The Money and Bond Markets in August

Money market rates were relatively steady in August, but yields on Treasury obligations increased until the closing days of the period. Heavy new supplies and burdensome financing costs led to a steep rise in Treasury bill rates as dealers found their inventories heavy. Disappointment over the absence of investments by oil-producing nations in special Treasury issues also weighed heavily on the market. Even the unprecedented response by small investors to the two 9 percent notes auctioned as part of the August refinancing failed to bolster market sentiment. Thus, later in the month when the Treasury announced further bill offerings, rates on new bills in the weekly and monthly auctions advanced to record levels. In the closing days of the month, however, yields generally declined against a background of slightly lower money market rates.

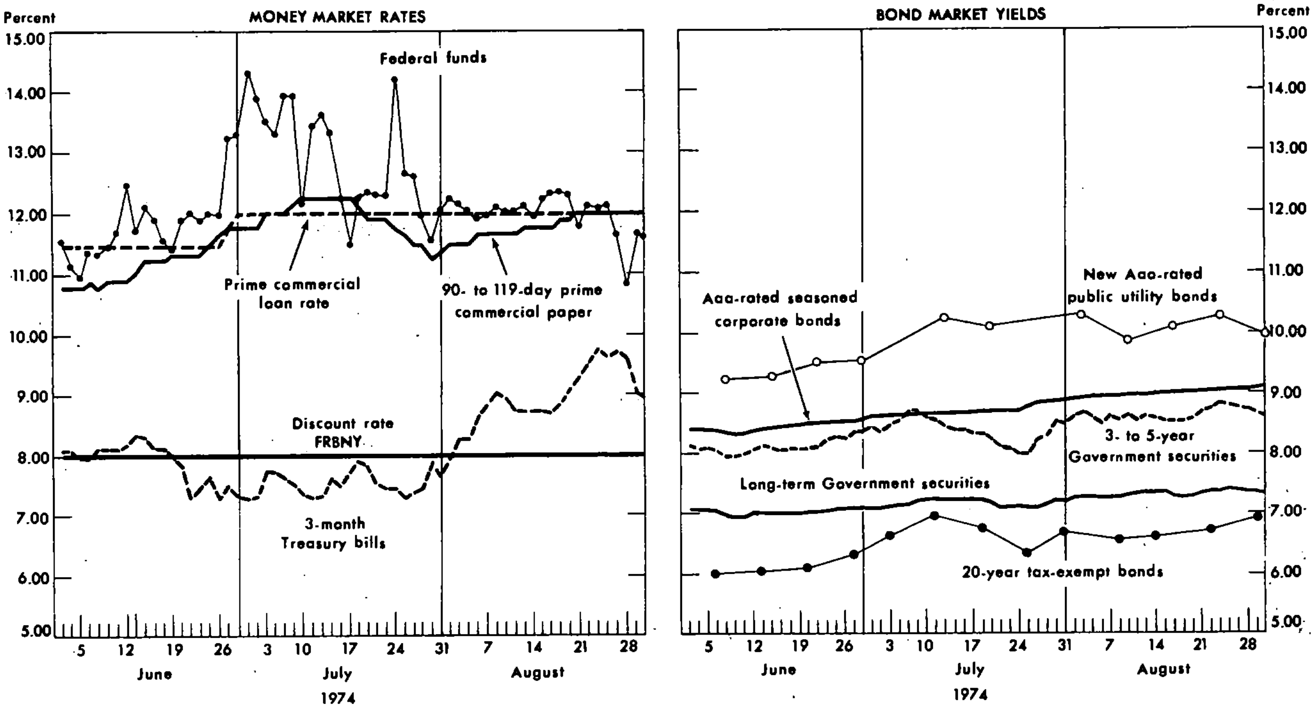
Prices of corporate and tax-exempt securities were also under pressure over much of August. However, a large number of postponements kept new supplies relatively light. Investor demand was modest for all new issues except those of the highest quality. Preference for telephone company issues relative to electric utility issues widened yield spreads between the two and prompted issuers to reduce the size and maturity of most electric utility issues.

During the month, the Board of Governors of the Federal Reserve System announced revisions in the money stock measures to reflect new bench-mark data for nonmember banks, available from the April 1974 call report. The revisions cover the first seven months of this year. The first-quarter growth of the seasonally adjusted narrow money stock (M_1)—private demand deposits adjusted plus currency outside banks—was adjusted downward from an annual rate of 7.1 percent to a 5.6 percent annual rate and in the second quarter to 6.4 percent from 7 percent. Smaller downward adjustments were announced for the growth of the broad money supply (M_2), which includes time and savings deposits other than large negotiable certificates of deposit (CDs). According to preliminary data, the narrowly defined money supply continued to grow at a sluggish pace during the four statement weeks ended August 21, while the broad money supply advanced at a slightly quicker pace over the same period relative to its average level in the first four statement weeks in July. The volume of CDs declined in the four statement weeks ended August 21, the first such decrease since March of this year.

THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

Rates on most money market instruments were relatively steady in August (see Chart I). The effective rate on Federal funds hovered close to 12 percent through most of the period but was somewhat under that level in the closing days. For the month as a whole, it averaged 12.01 percent, down 91 basis points from the record level of 12.92 percent set in July. In the secondary market for CDs, rates on three-month issues traded also around 12 percent in the first two weeks of the period but gradually edged up about 12½ percent near the month end. Dealers in prime commercial paper gradually but persistently raised their offering rates for all maturities throughout the month, as the volume of nonbank-related commercial paper rose significantly. At the close of the month, the rate on 90- to 119-day commercial paper reached 12 percent, an increase of ½ percentage point from its level at the end of July. As commercial paper rates rose, the formula guidelines of several commercial banks that tie their prime lending rates to past market rates called for prime rates in the range of 12.6 percent to 12.8 percent late in the month. However, these banks kept their prime rates at 12 percent as did most other major banks. In contrast to the movement of rates on other money market instruments, rates on bankers' acceptances declined slightly over the month, and trading volume in bankers' acceptances was slightly less than July's record level. Meanwhile, the volume of bank-related commercial paper dropped sharply during the month. The decline apparently reflected the paydown of maturities by bank holding com-

Chart I
SELECTED INTEREST RATES
June - August 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.

panies that sold floating-rate notes late in July and in August.

According to preliminary data, the narrow money supply continued to grow sluggishly in August while the broad money supply advanced at a slightly more rapid pace than in July. For the four weeks ended August 21, M_1 grew at a 2.8 percent seasonally adjusted annual rate relative to its average of the first four statement weeks of July. The growth of M_1 from the corresponding period ended thirteen weeks earlier to the four weeks ended August 21 was 4.6 percent at an annual rate (see Chart II). M_2 advanced at a seasonally adjusted annual rate of 7 percent in the four weeks ended August 21 over the preceding four-week period. In contrast to the money stock measures, the growth of the adjusted bank credit proxy decelerated to 5.6 percent. This slower growth of the proxy can be attributed to the decline in the seasonally adjusted volume of large CDs outstanding. CDs outstanding decreased at a 4.6 percent annual rate in the four weeks ended August 21. This marks the first decline in the use of large CDs since March of this year. In comparison to the four-week average of a year earlier, large CDs were up 54.2 percent in the four weeks ended August 21. Member bank borrowings from the Federal Reserve averaged \$3.3 billion during August (see Table I), about the same as in the previous month.

On August 21, the Board of Governors of the Federal Reserve System proposed an amendment to its regulations governing member bank borrowings that would permit application of a special discount rate to member banks needing exceptionally large assistance over a prolonged period. Under the proposal, the special discount rate would ordinarily be higher than the basic discount rate (currently 8 percent) but would not exceed the rate established for emergency loans to nonmember banks, which is now 10 percent. Comments on the Board's proposal will be received through September 23.

THE GOVERNMENT SECURITIES MARKET

Yields on Treasury issues rose substantially in August, largely in response to the depressing effect the gloomy price statistics had upon market participants and the substantial volume of new bill offerings. At the same time, many participants were disappointed that the Treasury did not attract funds from the oil-producing nations into special issues. This increased market apprehension over the large impending needs of the Treasury and caused bill rates in particular to soar until late in the month.

As the month began, prices of outstanding longer term issues fell sharply in an adjustment to the terms of the August refunding. Weakness in the bill market and prospects for a large supply of new Federal Home Loan Bank debentures contributed to the concern. On Tuesday, August 6, the Treasury auctioned $2.25 billion of 33-month 9 percent notes as part of the August refunding package. Interest in this issue, particularly from small investors, was unprecedented, and the average issuing rate was set at 8.59 percent. Interest in the six-year 9 percent note offered the following day was also good, and a yield of 8.75 percent was established on the $1.75 billion issue. Noncompetitive allotments for the two issues amounted to $2.2 billion, or 55 percent of the total volume. This was the largest subscription by small investors to note auctions since the Treasury began using the auction technique regularly for note issues in November 1970. Besides the attractive 9 percent coupon of the two notes, part of the response by small investors was attributed to the availability of the $1,000 minimum accepted denomination.

Although market participants' reactions were buoyed by the response of small investors to the new notes, news of the rapid rise in wholesale prices in July dampened market enthusiasm for $400 million of 24¾-year 8½ percent bonds, the final part of the refinancing. In restrained bidding, the average yield was set at 8.63 percent. However, as the month progressed, underlying demand for the refunding issues was evident, permitting dealers to reduce their inventories of these issues at stable prices. For the month as a whole, yields on three- to five-year Treasury securities were 3 to 21 basis points higher and yields on longer term Treasury securities were 6 to 38 basis points higher.

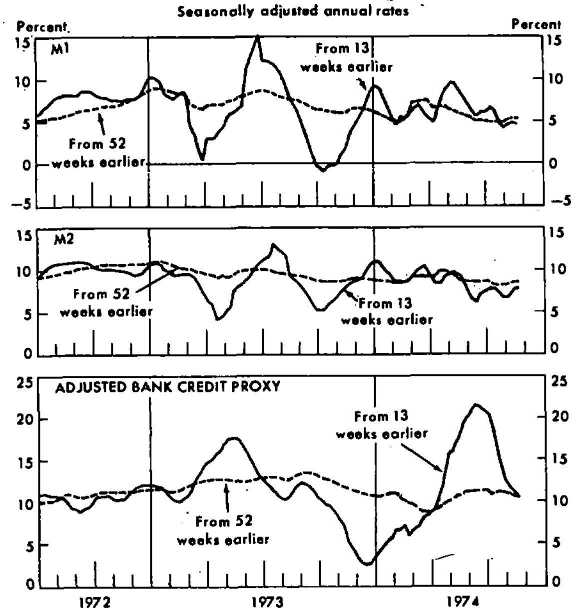
A large volume of additional supplies of Treasury bills came to the market in August, enlarging dealer inventories at a time when financing costs were burdensome. This sent bill rates soaring over much of the month. With rates on other short-term market instruments changing relatively little during the period, the differential between these and bill rates returned to a more normal relationship. In the two preceding months, the differential between these rates widened sharply, as investor preference for quality together with demand from foreign official institutions tended to insulate bill rates from the pressures felt in other markets.

The period began with an auction of $1.5 billion of 44-day tax anticipation bills on August 1. Demand

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 August 21, 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.

Table I

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

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

Factors	Changes in daily averages— week ended Aug. 7	Aug. 14	Aug. 21	Aug. 28	Net changes
"Market" factors					
Member bank required reserves	+ 332	— 109	— 127	+ 31	+ 127
Operating transactions (subtotal)	+ 883	+ 163	—1,544	— 237	— 735
Federal Reserve float	+ 298	— 77	— 50	— 53	+ 118
Treasury operations*	+ 501	+ 887	— 572	— 740	+ 76
Gold and foreign account	+ 19	+ 5	— 159	+ 121	— 14
Currency outside banks	— 253	— 521	— 653	+ 512	— 915
Other Federal Reserve liabilities and capital	+ 318	— 131	— 110	— 77	—
Total "market" factors	+1,215	+ 54	—1,671	— 206	— 608
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	— 588	— 162	+2,002	— 145	+1,107
Outright holdings:					
Treasury securities	+ 121	— 162	+1,234	— 74	+1,119
Bankers' acceptances	+ 6	—	+ 16	+ 36	+ 58
Federal agency obligations	— 4	—	—	—	— 4
Repurchase agreements:					
Treasury securities	— 383	—	+ 435	— 133	— 81
Bankers' acceptances	— 130	—	+ 78	+ 37	— 15
Federal agency obligations	— 198	—	+ 239	— 11	+ 30
Member bank borrowings	— 607	— 43	+ 397	+ 96	— 157
Seasonal borrowings†	+ 11	— 14	+ 6	— 5	— 2
Other Federal Reserve assets‡	+ 27	+ 63	— 610	+ 231	— 289
Total	—1,166	— 142	+1,789	+ 182	+ 663
Excess reserves‡	+ 49	— 88	+ 118	— 24	+ 55
	Daily average levels				**Monthly averages§**
Member bank:					
Total reserves, including vault cash‡	36,921	36,942	37,187	37,132	37,045
Required reserves	36,688	36,797	36,924	36,893	36,826
Excess reserves	233	145	263	239	220
Total borrowings	3,083	3,040	3,437	3,533	3,273
Seasonal borrowings†	174	160	166	161	165
Nonborrowed reserves	33,838	33,902	33,750	33,599	33,772
Net carry-over, excess or deficit (—)‖	122	118	109	165	129

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 August 28, 1974.
‖ Not reflected in data above.

stemmed largely from investors who swapped outstanding issues of similar maturity for these new bills. The average issuing rate for the new bills was set at 9.66 percent and, following this auction, rates on outstanding shorter maturity bills rose appreciably.

Expectations of additional Treasury financing beyond the $200 million increment to each of the weekly auctions weighed heavily upon the market, as did concern that the refunding would siphon small investor interest away from the retail bill market. In the first weekly auction of the month, three- and six-month bill rates rose 81 and 61 basis points, respectively, above their levels in the last auction of July. In the ensuing auctions, gloomy crop forecasts, the spurt in wholesale prices in July, and official statements concerning the tenacity of inflation generated restrained bidding. When expectations that a new bill issue would be marketed were confirmed, bill rates escalated further. In the monthly auction of 52-week bills on August 21, the average issuing rate was 9.56 percent (see Table II), 114 basis points above the historic peak established in the May 2 auction. In the weekly bill auction on August 26, record average rates were set on the three- and six-month issues of 9.91 and 9.93 percent, respectively. By August 28 the atmosphere had begun to brighten against the background of slightly lower money market rates. Bidding was rather aggressive in the auction held that day for $2 billion of 299-day bills. The average issuing rate was 9.77 percent. In the final auction of weekly bills, held on August 30, the average rates on three- and six-month bills receded to 9.17 and 9.28 percent, respectively.

Prices of Federal agency obligations eroded over the month amid relatively light new issue activity. Nevertheless, dealer inventories remained large, while expectations of future heavy financing coupled with the surge in yields on Treasury securities weakened the agency market. On August 9, the Federal Home Loan Banks marketed $1.8 billion of new securities, paying rates of 9.20 percent on eighteen-month bonds, 9.15 percent on 3¼-year bonds, and 9.10 percent on 4¼-year bonds. Interest for this issue was very good. One week later, the Banks for Cooperatives (COOP) and the Federal Intermediate Credit Banks (FICB) marketed $1.23 billion of securities with yields of 9.85 percent for the six-month COOP bonds and 9.80 percent for the nine-month FICB bonds. At the close of the period, the Federal National Mortgage Association sold $1.6 billion of bonds. The offering consisted of $700 million of 10 percent bonds due June 10, 1976, $600 million of 9.80 percent bonds due June 11, 1979, and $300 million of 9.70 bonds due September 10, 1981. The issues were well received.

THE OTHER SECURITIES MARKETS

The corporate bond market was characterized in August by a modest supply of new issues and light trading activity. The light volume was balanced by a lack of investor demand, particularly for longer maturities, as bleak price statistics prompted investors to be cautious about committing their funds to long-term investments. A significant volume of scheduled issues was postponed, and this weighed upon market sentiment given the realization that the large capital needs of industry would have to be financed eventually. Issuers that did not postpone their financing generally confined their offerings to shorter maturities and made substantial yield concessions to sell their securities.

The month began with a reoffering of $130 million of A-rated five-year debentures yielding 11 percent. This issue, which did not receive any valid bids when previously offered with a coupon rate of 11⅝ percent and a thirty-year maturity, sold quickly. On the same day, an Aa-rated issue of another electric utility was successfully sold when it was priced to yield 10.75 percent in thirty years, 1⅜ percentage points above the last such offering in June. Investor preference for quality issues helped the Mountain States Telephone and Telegraph Company market $175 million of Aaa-rated bonds priced to yield 9.82 percent in thirty-eight years. Although this yield was 17 basis points above a similar Bell issue marketed three weeks earlier, it was almost a percentage point below the most recently marketed non-Bell issue. On August 14, the yield for new medium-grade electric utility bonds reached the unprecedented height of 12.13 percent when Boston Edison marketed a five-year 12½ percent issue. The high yield was primarily the result of a substantial downgrading of the company's rating to Baa. Late in the month when syndicate price restrictions were removed, the issue fell in price to produce a yield close to 13 percent.

New issues in the corporate bond market in August also included a substantial volume of floating-rate notes. Following in the wake of the $650 million issue in July by Citicorp, six additional companies—four of which were commercial bank holding companies—marketed a combined $600 million of the floating-rate securities. The basic features of these notes are similar: a fixed interest rate for a specified period and later a return based upon the three-month Treasury bill rate plus some premium, substantial call protection, and periodic redemption of the securities at par after a certain minimum interval. An exception to the latter provision was provided by the New York Bank for Savings offering of seven-year notes which are not redeemable before maturity. These notes, in contrast to the others, provide an interest rate floor of 8 percent. Investor interest in most of the floating-rate notes seemed to wane after the positive reaction to the notes issued by Citicorp. After observing the modest investor response to the $40 million New York Bank for Savings offering and the sharp price decline after syndicate price restrictions were removed from the Chase Manhattan Corporation issue marketed in the beginning of the period, both Crocker National Corporation and Continental Illinois Corporation postponed their scheduled offering dates to later in the month. In addition, Crocker reduced the amount to be offered from $75 million to $40 million, while Mellon National Corporation increased its initial premium from 9.70 percent to 10 percent and decreased its volume to $90 million from $100 million. In the final floating-rate issue of the month, Continental Illinois Corporation's 10 percent notes were sold at a price to yield 10.30 percent initially despite a reduction in the total volume from $125 million to $80 million.

In the market for tax-exempt securities the volume of new issues was smaller than in the past several months, partly because of statutory interest limitations which constrained scheduled offerings and also as a result of the lackluster receptions accorded several highly rated offerings. The modest supply of new issues kept prices from deteriorating at as fast a pace as in other capital markets. The month began with an $85 million utility improvement issue rated Aaa, with returns ranging from

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—August 1974				
	Aug. 5	Aug. 12	Aug. 19	Aug. 26	Aug. 30
Three-month	8.505	8.763	8.846	9.908	9.167
Six-month	8.660	8.719	8.890	9.930	9.283
	Monthly auction dates—June-August 1974				
	June 26	July 24	Aug. 21		
Fifty-two weeks	8.256	7.836	9.564		

* 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.

5.50 percent in 1976 to 7.00 percent in 1997. This issue encountered a lack of investor interest and set the tone for the balance of the month. At midmonth two additional offerings, though highly rated, sold slowly. The larger of the two issues, $50 million of Aaa-rated general obligation bonds priced to yield from 5.40 percent in 1975 to 6.00 percent in 1993 was 20 percent unsold a week later. At this time, a similarly rated issue priced about 5 basis points higher than this issue also had difficulty attracting investors. Given the restrained reception accorded most issues, the weekly volume of scheduled offerings became smaller as the month progressed. On August 29, The Bond Buyer index of municipal yields was 6.91 percent, 21 basis points above the level on August 1. The Blue List of dealers' advertised inventories fell $95 million to $360 million over the month.