The Money and Bond Markets in June

Interest rates rose in the money and bond markets during June. Short-term rates began to rise early in the month, and the general consensus seemed to be that these rates might increase somewhat further, along with expanding economic activity. There were, in fact, several upward adjustments as the month progressed and, by the close, yields on most money market instruments were from ¼ to ½ percentage point higher than when the month opened.

Substantial investor resistance emerged to the lower rate levels established in the bond market during May but, even after prices were marked down on several issues in June, only modest and sporadic interest was displayed much of the time. There were several news developments during the month which apparently contributed to a fairly pervasive feeling that pressures in the long-term markets were also increasing, and investors tended to remain on the sidelines in anticipation of yet higher rates. These developments included announcements of accelerated rises in wholesale and consumer prices during May and discussions in the press that the Treasury's need for new cash during the fiscal year 1973 might be higher than previously estimated. The turmoil in the foreign currency markets during the latter part of the month was an additional factor depressing securities prices.

Indicative of the trend in the long-term markets during the month, The Bond Buyer index of yields on twenty municipal bonds climbed by 28 basis points to a level of 5.43 percent at the end of the month. In addition, the backlog of unsold tax exempts measured by inventories advertised in the Blue List mounted to the highest levels since mid-January before declining toward the end of June. Rates on new Aa-rated utility bonds rose to 7.60 percent from 7.25 percent at the start of the month. Yields on long-term Treasury bonds, on the other hand, were relatively steady, ranging for the most part from 4 to 13 basis points higher over the period.

BANK RESERVES AND THE MONEY MARKET

The increases in interest rates on most short-term instruments occurred in several steps during June. Yields on most maturities of dealer-placed prime commercial paper rose by ⅜ to ½ percentage point, while those on paper placed directly ranged from ¼ to ½ percentage point higher. A rise in rate of ½ percentage point was also posted on bankers' acceptances. Anticipating runoffs of negotiable certificates of deposit (CDs) around the mid-June corporate dividend and tax payment dates, major banks began raising CD rates early in June and continued to post increases throughout the month. Similarly, rates on CDs trading in the secondary market rose about ⅜ to ½ percentage point during June. Largely in response to the rise in money market rates, most major banks raised their prime rate to 5¼ percent from 5 percent effective the final week in June. Two large banks with "floating" prime rates increased these even further to 5⅜ percent on June 30. Rates on Euro-dollars shot upward after midmonth, as tensions mounted in the foreign exchange markets leading up to the floating of the British pound. Euro-dollar rates subsequently fell back but remained above their levels at the beginning of the month (see Chart I).

The effective rate on Federal funds in June averaged 4.46 percent, 19 basis points above the May level. Member bank borrowings at the Federal Reserve discount window declined slightly to \$86 million on average, however (see Table I), as excess reserves increased. The forty-six major money center banks were particularly restrained in their use of the discount window. Preliminary data indicate that total reserves of member banks grew at a seasonally adjusted annual rate of about 8½ percent in June, while "reserves available to support private nonbank deposits" (RPD) grew at about a 9 percent rate, a slightly more rapid pace for RPD than in May (see Chart II).

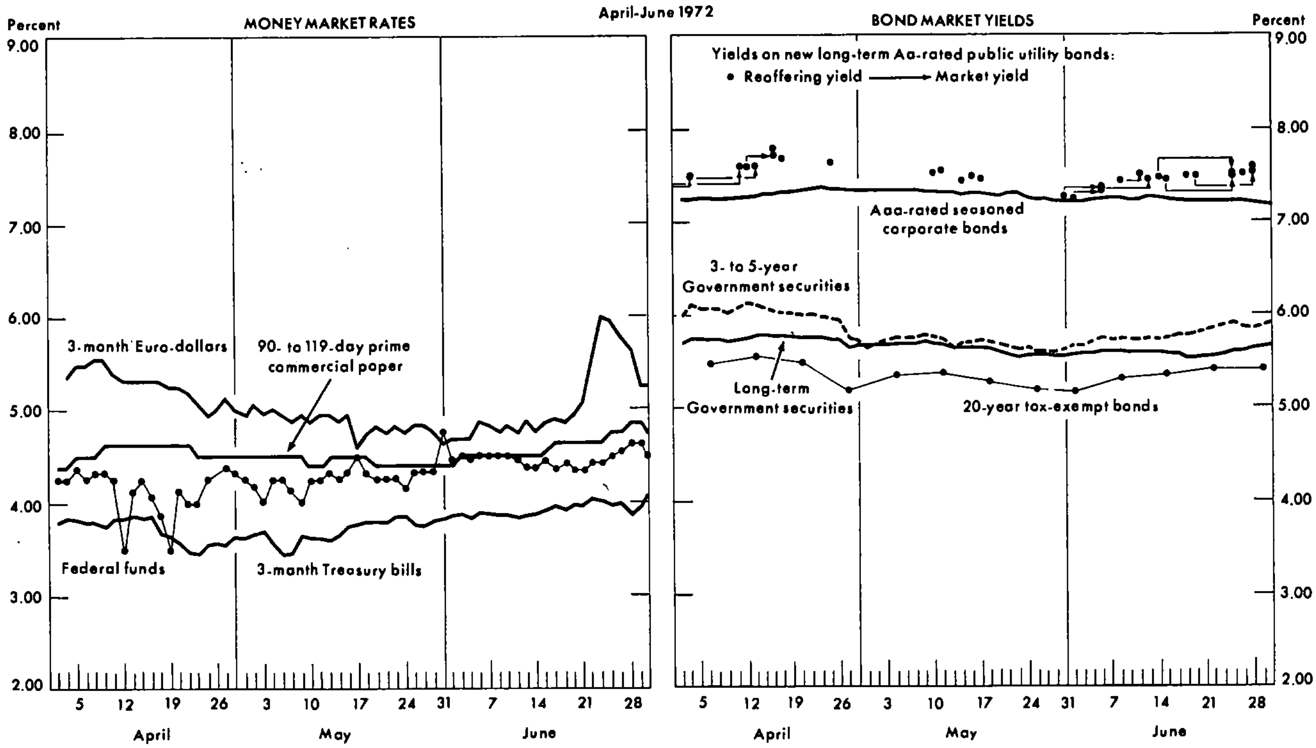
According to preliminary estimates based on data for the four weeks ended June 28, the narrow money supply (M_1)—adjusted demand deposits and currency held by the public—rose at about a 5 percent seasonally adjusted annual rate in June, up somewhat from its increase of 3.6 percent in May. Over the second quarter as a whole, the annual rate of growth of M_1 also amounted to some 5 percent. For the first six months of the year, M_1 grew at an annual rate of slightly over 7 percent.

The broader money supply (M_2) also advanced somewhat more rapidly in June at a rate of about 9½ percent, compared with 8.4 percent in May. The recent acceleration resulted from a faster rise in both components of M_2, consumer-type time and savings deposits as well as M_1. For the three months ended in June, however, the growth in this measure was at a seasonally adjusted annual rate of 8½ percent. Over the January-June period, M_2 has grown at an 11 percent annual rate.

In contrast to M_1 and M_2, the growth of the adjusted bank credit proxy decelerated in June to an annual rate of 5 percent, down from 14.4 percent a month earlier. Both time and private demand deposits expanded substantially during June, but United States Government deposits at commercial banks declined by $2 billion on average from the May level, in spite of a buildup in these balances in the second half of June. It is estimated that the proxy expanded at an 11 percent annual rate in the latest quarter and at about the same rate over the first six months of 1972.

On June 22 the Board of Governors of the Federal Reserve System announced its unanimous approval of two regulatory changes designed to restructure the reserve requirements of member banks on a more equitable basis and to modernize the nation's check collection system. The changes, which will begin to go into effect on September 21,

Chart I
SELECTED INTEREST RATES
April-June 1972



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 four 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 Aa-rated public utility bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); 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, and The Bond Buyer.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JUNE 1972

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

Factors	Changes in daily averages— week ended: June 7	June 14	June 21	June 28	Net changes
"Market" factors					
Member bank required reserves	+ 380	+ 37	— 82	+ 217	+ 552
Operating transactions (subtotal)	— 123	— 360	+ 555	— 784	— 712
Federal Reserve float	+ 346	— 316	+ 728	— 222	+ 536
Treasury operations*	— 355	— 27	+ 189	— 735	— 928
Gold and foreign account	+ 189	— 4	— 12	— 4	+ 169
Currency outside banks	— 195	— 248	— 313	+ 251	— 505
Other Federal Reserve liabilities and capital	— 109	+ 235	— 37	— 73	+ 16
Total "market" factors	+ 257	— 323	+ 473	— 567	— 160
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 111	+ 78	— 410	+ 341	+ 120
Outright holdings:					
Treasury securities	+ 214	+ 8	— 403	+ 323	+ 142
Bankers' acceptances	— 1	+ 1	— 7	— 3	— 10
Federal agency obligations	+ 39	+ 100	—	—	+ 139
Repurchase agreements:					
Treasury securities	— 138	— 21	—	+ 9	— 150
Bankers' acceptances	— 1	— 8	—	+ 11	+ 2
Federal agency obligations	— 2	— 2	—	+ 1	— 3
Member bank borrowings	— 196	+ 35	— 36	+ 78	— 119
Other Federal Reserve assets†	+ 71	+ 18	+ 45	+ 61	+ 195
Total	— 14	+ 131	— 401	+ 481	+ 197
Excess reserves	+ 243	— 192	+ 72	— 86	+ 37

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash	32.677	32,448	32,602	32.299	32,507‡
Required reserves	32.346	32,309	32,391	32.174	32,305‡
Excess reserves	331	139	211	125	202‡
Borrowings	58	93	57	135	86‡
Free, or net borrowed (—), reserves	273	46	154	— 10	116‡
Nonborrowed reserves	32.619	32,355	32.545	32,164	32.421‡
Net carry-over, excess or deficit (—)§	42	187	106	108	111‡

Note: Because of rounding, figures do not necessarily add to totals.
*Includes changes in Treasury currency and cash.
†Includes assets denominated in foreign currencies.
‡Average for four weeks ended June 28.
§Not reflected in data above.

were first proposed in late March when the Board invited comments from interested parties during the next month and a half. The major effects of the changes will be that reserve requirements on demand deposits will be based upon size of bank rather than location and that all banks using the System's check collection facilities must make payment in immediately available funds (see box on page 154 for details). The Board received comments from less than 5 percent of the nation's banks, and the main modifications suggested had to do with minimizing the effects of the new check collection procedures upon funds available for loans and investments. Taking these suggestions into account, the Board modified the regulations somewhat further. Thus, it reduced the new reserve requirement for one size category of banks which will lose a large amount of reserves as a result of the new check collection rules and set up conditions under which it will be appropriate for a Reserve Bank to waive penalties for certain member bank reserve deficiencies resulting from these changes. The waiver of penalties will be granted for a maximum of twenty-one months. Moreover, to equalize competitive conditions among banks and ease adjustment to the new check collection procedures, the Board is assigning high priority to extending Regional Check Processing Centers for clearing services.

THE GOVERNMENT SECURITIES MARKET

Yields on most Treasury securities advanced during June, in response to slackened investor demand and an expectation on the part of many participants that interest rates will rise as the economy continues to expand and as the Treasury's demand for funds places additional pressure on the credit markets in months to come. This expectation was fueled somewhat further by May increases in wholesale and consumer prices which surpassed those in April. Rates on Treasury bills and short- and intermediate-term coupon issues rose substantially, while relatively modest increases were posted in yields on long-term Treasury bonds. The increases in rates occurred in spite of the retirement by the Treasury of $3 billion of tax anticipation bills (TABs) and $1.2 billion of maturing bonds.

There was some tightening in the Federal funds market at the start of the month, and a cautious atmosphere hung over the bill market resulting from concern among participants that some firming of monetary policy might be under way. Modest investor demand developed, however, and bidding in the first weekly auction was relatively aggressive though rates did rise somewhat from the levels set during the final auction in May. Investor interest soon waned, however, and despite some professional demand rates trended higher over the next several days. Market sentiment brightened at the beginning of the next week, reflecting some modest investor demand prior to the weekly auction and the expectation of sizable reinvestment demand from persons holding Treasury bonds maturing June 15 and TABs coming due six days later. As a result, at the auction on June 12 the average issuing rates on three- and six-month bills were down slightly from the week earlier (see Table II). Buoyed by the potential reinvestment demand and additional moderate investor purchases, the market steadied briefly but then began to falter when demand proved less than expected. Substantial payments of corporate income taxes on June 15 were met through the runoff of liquid assets including TABs, while borrowing was relatively light, thereby reducing the corporate reinvestment demand for Treasury bills.

Some modest investor demand once again appeared after several days of rising bill rates and improved the market's tone. Participants once again bid rather aggressively in the regular auction on June 19, and a better atmosphere prevailed in the market for the next several sessions. An additional lift was provided by the possibility that, in the international currency uncertainty surrounding heavy selling of the British pound and the dollar, some demand for bills might be forthcoming from foreign central banks. Demand again proved disappointing following the floating of the pound early on June 23, and in the unenthusiastic monthly auction held that day, average issuing rates on the new nine- and twelve-month bills reached their highest levels since last September.

A better tone emerged over the next few days in response to some investor demand for bills for quarterly financial statement purposes. Dealers were concerned about the reversal of this demand following the end of the quarter, however, and bidding was restrained in the final weekly auction which was advanced to Friday, June 30, because many participants were expected to take a long Fourth of July holiday weekend. In this second auction for the week, average issuing rates on the three- and six-month bills were set at 4.138 percent and 4.688 percent, respectively, their highest levels since late in 1971. Over the month as a whole, most bill rates rose by some 20 to 60 basis points.

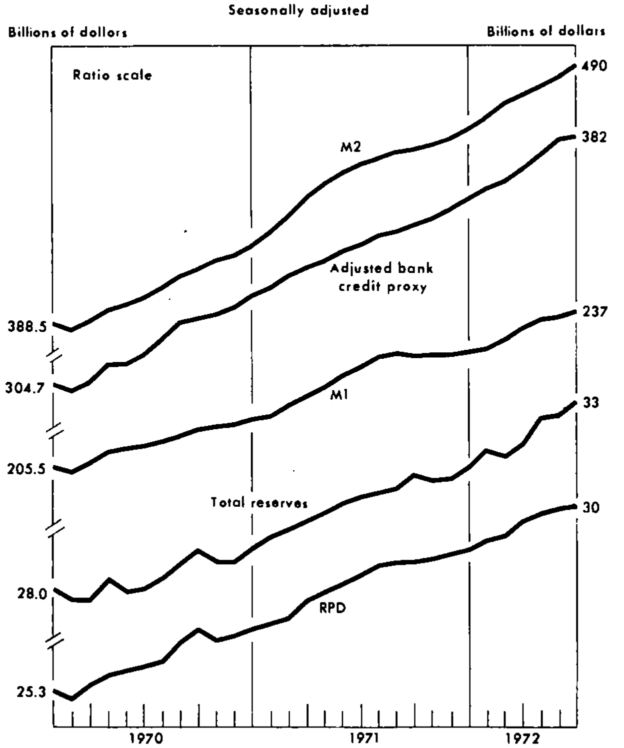
Treasury coupon issues came under many of the same pressures affecting the bill market during June, and yields on most issues maturing within five years were also about 20 to 60 basis points higher over the month. Modest investor demand and some dealer short covering limited price changes on longer term notes and bonds to a somewhat narrower range.

A cautious tone emerged in this market early in June when buying interest was sluggish and participants pondered the implications of a firming Federal funds rate for near-term monetary policy. The possibility of renewed inflation, given the 5½ percent (annual rate) rise in the wholesale price index during May, and the corporate bond market's inability to sustain lower yields despite a reduced calendar were further depressants to the market, and prices of most issues eased over the first week in June. The lower price levels attracted some investor interest, as well as the opportunity for dealer short covering, and the market began to firm. Prices fluctuated narrowly over the next several days and then drifted lower amid predictions by some analysts that the Treasury's cash needs in the fiscal year 1973 would be somewhat greater than estimated earlier. In the face of renewed buyer apathy, dealers marked prices lower in an attempt to elicit some interest but to no avail. There was no selling pressure on the mar-

Chart II

MONETARY AND RESERVE AGGREGATES

Seasonally adjusted



Note: Data for June 1972 are preliminary estimates.

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.

RPD = Total member bank reserves less those required to support United States Government and interbank deposits.

Source: Board of Governors of the Federal Reserve System.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—June 1972				
	June 5	June 12	June 19	June 26	June 30
Three-month	3.861	3.798	3.924	4.023	4.138
Six-month	4.243	4.187	4.328	4.484	4.688

Maturities	Monthly auction dates—April-June 1972		
	April 25	May 23	June 23
Nine month	4.234	4.367	4.754
One-year	4.362	4.465	4.854

*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.

ket, however, as investors seemed content with their current holdings, and prices of coupon issues drifted steadily lower over the remainder of the month.

OTHER SECURITIES MARKETS

Considerable investor resistance was evident in both the corporate and municipal bond markets during much of June after rates had fallen early in the month to their lowest levels since January. The announcement of larger increases in the wholesale and consumer price indexes during May as compared with April contributed to an expectation of higher interest rates, and investors remained on the sidelines a good part of the time.

On May 31 underwriters were able to sell only about 10 percent of a $100 million issue of new Aa-rated utility bonds which were aggressively priced to yield 7.29 percent, the lowest return since mid-January. Despite this experience, on the following day, June 1, an additional $50 million of similarly rated power company bonds was marketed at an even lower yield of 7.25 percent, and by late Friday, June 2, only about $30 million of these two issues had been bought by investors. Although the calendar of scheduled offerings was relatively light, substantial retail demand failed to materialize at the beginning of the next week. As a result, on Tuesday, syndicate restrictions were removed from the unsold balances of these two issues together with two others, and yields on these bonds adjusted as much as 12 basis points higher.

Recognizing the fact that rates had already been pushed beyond their currently acceptable levels, underwriters began pricing new offerings at progressively higher yields over the next several days but with only moderate success. Then, faced with a somewhat heavier schedule than there had been in recent weeks, several syndicates disbanded on the following Monday in advance of the sale of $125 million of New Jersey Bell Telephone securities the next day. This two-part Aaa-rated offering of $75 million of forty-year bonds and $50 million of six-year notes, yielding 7.45 percent and 6.53 percent, respectively, sold out quickly. The return on the bonds matched that placed on a slow-selling Aa-rated offering three days earlier. Immediately following the successful sale of the New Jersey Bell issues, however, underwriters priced two Aa-rated utility bond offerings to yield little more than the Aaa-rated Bell bonds and investors once again balked. Finally, early in the week of June 19, returns on new Aa-rated utility bonds were placed at 7½ percent. Investors responded favorably to this higher rate structure and the corporate bond market tended to stabilize over the next few days, albeit with yields on Aa-rated utility bonds some 25 basis points higher than at the start of the month. In reaction to the uncertainties in the international money market, rates moved higher as the month drew to a close, and a subsequent issue sold slowly at a yield of 7.60 percent.

Confronted with an increased supply of scheduled new issues, investors displayed little interest in the lower yields available on tax-exempt bonds at the start of June. There was a sizable buildup in the Blue List of inventories advertised for sale, as dealers made preparation for the heavier calendar which included $209 million of Aaa-rated local housing bonds guaranteed by the Department of Housing and Urban Development (HUD). Providing yields of 2.60 to 5.08 percent, the HUD bonds were marketed on June 7 and, even though many analysts believed they were not aggressively priced, only about one half were sold during the first three business days. Some additional sales resulted from a markdown in the price of these bonds on the fourth day, but a sizable balance remained.

The tax-exempt market registered a short-lived improvement just before midmonth, when investors bought heavily of several new issues, but faltered again in response to the somewhat restrained reception to a $90 million offering of Aaa-rated Connecticut securities. Two business days later, the unsold portion of the thirty-year term bonds was released from syndicate with an upward yield adjustment to 5.40 percent from an initial 5.25 percent. On the following day, other recent issues were also released from pricing restrictions with increases in yields of as much as

25 basis points. Despite such adjustments, buyers remained quite hesitant and showed very little interest in the new offerings which were marketed later in the month. For example, the unsold HUD bonds were reduced in price a second time on June 22 and, despite some sales, an estimated $20 million remained in dealers' hands; at the same time a one-day-old issue was released from syndicate after first-day sales of less than 50 percent. While the corporate bond market was stabilizing temporarily, tax-exempt securities had difficulty finding a viable level of rates, and that market continued under pressure until late in the month. Reflecting developments in this area over the period, The Bond Buyer index of yields on twenty municipal bonds rose steadily from 5.15 percent on June 1 to 5.43 percent on June 22. Following postponement of a $151 million issue scheduled for June 27, however, pressures abated somewhat and rates stabilized.