The Money and Bond Markets in December

Most short-term interest rates fell during December, although this trend was interrupted at times. The Federal funds rate fell to its lowest level since early in the year, and Treasury bill rates also declined. Signs of a further weakening economy encouraged many investors to expect a continued moderation in credit demands in the months ahead. In addition, market sentiment was also bolstered by the Federal Reserve System's more generous provision of nonborrowed reserves as well as the reduction in the Federal Reserve Banks' discount rates in December from 8 percent to 7¾ percent, the first reduction in three years. Early in January, the Board of Governors of the Federal Reserve System approved a further reduction of ½ percentage point in the discount rate to 7¼ percent at six Federal Reserve Banks effective January 6.

During December, yields in the intermediate- and long-term debt markets were mixed. In the Government securities market, despite a sizable volume of current and prospective issues, yields on some coupon issues posted sizable declines. New offerings in the corporate sector continued heavy, and corporate yields generally edged upward over the month, although demand for these securities remained strong. In the municipal bond market, yields rose sharply for the second month in a row as demand from commercial banks and insurance companies, which are traditionally heavy purchasers of these securities, was largely absent from the market. By midmonth, the widely followed indexes of tax-exempt bond yields reached record highs. Some cancellations in new offerings occurred as the month progressed, and yields retraced part of their movement by the close of the period.

At the end of December, Americans were again permitted to hold gold for the first time since April 1933. With the expiration of the gold regulations, trading in gold futures also became legal and member banks were permitted by the Board of Governors of the Federal Reserve System to buy and sell gold for their customers. Gold, however, was not returned to the status of legal tender and hence will not be accepted as part of a bank's required reserves nor as collateral for advances from the discount window. On December 3, the Treasury announced the sale in January of up to two million troy ounces from its gold stockpile to help satisfy any pent-up demand by individuals and to prevent a serious outflow of dollars as Americans attempt to satisfy this demand by purchasing from foreign gold suppliers. The initial response on the part of American investors to gold ownership was restrained, however, and, in early January trading, gold experienced sharp price declines on several major markets.

Preliminary data through the week ended December 25 show a mixed pattern in the growth of the monetary aggregates in the fourth quarter of the year. Both the narrowly defined money supply (M_1) and the more broadly defined money supply (M_2) advanced at a moderate pace, after showing little growth in the third quarter. A sharp drop in the level of Government deposits, however, was at least partially responsible for a slow rate of growth in the adjusted bank credit proxy during the fourth quarter. Taking a longer view, the growth of the money supply measures in 1974 as a whole was substantially below the gains registered in 1973 and 1972, while the rate of increase in the proxy was only slightly lower than its growth over these two years.

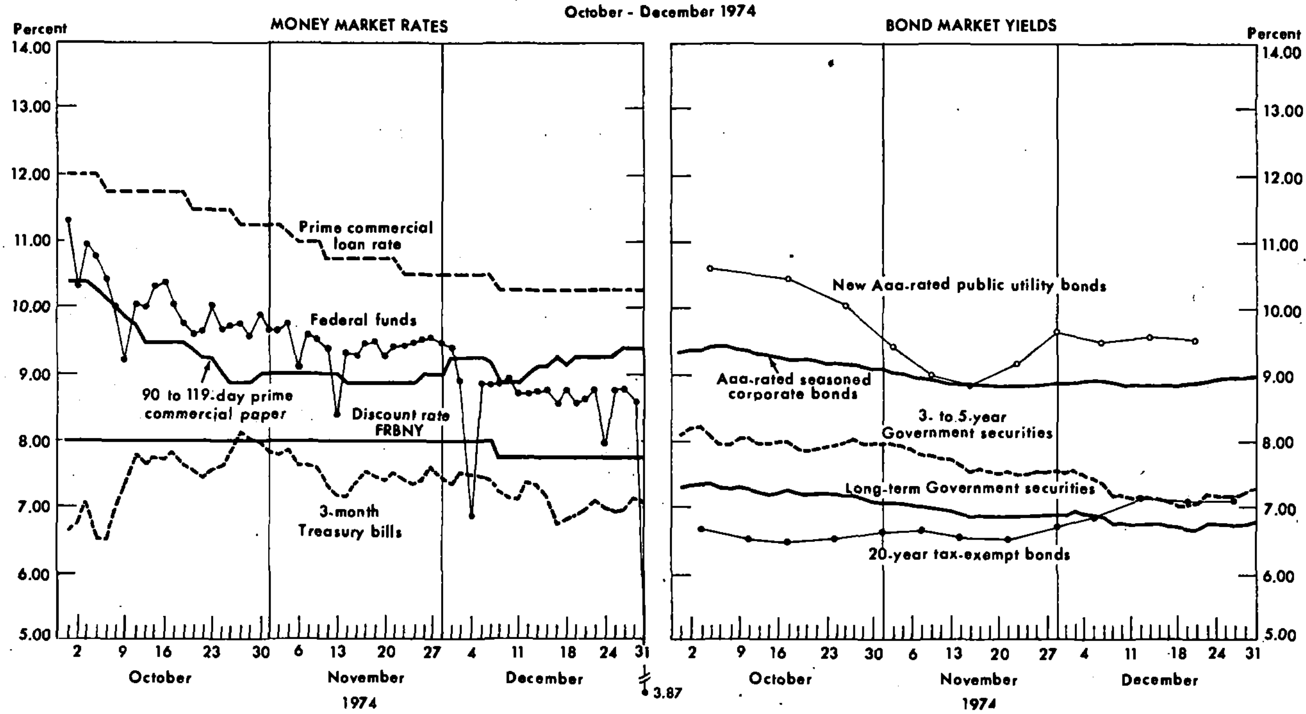
THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

Most money market rates declined further in December, continuing the trend which began late in the third quarter, but some rates were under upward pressure at times (see Chart I). During the month, the effective rate on Federal funds averaged 8.53 percent, 92 basis points below its average over the preceding month and the lowest level since June 1973. Rates on bankers' acceptances fell about 50 basis points over the month, while rates on three-month CDs in the secondary market declined about 28 basis points. Rates on shorter maturities generally rose as major banks sought to raise funds in this market. Several commercial banks lowered their prime lending rate to 10¼ percent. By the close of the period, the number of major banks was about evenly divided between those posting a 10¼ percent prime rate and a 10½ percent rate, while one major bank maintained a 10 percent rate until

Chart I

SELECTED INTEREST RATES

October - December 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.

early January when it raised its rate to 10¼ percent. In contrast to interest rates on other money market instruments, commercial paper rates generally edged upward in December. Rates on 90- to 119-day dealer-placed commercial paper advanced ¼ percentage point to close at 9⅜ percent.

Businesses continued to borrow heavily from major money center banks during the month. At New York City weekly reporting banks, business loans, including loans sold to affiliates, rose over the four-week period ended December 25 by $1,016 million, a much larger gain than experienced over comparable periods during the last several years. Part of this rise reflected a sharp increase in utility borrowings at money center banks. Faced with strong business loan demand in December, as well as a substantial volume of maturing CDs, New York City weekly reporting banks were quite aggressive in bidding for CDs and Euro-dollar borrowings. Over the four statement weeks of the month, the volume of CDs outstanding at these banks rose $1,930 million while Euro-dollar liabilities increased $930 million. Businesses shifted their borrowing away from the commercial paper market, resulting in the volume of nonfinancial commercial paper decreasing substantially over the month by $554 million.

According to preliminary estimates, M_1—demand deposits adjusted plus currency outside banks—for the four weeks ended December 25 was up at an annual rate of 5 percent from its average level in the corresponding four weeks of September. Similarly, M_2—which consists of M_1 plus time deposits excluding large CDs—grew at a rate of 7.2 percent over the same period, while the adjusted bank credit proxy—which includes deposits of member banks plus certain other liabilities—grew at a rate of 4.3 percent. When measured from the corresponding four-week period in December 1973, growth of the money supply measures closely resemble the three-month figures (see Chart II), with M_1 growing at 4.7 percent and M_2 at 7.5 percent. The credit proxy grew at a rate of 10.2 percent over the same period. Member bank borrowings from the Federal Reserve Banks averaged $801 million during the month (see Table I), a decline of $467 million from November's average and the lowest level since November 1972. The reduction in borrowings probably resulted, in part, from the increased availability of nonborrowed reserves.

On December 6, the Board of Governors of the Federal Reserve System announced a change in Regulation Q, effective December 23, providing for the establishment of investment certificates, a new category of long-term consumer-type time deposits. Under the new regulations, member banks are allowed to pay up to 7½ percent annual interest on these certificates which can be issued in maturities of six years or more and in amounts of $1,000 or greater. The certificates can be issued in either negotiable or nonnegotiable form. The negotiable certificates may not be redeemed prior to maturity, while the nonnegotiable certificates may be redeemed under the Board's existing rules for early withdrawal of time deposits. In announcing the change, the Board said that the action was intended to permit member banks to offer longer term time deposits to small savers at more competitive rates of interest. Similar actions were taken during December by the Federal Deposit Insurance Corporation (FDIC) and the Federal Home Loan Bank (FHLB) Board. Under their new regulations, FDIC-insured nonmember commercial banks also will be permitted to pay 7.5 percent annual interest on these certificates, while FDIC-insured mutual savings banks and savings and loan associations that are members of the FHLBs will be allowed to offer 7.75 percent.

THE GOVERNMENT SECURITIES MARKET

Rates on all types of Government securities fell during most of the month of December. Investors were encouraged by the reduction in the discount rate and the continued decline in the Federal funds rate. Over the month, Treasury bill rates in the secondary market fell 33 to 61 basis points. Yields on intermediate-term coupon issues declined 10 to 38 basis points, while long-term

Table I

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

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

Factors	Changes in daily averages—week ended				Net changes
	Dec. 4	Dec. 11	Dec. 18	Dec. 25	
"Market" factors					
Member bank required reserves	— 221	+ 236	— 141	+ 174	+ 48
Operating transactions (subtotal)	— 386	— 31	— 132	—2,484	—3,033
Federal Reserve float	+ 750	— 289	— 62	— 217	+ 182
Treasury operations*	— 119	+ 215	+ 469	—1,529	— 964
Gold and foreign account	— 150	+ 169	— 38	+ 62	+ 43
Currency outside banks	— 542	— 428	— 513	— 620	—2,103
Other Federal Reserve liabilities and capital	— 325	+ 302	+ 12	— 180	— 191
Total "market" factors	— 607	+ 205	— 273	—2,310	—2,985
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 532	— 243	+ 432	+2,612	+3,333
Outright holdings:					
Treasury securities	— 109	+ 958	+ 78	+ 398	+1,325
Bankers' acceptances	+ 69	+ 67	+ 10	+ 33	+ 179
Federal agency obligations	—	—	+ 154	+ 206	+ 360
Repurchase agreements:					
Treasury securities	+ 287	— 746	+ 118	+1,255	+ 914
Bankers' acceptances	+ 116	— 196	+ 25	+ 179	+ 124
Federal agency obligations	+ 169	— 326	+ 47	+ 541	+ 431
Member bank borrowings	— 411	— 425	+ 174	— 159	— 821
Seasonal borrowings†	— 14	— 17	— 4	— 1	— 36
Other Federal Reserve assets‡	+ 198	— 60	— 6	+ 94	+ 226
Total	+ 319	— 728	+ 601	+2,547	+2,739
Excess reserves‡	— 288	— 523	+ 328	+ 237	— 246

	Daily average levels				Monthly averages§
Member bank:					
Total reserves, including vault cash‡	37,051	36,292	36,761	36,824	36,732
Required reserves	36,696	36,460	36,601	36,427	36,546
Excess reserves	355	— 168	160	397	186
Total borrowings	1,072	647	821	662	801
Seasonal borrowings†	51	34	30	29	36
Nonborrowed reserves	35,979	35,645	35,940	36,162	35,932
Net carry-over, excess or deficit (—)‖	200	221	— 50	25	99

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 December 25, 1974.
‖ Not reflected in data above.

bond yields dropped about 4 to 31 basis points.

Yields at the first weekly bill auction of the month (see Table II) were higher than those at the last auction in November. The average yields on the three- and six-month bills were set at 7.52 and 7.56 percent, respectively, each about 20 basis points above the rates established at the previous auction. When expectations of interest rate declines strengthened, rates fell 35 and 65 basis points at the next auction of three- and six-month bills. The Treasury announced that the third weekly bill auction of the month would not raise any new cash for the first time in ten weeks. Following this news, bidding became more aggressive and, in that auction, rates fell to 7.06 percent for three-month bills and 6.86 percent for six-month bills. Interest faded somewhat toward the end of the month, and higher rates were set in the next two auctions. The Treasury used the last auction of the month as a means of again raising new cash in the amount of $200 million. In the regular monthly auction of 52-week bills, the average issuing rate was set at 6.63 percent, down from 7.36 percent in the previous month's sale and the lowest issuing rate since March.

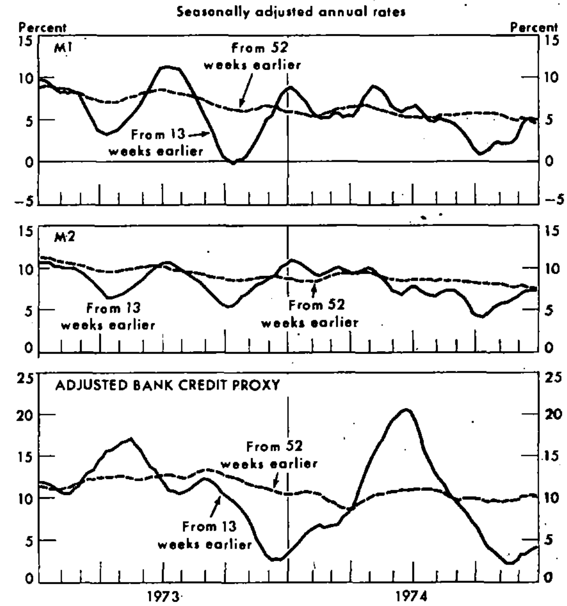
Treasury note financing consisted of two auctions, one on December 23 of $2.3 billion in two-year notes ($0.3 billion of which was sold to official accounts) and the other on December 30 of $1.25 billion in additional 7⅞ percent notes maturing in May 1979. Proceeds from the sales were used to redeem $1.9 billion of debt maturing at the year-end and to provide additional cash. Bidding at the first auction resulted in an average yield of 7.32 percent, while the second auction produced an average yield of 7.33 percent. The Treasury also auctioned $750 million on January 2 of additional 8 percent notes due in March 1976 at an average yield of 7.24 percent.

A modest volume of new agency issues and investor expectations about future interest rate movements both contributed to agency financing during December at lower yields than in the previous month. On December 11, the FHLBs sold $500 million of five-year bonds for new cash at a yield of 7.5 percent. This compared quite favorably with a similar sale in the previous month by the same agency at a yield of 8.15 percent. At midmonth, the Federal Intermediate Credit Banks raised $19.5 million in new money by selling $457.5 million of nine-month bonds at a yield of 7.35 percent and $410.2 million of five-year bonds at a yield of 7.4 percent. On the same day, the Banks for Cooperatives raised $19.7 million in new money in a sale of $439.7 million of six-month bonds at a rate of 7.4 percent. Both issues were well received at yields ranging about 65 to 70 basis points below similar offerings in the previous month.

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 December 25, 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 OTHER SECURITIES MARKETS

Investor demand for corporate securities remained strong in December, as further evidence of an economic slowdown encouraged investors to expect a decline in interest rates. With a heavy calendar of new offerings, however, underwriters were required to post slightly higher yields on issues, compared with the previous month. Investor concern over issue quality, which became evident earlier in the year, continued into December, and yield spreads between issues of different quality ratings remained unusually wide. The tax-exempt market continued to be characterized by light investor demand and concern over quality. The Bond Buyer index of twenty municipal bond yields reached a new record high during midmonth. The unfavorable market conditions in the tax-exempt market caused many offerings to be withdrawn, and the light new issue supply aided in selling high-quality debt later in the month.

The market for industrial offerings was typified by two 25-year issues. An Aa-rated pharmaceutical firm's $60 million in bonds was priced to yield 8.85 percent at midmonth, while an A-rated manufacturer offered $50 million in bonds at 9.45 percent. These yields were 10 to 12 basis points above similar offerings of the previous month. Utilities were forced also to post higher yields during the month. An Aa-rated Bell Telephone subsidiary offered 9.63 percent on $80 million in bonds due in the year 2010. This was 48 basis points above the yield on similarly rated issues of the previous month. The International Bank for Reconstruction and Development offered $300 million of six-year notes at a yield of 7.93 percent and $200 million of eleven-year notes at a yield of 8.15 percent. The Aaa-rated issues were very well received.

Well-publicized budget difficulties afflicting New York City constituted an important contributing factor to the record high of 7.15 percent in The Bond Buyer index of tax-exempt yields posted at midmonth. Other components of the index, however, were actually lower than they had been earlier in the year. Dealers in tax-exempt issues who held large inventories of depreciating city debt obligations became increasingly reluctant to underwrite a large volume of new issues. These conditions caused several issues to be withdrawn, and the resulting light supply of new municipals contributed to some improvement in selling conditions toward the latter half of the month. For example, early in the month an Aaa-rated county government sold competitively $35 million in various-purpose bonds at yields ranging from 4.7 percent to 7.25 percent for maturities in 1976 and 1990, respectively. After midmonth, however, the state of Ohio experienced a swift sellout of its $60 million in Aaa-rated bonds at the slightly lower yields of 4.6 percent and 6 percent for maturities in 1975 and 1988, respectively. New York City again brought into the market a sizable offering of $600 million in short-term notes in early December. The offering provided yields of 8.5 percent on $200 million in six-month notes and 9 percent on $400 million in one-year notes. By the close of the period, The Bond Buyer index stood at 7.08 percent, 37 basis points above its level at the end of November. The Blue List of dealers' advertised inventories declined over the month by $316 million to a level of $720 million on December 31.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—December 1974				
	Dec. 2	Dec. 9	Dec. 16	Dec. 20	Dec. 27
Three-month	7.524	7.172	7.058	6.963	7.113
Six-month	7.564	6.911	6.858	7.032	7.101
	Monthly auction dates—October-December 1974				
	Oct. 16	Nov. 13	Dec. 11		
Fifty-two weeks	7.629	7.362	6.625		

* 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 invested, would be slightly higher.