The Money and Bond Markets in June

June was marked by a broadly based advance in interest rates, with rates for the shorter maturities reaching levels that had not been experienced since 1970. Concern about inflation continued to mount over the month. Reports early in June that the Nixon Administration was contemplating stronger price controls temporarily buoyed the securities markets. However, the President's June 13 announcement of a price freeze had little initial impact on yields. Interest rates resumed their climb shortly thereafter as market participants doubted that the new moves would significantly reduce underlying inflationary pressures. Short-term rates of interest experienced the largest increases in June, and yields on long-term securities joined in the general advance in rates in the second half of the month. An increased volume of new issues contributed additional upward pressure on yields in the corporate and municipal bond markets.

During June the Federal Reserve took a series of steps to slow the rise in the money and credit aggregates. Around midmonth, the Federal Reserve discount rate was increased by ½ percentage point to 6½ percent. Then, at the end of June, the discount rate was raised another ½ percentage point to 7 percent, its highest level in more than fifty years. At this time, reserve requirements on most demand deposits at member banks were raised ½ percentage point. Earlier in the month, reserve requirements had been imposed upon finance bills. For reserve purposes, these bills were placed on the same footing as large certificates of deposit (CDs) and bank-related commercial paper.

M_1—defined as demand deposits adjusted plus currency outside banks—and M_2, which also includes time and savings deposits other than large CDs, expanded more rapidly than desired in June, despite efforts by the Federal Reserve to restrain the growth in nonborrowed reserves. Similarly, growth of the adjusted bank credit proxy remained rapid, although growth was at a somewhat more moderate pace than the expansion experienced earlier in the year.

BANK RESERVES AND THE MONEY MARKET

Interest rates on money market instruments rose markedly in June, reflecting strong demands for credit and Federal Reserve pressure on bank reserve positions against a background of growing concern over the rate of inflation. The average effective rate on Federal funds reached 8.49 percent in June, compared with 7.84 percent in May. By the end of the month, the rate was around 9 percent. Commercial paper rates climbed steadily throughout the month. The rate on 90- to 119-day commercial paper advanced 1 percentage point over the month, and closed at 8½ percent (see Chart I). Rates quoted by dealers in bankers' acceptances also adjusted sharply higher during June, increasing by 1⅛ percentage points. The commercial bank prime lending rate for large business borrowers was raised to 7¾ percent in two ¼ percentage point steps in the first and third weeks in June and was lifted to 8 percent on July 2. However, given the greater increases in commercial paper rates, the prime rate remained relatively attractive and continued to encourage heavy business loan demand.

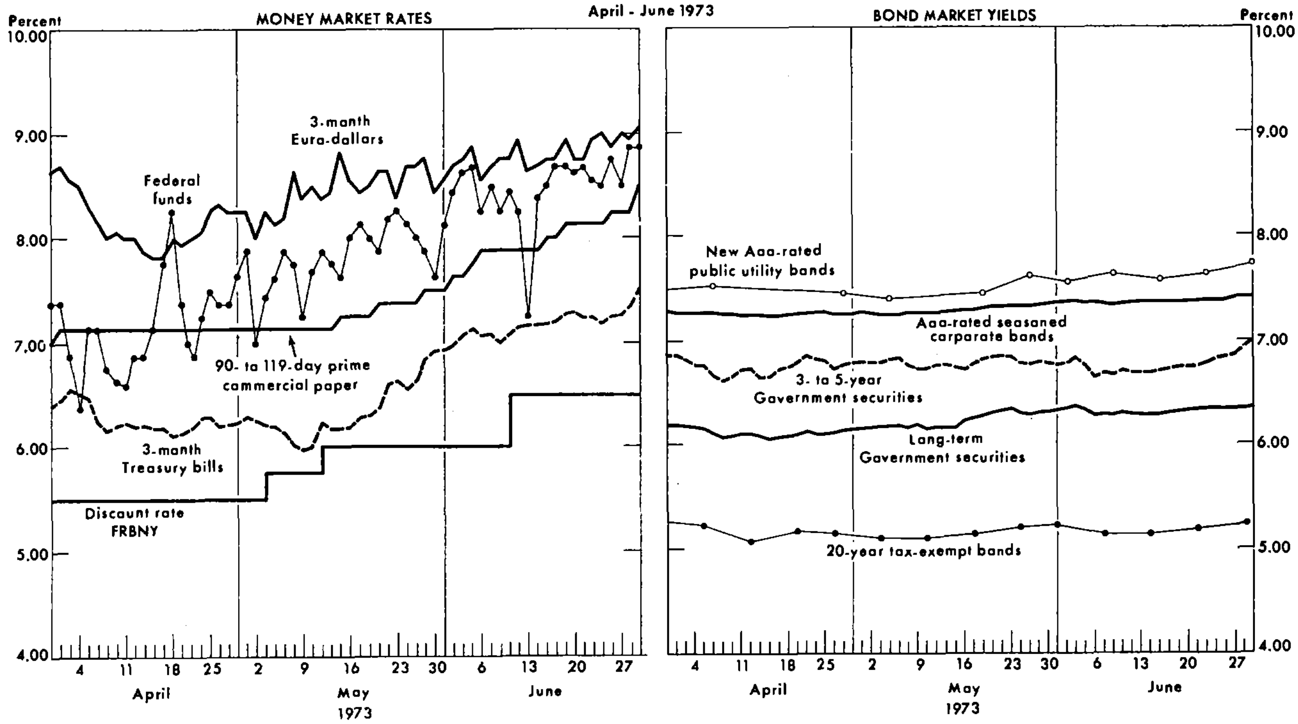
On June 8, the Board of Governors of the Federal Reserve System announced that it had approved increases in the discount rate to 6½ percent from 6 percent at ten of the twelve Federal Reserve Banks, including the New York Bank, effective June 11. By the end of that week, the higher discount rate had become uniform throughout the System. The action was taken in recognition of increases that had already occurred in other short-term rates. The Board also indicated that the decision to approve a rise in the discount rate to a level that had not been equaled since mid-1921 reflected concern over the recent growth in money and bank credit and the continuing rise in the general price level. Borrowings by member banks from the discount window were $1.79 billion on average in June (see Table I), somewhat below the $1.84 billion borrowed in May.

Two steps were taken at the end of June by the Federal

Chart I

SELECTED INTEREST RATES

April - June 1973



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 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.

Reserve in a further effort to slow the advance in money and credit. First, the discount rate was raised to 7 percent from 6½ percent. This rate equaled that charged in late 1920 and early 1921 and is the highest in Federal Reserve history. In conjunction with the increase in the discount rate, the Board announced an increase in reserve requirements on member bank demand deposits. Reserve requirements were raised by ½ percentage point on all but the first $2 million of deposits at member banks. The new requirements will become effective during the reserve-computation period beginning July 19 and will apply to net demand deposits held in the week ended July 11. The higher requirements will absorb approximately $800 million of reserves.*

Earlier, on June 18, the Board of Governors had announced that it was carrying out its proposal to impose reserve requirements on funds raised by member banks through the sale of finance bills. The Board amended

* The new reserve requirement structure is:

On net demand deposits of	*Reserve percentage applicable*
First $2 million or less	8 percent (unchanged)
Over $2 million to $10 million	10½ percent
Over $10 million to $100 million	12½ percent
Over $100 million to $400 million	13½ percent
Over $400 million	18 percent

Regulation D, which governs member bank reserves, to apply a basic 5 percent reserve requirement to finance bills. In addition to the basic requirement, a 3 percent marginal reserve requirement is being applied to the combined total of finance bills, large-denomination CDs, and bank-related commercial paper to the extent that the total exceeds the level outstanding during the week ended May 16 or $10 million, whichever is larger. Finance bills outstanding in the week beginning June 28 were included in reserve calculations, and the banks are required to hold the additional reserves in the week beginning July 12.

The monetary aggregates continued to grow at a rapid pace in June. Preliminary estimates indicate that M_1 advanced at a seasonally adjusted annual rate of 12½ percent in that month. This advance brought the growth rate in M_1 for the second quarter to about 10¼ percent, and growth for the year ended in June to 7½ percent (see Chart II). M_2 advanced at an estimated 10 percent seasonally adjusted annual rate in June, slightly faster than the pace for the second quarter and for the last twelve months.

The adjusted bank credit proxy continued to grow rapidly in June, increasing at an estimated 11 percent seasonally adjusted annual rate. This is, however, a slightly slower pace than that of the preceding four months. Large CDs, which had been expanding at an explosive 103 percent annual rate during the first five months of 1973, grew only modestly in June. Because banks had been restricted to selling short-dated CDs between the end of February and mid-May by the Regulation Q ceilings on CDs with initial maturities of ninety days or more, they were faced with an unusually large volume of maturing CDs in June. In addition, corporations relied heavily on CDs to meet their June 15 tax obligations. In attempting to replace the maturing CDs, many banks competed for short-term funds by raising offering rates on CDs of under six months' maturity a full percentage point or more. In contrast, after an initial upward adjustment following the removal of interest rate ceilings on May 16, rates on longer dated CDs have advanced very little and are now generally lower than rates on the one-month to six-month maturities. Growth in reserves available to support private nonbank deposits (RPD) accelerated to an estimated 15½ percent rate in June, bringing growth in this series to 11 percent for the first half of 1973.

THE GOVERNMENT SECURITIES MARKET

Treasury bill rates rose sharply in June. Advances were concentrated in the shorter maturity ranges during most

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JUNE 1973

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

Factors	Changes in daily averages— week ended				Net changes
	June 6	June 13	June 20	June 27	
"Market" factors					
Member bank required reserves	+ 243	+ 220	— 533	+ 128	+ 58
Operating transactions (subtotal)	+ 809	+1,455	— 536	—1,013	+ 715
Federal Reserve float	+ 568	— 21	+ 186	+ 111	+ 844
Treasury operations*	+ 548	+1,650	— 244	—1,399	+ 555
Gold and foreign account	+ 57	+ 11	+ 7	— 31	+ 44
Currency outside banks	— 278	— 418	— 365	+ 302	— 759
Other Federal Reserve liabilities and capital	— 85	+ 232	— 120	+ 4	+ 31
Total "market" factors	+1,052	+1,675	—1,069	— 885	+ 773
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	— 140	—2,156	+ 968	+ 951	— 377
Outright holdings:					
Treasury securities	— 901	—1,369	+ 604	+1,060	— 606
Bankers' acceptances	— 8	— 10	— 2	+ 1	— 19
Federal agency obligations	— 2	— 6	— 14	+ 229	+ 207
Repurchase agreements:					
Treasury securities	+ 565	— 565	+ 291	— 268	+ 23
Bankers' acceptances	+ 50	— 50	+ 25	— 23	+ 2
Federal agency obligations	+ 156	— 156	+ 64	— 48	+ 16
Member bank borrowings	— 736	+ 33	+ 231	— 79	— 551
Seasonal borrowings†	+ 18	+ 3	+ 6	+ 23	+ 50
Other Federal Reserve assets‡	+ 59	+ 30	+ 47	+ 59	+ 195
Total§	— 817	—2,093	+1,246	+ 937	— 727
Excess reserves‡	+ 235	— 418	+ 177	+ 52	+ 46
	Daily average levels				**Monthly averages**
Member bank:					
Total reserves, including vault cash‡	32,218	31,580	32,290	32,214	32,076‖
Required reserves	31,817	31,597	32,130	32,002	31,887‖
Excess reserves§	401	— 17	160	212	189‖
Total borrowings	1,664	1,697	1,928	1,849	1,785‖
Seasonal borrowings†	64	67	73	96	75‖
Nonborrowed reserves	30,554	29,883	30,362	30,365	30,291‖
Net carry-over, excess or deficit (—)#	135	233	58	95	130‖

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.
§ Adjusted to include $172 million of certain reserve deficiencies on which penalties can be waived for a transition period in connection with bank adaptation to Regulation J as amended effective November 9, 1972. The adjustment amounted to $450 million from November 9 through December 27, 1972 and $279 million from December 28, 1972 through March 28, 1973.
‖ Average for four weeks ended June 27.
Not reflected in data above.

of the month, but rates on longer term bills climbed substantially during the final days. Much of the increase in bill rates reflected the advances in money market interest rates generally. Factors that had previously shielded the bill market from some of the upward pressures in other markets have largely disappeared. Foreign demand for Treasury bills has slackened, as foreign central banks have generally not been accumulating dollars in the foreign exchange markets. In addition, seasonal needs led the Treasury to run down balances at the Federal Reserve during the first half of June. To counteract the expansionary impact these reductions have on reserves, the Federal Reserve sold sizable quantities of Treasury bills in the market. Furthermore, sharp increases in the cost to Government securities dealers of financing their inventories have made them reluctant to hold large quantities of bills.

Anticipations that the Administration would take steps to counteract inflation gave slight pause to the upward movement in bill rates early in June. However, the discount rate increase announced June 8 and the feeling that the new controls would not reduce the need for a restrictive monetary policy led quickly to a resumption of the upward trend in bill rates, which continued over the remainder of the month.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

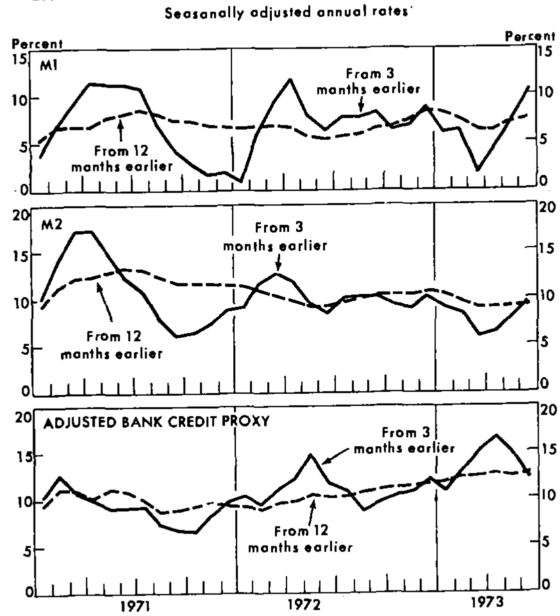
Maturities	Weekly auction dates—June 1973			
	June 4	June 11	June 18	June 25
Three-month	7.133	7.129	7.263	7.228
Six-month	7.210	7.172	7.255	7.299
	Monthly auction dates—April-June 1973			
	April 24	May 24	June 26	
Fifty-two weeks	6.598	6.818	7.235	

* 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.

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for June 1973 are preliminary.

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.

Sources: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York.

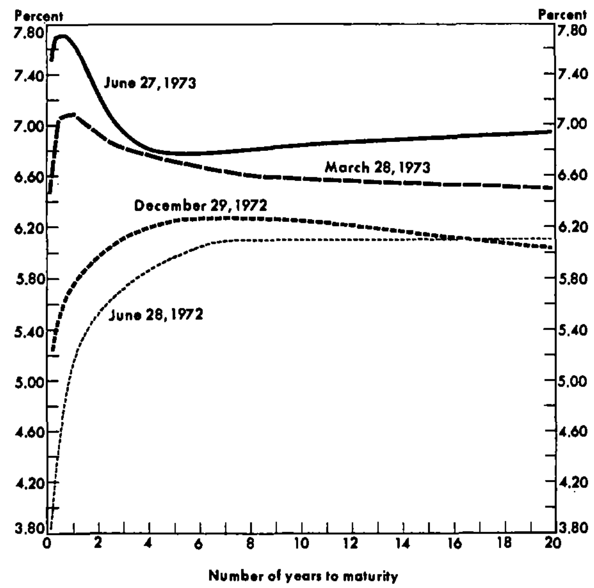
Advances in the average issuing rates established at the weekly bill auctions were initially greatest for the shorter term issues. At the June 18 auction, the average issuing rate for the three-month bill, at 7.263 percent, actually moved above that for the six-month bill (see Table II). The rate for three-month bills retreated slightly at the next auction but still finished 53 basis points higher than the rate set at the final auction in May. The rate for the six-month bill was 44 basis points above its month-earlier level at the June 25 auction, while the yield on 52-week bills in the June 26 auction was 7.235 percent, 42 basis points above the month-earlier level. Rates on all maturities adjusted even higher at the end of the month to levels that had not been experienced since early 1970.

Yields on longer term Treasury coupon issues were insulated to some extent from the persistent rise in bill rates. Price increases during the first half of June were reversed later in the month and, on balance, prices on most issues fell slightly. Over the month as a whole, yields on three- to five-year issues rose by an average of 22 basis points while yields on longer term issues increased by about 7 basis points.

The steep rise in short-term interest rates relative to longer rates in the last few months has led to the so-called inverted yield curve in which short-term securities offer higher returns than longer dated issues. The interest rate pattern that normally prevails is one in which yields increase with the term to maturity. However, short-term interest rates tend to be subject to wider fluctuations than longer rates, and an inverted or "humpback" yield curve is typical in extended periods of robust economic activity and large credit demands. Chart III, which was constructed from dealer bid prices on representative issues, illustrates that an inverted yield curve emerged in the first quarter of 1973 and has subsequently become more pronounced.

The market for Federal agency securities remained active in June. On June 6, the Federal Home Loan Bank Board offered $600 million of 35-month bonds priced to yield 7.20 percent. The issue sold out quickly and was soon trading at a premium. Late in the month, the Federal National Mortgage Association raised $500 million in new cash through the sale of 4½-year debentures yielding 7.25 percent. The issue was well received.

Chart III
YIELDS ON UNITED STATES GOVERNMENT SECURITIES



OTHER SECURITIES MARKETS

Prices of corporate and municipal bonds fell in June in the face of continuing increases in short-term interest rates and an expanding new-issue calendar. There was a brief rally during the week and a half preceding the President's price freeze announcement, based upon anticipations that a strong program of controls might serve to reduce the need for monetary restraint and thereby reduce interest rates. Following the speech the market initially retained its price gains, but subsequently prices resumed their downward drift.

After several months in which there was only a limited volume of new corporate offerings, the new-issue calendar picked up sharply in June. The rally that began June 5 aided sales of two thirty-year A-rated utility bond issues, marketed June 5 and 6 and yielding 7.88 percent and 7.85 percent, respectively. However, in the succeeding week, several utility offerings carrying either straight Aa ratings or split Aa/A ratings (Moody's/Standard and Poor's) met with poor receptions at yields ranging from 7.65 percent to 7.70 percent. On June 20, underwriters priced a $250 million issue of Aaa-rated debentures of a Bell Telephone subsidiary to yield 7.75 percent. These forty-year debentures offered a return that was ⅛ percentage point above the late-May offering of another Bell Telephone subsidiary despite the higher rating on these new debentures. With the more generous yield, the debentures sold well. This good reception also stimulated sales of older issues but did not prevent yields from increasing further in the final week. On June 25, thirty-year bonds of an A-rated power company sold slowly despite a yield of 7.97 percent, the highest yield on a major A-rated utility issue since September 1971.

Prices in the tax-exempt sector fluctuated in response to the outlook for economic controls. On June 20, an offering of $100 million of A-rated 35-year bonds was priced to yield 6.00 percent. This yield proved to be exceedingly popular, and these bonds were soon trading at a premium. In the final week, the market was faced with an unusually heavy calendar, and new issues received mixed receptions despite higher yields. Yields on outstanding tax-exempt issues dipped early in the month but advanced later in the period. The Bond Buyer index of twenty tax-exempt bonds climbed from 5.13 percent on June 7 to 5.25 percent on June 28. Dealer inventories continued on the low side but expanded slightly as the month progressed. The Blue List of dealers' advertised inventories increased by $31 million to $694 million over the month of June.