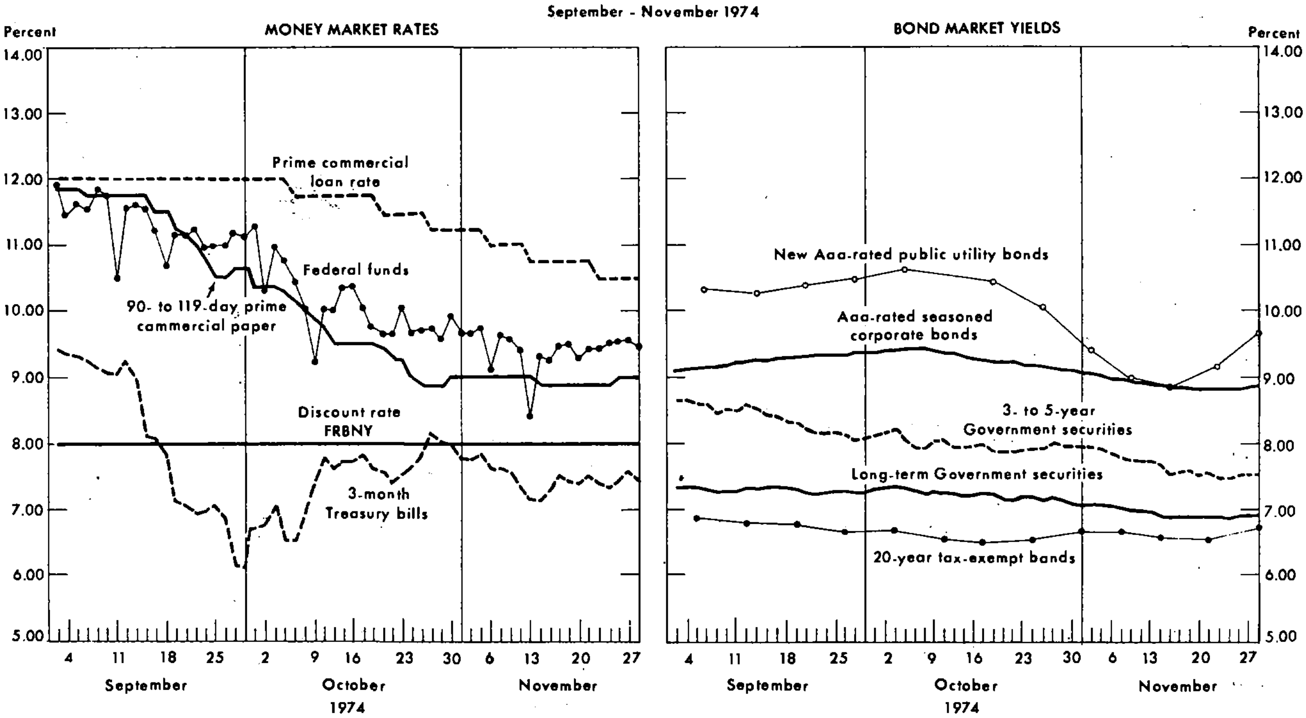
After falling sharply in the two preceding months, most money market rates changed little in November (see Chart I). While some further declines in rates were registered by midmonth, these movements were largely retraced by the close of the period. For the month as a whole, the effective rate on Federal funds averaged 9.45 percent, 61 basis points below October's average and the lowest monthly level since March. The Federal funds rate actually changed little from the end of October to the end of November, but it resumed declining in early December. The rate on 90- to 119-day dealer-placed commercial paper dipped ⅛ percentage point in mid-November to 8⅞ percent but increased to 9⅛ percent by the month end. Similarly, rates on other maturities of commercial paper were virtually flat over the period. The bankers' acceptance market sustained moderate rate increases over the month. In the early part of November the New York Federal Reserve Bank announced a suspension of the System's practice of guaranteeing acceptance purchases on behalf of foreign official accounts. In announcing the change, the Bank noted that the volume of bankers' acceptances held for foreign official accounts and carrying the Federal Reserve's guarantee had risen sharply in recent years to over $2 billion and that there was a good possibility of further large increases. Partly as a result of the suspension, small banks found they had to pay more in comparison with the large banks than previously.

Banks using floating-rate formulas continued to reduce their prime rates in several steps, in response to previous declines in other money market rates, but other banks generally lowered theirs at a slower pace. By the close of the month, a majority of banks were quoting a rate of 10½ percent, down from 11¼ percent at the end of

Chart I

SELECTED INTEREST RATES

September - November 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.

Table I

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

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

Factors	Changes in daily averages— week ended				Net changes
	Nov. 6	Nov. 13	Nov. 20	Nov. 27	
"Market" factors					
Member bank required reserves	— 109	+ 355	— 448	+ 306	+ 104
Operating transactions (subtotal)	+ 392	+ 892	—1,099	—1,182	— 997
Federal Reserve float	+ 102	+ 457	+ 521	— 952	+ 128
Treasury operations*	+ 328	+ 912	— 471	— 690	+ 79
Gold and foreign account	+ 10	—	— 210	+ 209	+ 9
Currency outside banks	— 131	— 856	— 856	+ 375	—1,468
Other Federal Reserve liabilities and capital	+ 83	+ 379	— 83	— 124	+ 255
Total "market" factors	+ 283	+1,247	—1,547	— 876	— 893
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 135	—1,342	+1,675	+1,389	+1,857
Outright holdings:					
Treasury securities	— 20	— 777	+ 775	+ 549	+ 527
Bankers' acceptances	+ 8	— 4	+ 39	+ 82	+ 125
Special certificates	+ 19	— 19	—	—	—
Federal agency obligations	—	—	+ 284	+ 47	+ 331
Repurchase agreements:					
Treasury securities	+ 65	— 274	+ 367	+ 458	+ 616
Bankers' acceptances	+ 46	— 97	+ 98	+ 54	+ 101
Federal agency obligations	+ 17	— 171	+ 112	+ 199	+ 157
Member bank borrowings	— 511	— 29	+ 269	+ 114	— 157
Seasonal borrowings†	— 25	— 9	— 7	+ 2	— 39
Other Federal Reserve assets‡	+ 80	+ 21	— 530	— 50	— 479
Total	— 296	—1,350	+1,414	+1,453	+1,221
Excess reserves‡	— 13	— 103	— 133	+ 577	+ 328

	Daily average levels				Monthly averages§
Member bank:					
Total reserves, including vault cash‡	36,990	36,532	36,847	37,118	36,872
Required reserves	36,688	36,333	36,781	36,475	36,569
Excess reserves	302	199	66	643	303
Total borrowings	1.127	1,098	1,367	1.483	1,269
Seasonal borrowings†	79	70	63	65	69
Nonborrowed reserves	35,863	35,434	35,480	35,635	35.603
Net carry-over, excess or deficit (—)‖	127	198	114	25	116

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 four weeks ended November 27, 1974.
‖ Not reflected in data above.

October. Despite the decline, the spread between the prime rate and commercial paper rates remained unusually wide by historical standards. This encouraged businesses to continue meeting part of their financing needs by selling their own commercial paper, although many continued to use bank lines. Business loans at New York City weekly reporting banks increased by $950 million over the four-week period ended November 27, and the volume of nonfinancial commercial paper outstanding rose over the same period by $574 million.

Banks continued to reduce their outstanding large certificates of deposit (CDs) over much of the month, but this trend was reversed in the final week. After declining by $715 million over the first three weeks, CDs at the twelve weekly reporting banks rose by $876 million over the November 27 statement period.

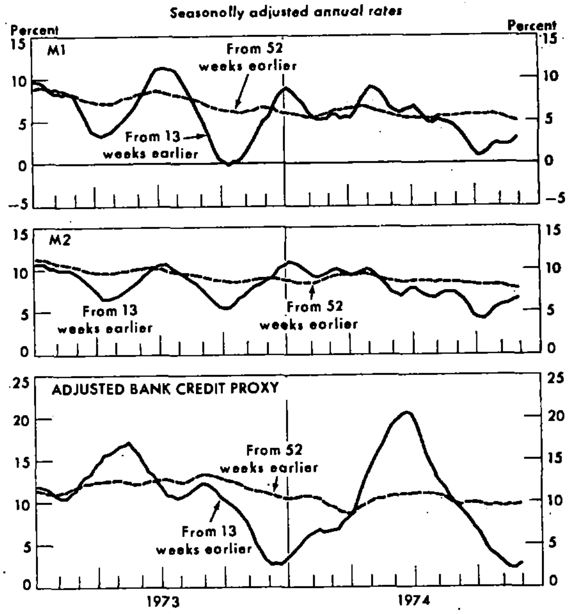
According to preliminary data, the growth in most of the widely followed monetary aggregates increased in November. M_1—demand deposits adjusted plus currency outside banks—advanced at a 6 percent seasonally adjusted annual rate in the four-week period ended November 27 over the average of the four weeks ended October 30. At the same time, the adjusted bank credit proxy—which includes deposits of member banks plus certain nondeposit liabilities—rebounded, growing at a 6.1 percent annual rate after showing virtually no change in October. Time deposits other than large CDs continued to rise rapidly, thus boosting the growth of M_2—which consists of these time deposits plus M_1—to a 9.4 percent rate over the same period. Taking a somewhat longer perspective, however, growth of M_1, M_2, and the proxy in the four weeks ended November 27 from the corresponding period thirteen weeks earlier remained well below the pace experienced over comparable periods earlier this year (see Chart II).

The restructuring of reserve requirements, as announced by the Board on November 13 and later amended slightly on November 18, incorporated the following changes. The reserve requirement on all time deposits with an initial maturity of six months or longer was reduced from 5 percent to 3 percent. The reserve requirement on all time deposits with an initial maturity of less than six months was increased from 5 percent to 6 percent. (The first $5 million of such deposits at each member bank is subject to a 3 percent reserve requirement.) The marginal reserve requirement of 3 percent on large-denomination CDs with a maturity of less than four months was removed. (The 3 percent marginal reserve requirement on longer term large CDs had been removed earlier this year.) Finally, the reserve requirement on net demand deposits over $400 million was reduced from 18 percent to 17½ 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 November 27, 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.

THE GOVERNMENT SECURITIES MARKET

Heavy financing activity by the United States Government dominated attention in the Government securities market throughout November. In addition to its quarterly refinancing during the first part of the month, the Treasury auctioned several short-term issues to obtain new cash. Evidence of further weakening in the economic situation encouraged market participants to expect moderation in credit demands and some easing in monetary policy in the months ahead. In this atmosphere, the interest in longer term securities strengthened. Yields on coupon issues continued recent declines, with returns on intermediate-term issues generally about 25 to 50 basis points lower and returns on long-term issues 4 to 27 basis points lower than in October.

In its refinancing, the Treasury sold $4.85 billion of notes and bonds to replace $4.3 billion of obligations maturing November 15 and to obtain $550 million of new cash. Investors were offered $2.5 billion of three-year notes, $1.75 billion of seven-year notes, and $600 million of additional 8½ percent bonds due in 1999. Market participants bid strongly in the auctions of these issues, which took place November 6, 7, and 8, resulting in average yields of 7.85 percent for the three-year notes, 7.82 percent for the seven-year notes, and 8.21 percent for the bonds.

In addition to offering at each regular auction $200 million more of Treasury bills than the volume maturing, the Treasury added to bill supplies on three occasions during the month. On November 20, $2.25 billion of April 16, 1975 tax anticipation bills (TABs) was auctioned at a 7.43 percent yield; on November 21, additions to outstanding short-term bill series totaling $1 billion were auctioned; and on November 26, $1.25 billion of June 17, 1975 TABs was auctioned at a 7.52 percent rate. The terms for these TAB sales were somewhat unusual in that banks were not permitted to pay for bill purchases by crediting their Treasury Tax and Loan Accounts.

Treasury bill rates moved lower over the month, even though supplies were substantially enlarged. Investor demand for issues was generally good, and expectations of further declines in rates buoyed the market over a good part of the month. The average issuing rate for three-month bills fell about 56 basis points from 7.89 percent at October's last auction to 7.33 percent at the November 25 auction (see Table II). Bill rates in the secondary market generally declined 25 to 30 basis points over the month.

The market for Federal agency securities benefited from a fairly light calendar and from the favorable interest rate expectations that prevailed over most of the month. As strong demands for new corporate issues pushed rates down toward those on agencies, demand for the latter picked up. A net redemption of $216 million in Federal Home Loan Bank debt obligations contributed to the good reception to the sale on November 8 of $500 million of 2¼-year bonds yielding 8.05 percent and $500 million of five-year bonds yielding 8.15 percent. The farm credit agencies again came to the market at midmonth with about $1.5 billion of securities, raising about $200 million of new cash. Yields were 40 to 50 basis points below similar offerings the previous month. On November 26, the Federal National Mortgage Association sold $1.2 billion of debentures in a three-part package; yields on the issues which raised $500 million in new cash were 7½ percent for $200 million due to mature on September 10, 1976, 7.80 percent for $700 million due in 4¾ years, and 7.95 percent for $300 million due in 9¾ years.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—November 1974			
	Nov. 1	Nov. 8	Nov. 18	Nov. 25
Three-month	7.880	7.604	7.528	7.328
Six-month	7.857	7.552	7.427	7.369
	Monthly auction dates—September-November 1974			
	Sept. 18	Oct. 16	Nov. 13	
Fifty-two weeks	8.341	7.629	7.362	

* 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.

THE OTHER SECURITIES MARKETS

Emerging investor demand for long-term corporate bonds allowed underwriters to place some large issues at reduced yields and supported a rally in prices of seasoned issues over a good part of the month. Concern over the effects of a weak economy on the financial condition of business, however, continued to temper market enthusiasm for lower rated debt. The calendar of new corporate issues remained very heavy and was highlighted by several high-quality offerings often combining notes and bonds. Utilities also benefited from the firmer tone, and some were able to obtain funds at lower cost and with less call protection than in recent months. However, the rates paid remained well above those paid by industrial borrowers, and the differential probably increased. Scant investor interest appeared in the tax-exempt market. New issues were not placed readily, and prices of seasoned bonds fell over most of the period.

Most new issue activity in the corporate sector remained on a negotiated basis. Underwriting syndicates easily placed large debenture offerings of two high-quality industrial firms long absent from the bond market. But investors responded selectively to other financings, with utility and lower quality issues less favored. For example, in two twenty-five-year industrial offerings, $100 million of debentures from an Aa-rated firm was priced to yield 8.73 percent, while underwriters were distributing $100 million of A-rated debentures that came to market on the final day of the preceding month at a 9.35 percent return. A typical Aa-rated utility offered 9.15 percent on $60 million of thirty-year first-mortgage bonds, and the yield on $25 million of similar securities sold by an A-rated utility was 10.25 percent. American Telephone & Telegraph Company canceled the largest financing ever undertaken by a utility, after the Department of Justice entered a major antitrust suit against the company. The offering, which was withdrawn for technical reasons, was very well received by investors and will be returned to the market late in January.

A large supply of unsold state and local government bonds weighed on the tax-exempt market throughout the month, and additions to this supply were foreseen from a sizable calendar of new issues. On the demand side of the market, interest on the part of major commercial banks failed to materialize, and casualty and insurance companies also remained on the sidelines. With traditional purchasers of these securities largely absent from the market, the municipal sector generally failed to participate in the rally. Distribution of three state issues provided a reading on the market for Aaa-rated tax-exempt issues during the month. Investors accorded a good reception to $95 million of state of Maryland bonds, yielding 4.85 percent in 1977 to 6.00 percent in 1989. However, two subsequent issues met resistance when priced more aggressively. The issues were a total of $100 million of state of California bonds reoffered at yields of 4.30 percent in 1975 to 6.10 percent in 1995 and $40 million of state of Ohio bonds returning 4.50 percent in 1975 to 6.60 percent in 1999. On November 29, The Bond Buyer index of twenty municipal bond yields stood at 6.71 percent, 6 basis points above its level at the end of October. The Blue List of dealers' advertised inventories rose over the month by $212 million to a level of $1,036 million on November 29.