The Money and Bond Markets in June

Long-term interest rates declined moderately in June, but virtually all short-term rates and yields on intermediate-term Government securities rose substantially. As the month opened, all sectors of the credit market displayed a hesitant tone, with upward pressure on rates stemming in part from market disappointment that the Federal funds rate did not decline further. A major rally in the Treasury bill market and all the coupon markets emerged upon announcement of a reduction in the volume of Treasury bill financing in June. By midmonth the yields on three- and six-month Treasury bills had fallen to their lowest levels in over two and one-half years. Demand proved disappointing at the lower yield levels, and announcements of the Treasury's plans to borrow considerably in the bill market in July caused a sharp, rapid retracing of previous declines. Market participants also became increasingly concerned about the rapid growth of the money supply and the persistent uptrend in the Federal funds rate. By the end of the month the yield on the three-month Treasury bill was 66 basis points above its level of 5.20 percent at the end of May.

In contrast to the fluctuating movements of Treasury bill yields, virtually all private money market rates moved steadily higher over the course of the month. Notably, the effective rate on Federal funds in June averaged 33 basis points above its average level in May, the first monthly increase in this rate since July of last year. Other money market rates displayed similar increases.

The announcement early in the month projecting less near-term borrowing by the Treasury caused intermediate-term Government yields to fall sharply, but this decline was virtually erased when the Treasury subsequently announced that it would borrow $9.4 billion in the bill market and the intermediate-term coupon sector prior to the August refunding. At the same time, the absence of immediate Treasury plans to offer further long-term bonds permitted that sector of the Government market to sustain the rate decline that had occurred earlier. The long-term Government market and the private long-term debt market also benefited from publication of data on wholesale and consumer prices which suggested an abatement of inflationary pressures. In the corporate market, where the volume of new offerings remained very high, most major issues offered early in the month sold out quickly at yields well below those on comparable securities offered in the preceding month. Resistance to some issues emerged toward the close of June in the wake of the rise in the Federal funds rate and the continuing heavy volume of offerings. The municipal market benefited initially from the favorable impact of the outlook for inflation which was augmented as the market gained confidence that New York City would avoid default on its debt due June 11. The tone of the municipal market deteriorated near the end of the month, however, as the calendar remained heavy.

Preliminary data suggest that the narrow and broad money supply measures grew very rapidly in June. The rapid growth of these monetary aggregates was partially due to the effects of tax rebates by the Treasury and the special social security payments made during the month. Banks continued to allow a large volume of certificates of deposit (CDs) to run off in June as loan demand remained weak. Despite this, the bank credit proxy posted a sizable increase on the strength of demand and consumer-type time deposit growth.

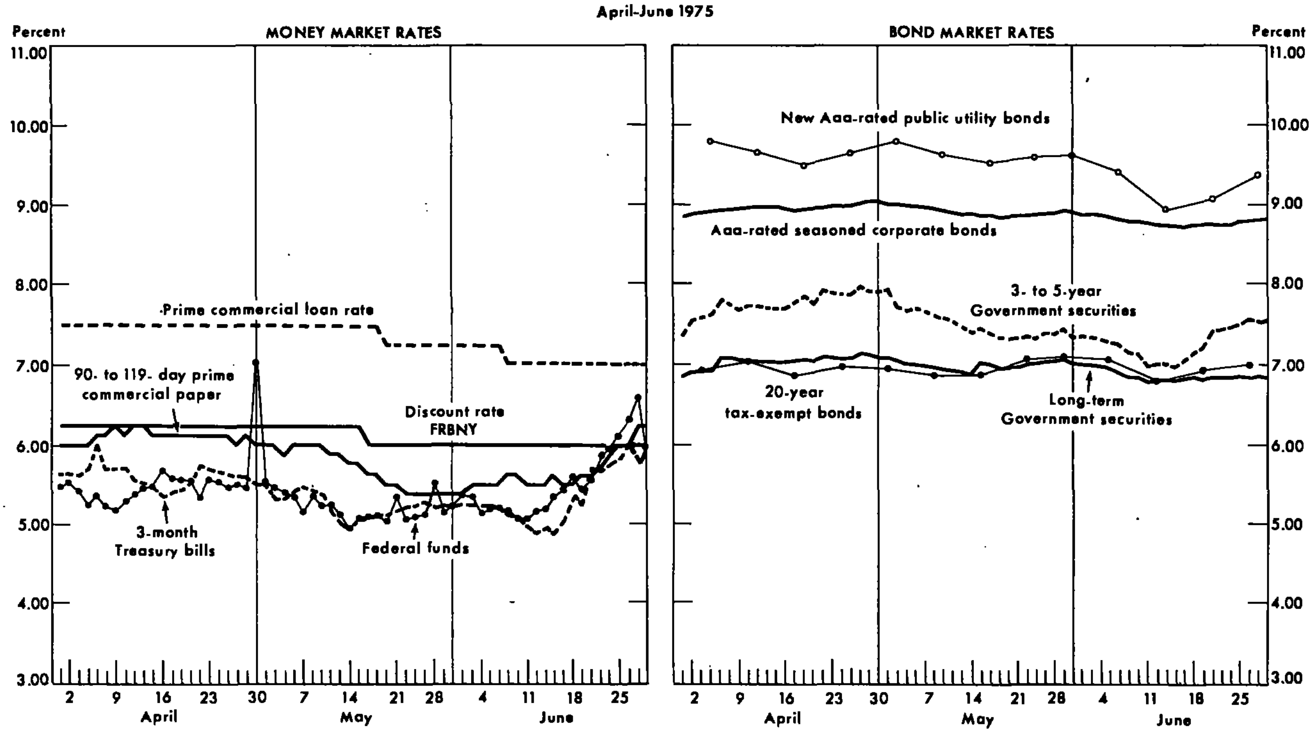
THE MONEY MARKET AND THE MONETARY AGGREGATES

Demand for short-term credit continued to be weak during June, a month typically characterized by strong credit demands. At weekly reporting commercial banks in New York City, business loans rose just $7 million in the four weeks ended June 25. Moreover, business loans (including loans sold to affiliates) at weekly reporting banks in New York City increased only $92 million during the statement week ended June 18, which included the June 15 tax date. By contrast, in the preceding three years, business loan growth had averaged $516 million in the statement week including the June 15 tax date. The volume of nonfinancial commercial paper outstanding

Chart I

SELECTED INTEREST RATES

April-June 1975



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.

decreased $673 million in the four weeks ended June 25, after having decreased $913 million in the four weeks ended May 28.

The persistent sluggishness of loan demand prompted reductions in commercial banks' prime lending rates in early June. A major New York City bank, which uses a formula as a guide in determining its prime rate, announced a reduction from 7 percent to 6¾ percent at the end of the initial calendar week of the month. The following Monday, most other major money-center banks lowered their prime rate from 7¼ percent to 7 percent (see Chart I).

Other money market rates generally rose in June, particularly during the last half of the period. The Federal funds rate averaged 5.55 percent during the month, up 33 basis points from its average in May. The rate on 90- to 119-day dealer-placed commercial paper increased from 5.38 percent at the end of May to 6.25 percent at the end of June. Similarly, the yield on 90-day commercial bank CDs in the secondary market closed the month at 5.93 percent, up 37 basis points from its end-of-May level. Most money market rates have fluctuated in a narrow range during the last several months, after dropping sharply from mid-1974 through early spring of this year. The rate on Federal funds, for example, fell from a peak of about 14 percent reached at the beginning of July 1974 to about 5¼ percent in April and has generally fluctuated between 5 percent and 6 percent since that time. Most other money market rates have exhibited a similar pattern.

Preliminary data suggest that the growth of the narrow money supply (M_1)—private demand deposits adjusted plus currency outside commercial banks—accelerated sharply during June. Seasonally adjusted, the average level of M_1 in the four weeks ended June 25 was 18.8 percent, on an annual basis, above the four-week average value four weeks earlier. This rapid growth of M_1 arose, to some extent, from the disbursement by the Treasury of tax rebates and from the special social security payments made during the month. Coupled with the substantial growth in May, the average level of seasonally adjusted M_1 in the four weeks ended June 25 was 10.8 percent, on an annual basis, above its seasonally adjusted average level in the four weeks ended thirteen weeks earlier (see Chart II). The recent expansion of M_1 appears somewhat less rapid when viewed over a longer time frame. Compared with its four-week average in the interval ended twenty-six weeks earlier, M_1 grew at a seasonally adjusted annual rate of 6.5 percent in the four weeks ended June 25.

Depositors continued to find yields on consumer-type time and savings accounts attractive relative to those available on open market instruments, and the outstanding volume of these accounts rose rapidly in June. As a result, M_2—which includes these deposits plus M_1—was 19.4 percent higher on a seasonally adjusted annual basis in the four weeks ended June 25 than it had been in the four-week period ended four weeks earlier. The average level of commercial bank large negotiable CDs outstanding declined at a seasonally adjusted annual rate of 27.3 percent over the same period. Despite this decline, the growth of the adjusted bank credit proxy—all deposits at member banks subject to reserve requirements plus certain nondeposit sources of funds—was also rapid in June. Its seasonally adjusted average level in the four weeks ended June 25 was 17.4 percent higher, on an annual basis, than its average level in the preceding four-week period. Member banks continued to make little use of the discount window, and borrowings equaled $97 million in June (see Table I).

THE GOVERNMENT SECURITIES MARKET

The tone of the Government securities market in June was dominated largely by anticipations and announcements regarding Treasury borrowing plans. An optimistic atmosphere emerged soon after the first regular bill auction, when the Treasury announced plans to reduce its borrowings at the second and third bill auctions of the month, and rates plummeted dramatically in response. The lower rate levels attained proved to be unsustainable, however, and announcements of further borrowing in the bill and

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JUNE 1975

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

Factors	Changes in daily averages— week ended				Net changes
	June 4	June 11	June 18	June 25	
"Market" factors					
Member bank required reserves	— 146	+ 454	— 841	— 27	—560
Operating transactions (subtotal)	+1,370	+4,023	— 7	—3,063	+2,323
Federal Reserve float	+ 331	— 2	+ 18	— 195	+ 152
Treasury operations*	+1,648	+4,031	+ 337	—2,763	+3,253
Gold and foreign account	— 4	+ 27	— 48	+ 63	+ 38
Currency outside banks	— 238	— 504	— 232	— 292	—1,261
Other Federal Reserve liabilities and capital	— 372	+ 470	— 82	+ 123	+ 139
Total "market" factors	+1,224	+4,477	— 848	—3,090	+1,763
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	—1,364	—4,744	+1,108	+2,677	—2,323
Outright holdings:					
Treasury securities	— 837	—2,680	+ 807	+1,477	—1,233
Bankers' acceptances	— 9	— 27	— 26	— 7	— 69
Federal agency obligations	— 54	— 3	—	—	— 57
Repurchase agreements:					
Treasury securities	— 568	—1,640	+ 307	+1,022	— 879
Bankers' acceptances	+ 53	— 119	+ 3	+ 106	+ 43
Federal agency obligations	+ 51	— 275	+ 17	+ 79	— 128
Member bank borrowings	—	— 46	+ 40	+ 110	+ 104
Seasonal borrowings†	— 1	+ 2	— 1	—	—
Other Federal Reserve assets‡	+ 325	— 48	+ 114	+ 25	+ 416
Total	—1,039	—4,838	+1,262	+2,812	—1,803
Excess reserves‡	+ 185	— 361	+ 414	— 278	— 40
	Daily average levels				Monthly averages§
Member bank:					
Total reserves, including vault cash‡	34,543	33,728	34,978	34,732	34,495
Required reserves	34,197	33,743	34,584	34,611	34,284
Excess reserves	346	— 15	399	121	218
Total borrowings	84	38	78	188	97
Seasonal borrowings†	9	11	10	10	10
Nonborrowed reserves	34,459	33,690	34,900	34,544	34,398
Net carry-over, excess or deficit (—)‖	36	42	— 109	124	23

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 June 25, 1975.
‖ Not reflected in data above.

intermediate sectors pressed rates upward quickly. Long-term Government securities yields remained firm at the lower rates attained, as that sector of the market was relieved by the absence of further long-term bond borrowing in the immediate future.

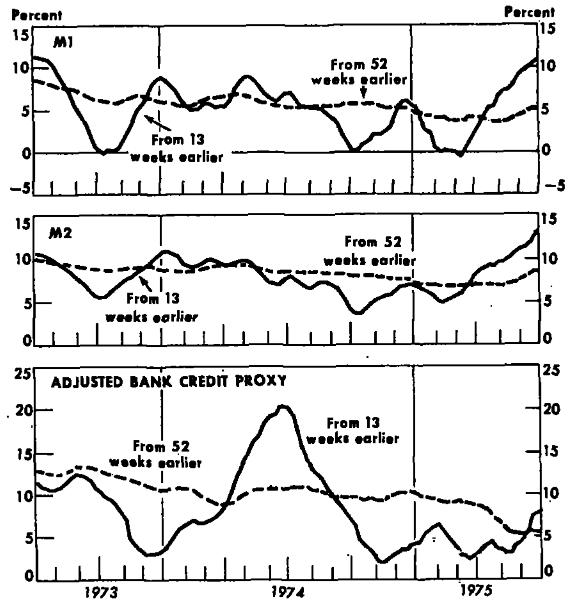
The bill market displayed a hesitant tone initially, and this prompted a slight increase in the average rates on three- and six-month bills at the first regular weekly auction of the month. A firmer tone began to manifest itself subsequent to the auction when it was announced that $300 million less would be raised at the following auction. The market improved even further when it was later announced that the Treasury would offer only $4.5 billion in bills at the June 16 auction in return for $6 billion in bills maturing on June 19. Rates moved down at the June 16 auction, as market participants contemplated this net repayment, and the average issuing rates for the three- and six-month bills were set at 4.77 percent and 5.13 percent, respectively (see Table II), down 44 basis points and 34 basis points from the rates set at the last auction in May. Market participants were disappointed, however, that tenders for bills were spread over an unusually wide range and that post-auction demand was not so strong as anticipated. The market weakened the following day, when interest in the two-year note auction was less enthusiastic than had been expected. It deteriorated even further later that week, when the Treasury announced plans to raise $9.4 billion of new cash between July 1 and August 15. Included in those plans were increases in the volume of offerings at the weekly bill auctions, beginning with the last regular weekly auction in June, and the raising of $600 million in new cash at the auction of 52-week bills in late June. Upward rate pressure also followed System action to absorb reserves on Friday, June 20, through matched sale-purchase agreements at a time when money market participants expected the System to supply reserves. In the wake of these developments, rates rose sharply. Yields on the three-month, six-month, and 52-week bills closed the month up 66, 68, and 65 basis points, respectively, from their end-of-May levels of 5.20 percent, 5.44 percent, and 5.78 percent.

The announcements of the reduction in the supply of bills early in the month had a positive influence upon the coupon sector of the Government securities market. And this sector also benefited from reports suggesting an abatement of inflation. Rates on most issues fell through midmonth, when an upward correction began to take hold. Investors and dealers were disheartened with the wide range of tenders at the June 16 bill auction and the unexpectedly low volume of bids at the two-year note auction on June 17. At that auction, only $2.6 billion in bids was received for the $2 billion in notes offered. Investors were also disappointed that the average issuing rate was not lower than the 6.61 percent set. The concern of participants in the intermediate portion of the market increased when the Treasury announced that included in the $9.4 billion it planned to raise between July 1 and August 15 was a $1.75 billion four-year note issue and a $1.5 billion two-year note issue. At the same time, the long-term sector of the market was encouraged by the absence of any long-term issue in the Treasury's financing plans. In this environment, intermediate rates rose sharply while long-term rates remained stable. The four-year note payable July 9 was auctioned on June 25. Investor interest was keen, and the note was awarded at an average rate of 7.83 percent. At the close of the month, the index of yields on intermediate-term Government securities stood at 7.56 percent, up 23 basis

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 June 25, 1975.

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.

points from its closing level in May. In contrast, the long-term Government bond yield index was down 15 points at 6.86 percent at the end of June.

Developments in the market for Federal agency obligations paralleled those in the intermediate sector of the Government securities market. Rates fell initially in the generally optimistic trading atmosphere, which prevailed early in the month, but then retraced earlier declines when the Government's borrowing plans for the July 1-August 15 period were announced. A further dampening factor in the agency market was the unexpected announcement by the Federal National Mortgage Association (FNMA) of its plans to market $300 million in nine-year notes dated June 26. The notes carried an 8.2 percent coupon and were placed slowly. Earlier in the month, a Banks for Cooperatives offering of $423.7 million of 5.65 percent bonds due January 5, 1976 was very well received when priced at par. A concurrent Federal Intermediate Credit Bank offering of $1.3 billion was also very well received. That offering consisted of $738.5 million of 5.8 percent bonds due April 1, 1976 and $531 million of 7.4 percent bonds due in four and one-half years. A Federal Land Bank $390.5 million offering of 8.10 percent bonds due in ten years was also very well received when priced at par.

Yields declined at the first two FNMA mortgage commitment auctions held in June, but the yield on FNMA commitments to purchase insured mortgages rose at the June 30 auction. At these auctions, held every other Monday, mortgage originators bid for four-month commitments from FNMA to purchase insured and conventional mortgages. Yields at these auctions and the volume of offerings to FNMA rose substantially in March and April, reflecting expectations of higher interest rates over the four-month horizon. These expectations stemmed in turn from the market's impression that the large volume of Federal borrowing would cause a sharp rise in interest rates. Beginning in late May and continuing through June, these expectations were revised in view of the overall stability of interest rate levels. At the last FNMA mortgage auction in June, the yield on four-month commitments on insured mortgages was set at 9.07 percent. Even though this was slightly above the yield set on insured mortgage commitments at the preceding auction, it was still 22 basis points below the 9.29 percent rate on insured mortgages set at the May 5 auction.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—June 1975				
	June 2	June 9	June 16	June 23	June 30
Three-month	5.258	5.080	4.767	5.665	6.009
Six-month	5.505	5.283	5.129	5.935	6.262

Maturity	Monthly auction dates—April-June 1975			
	April 2	April 30	May 28	June 24
Fifty-two weeks	6.475	6.400	5.803	6.292

* 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

Both the corporate and municipal bond markets improved in June. These markets sustained strong rallies through the middle of the month, largely in response to the near-term decline in the volume of Treasury offerings and the reported reductions in the rate of inflation. In the municipal market, a further impetus to higher prices was provided by the temporary resolution of New York City's liquidity problems. The city had been in danger of defaulting on $792 million in notes and interest due June 11. The possible default on these securities was avoided when the New York State legislature enacted legislation establishing the Municipal Assistance Corporation (MAC). Among its various powers and responsibilities, the corporation is authorized to issue up to $3 billion in long-term debt in order to repay a like amount of the city's short-term debt. Upon enactment of the legislation establishing the MAC, funds were made available to the city to pay off its maturing debt through a combination of rollovers of outstanding loans, advances from New York State, and incoming city revenues. The initial issue by the MAC of a record $1 billion of tax-exempt bonds on June 30 sold slowly despite offering yields ranging from 6.5 percent in 1977 to 9.5 percent in 1990.

With the exception of the MAC offering, the largest tax-exempt issue of the month was a $450 million offering by Massachusetts sold on June 30. The state's credit rating had been lowered to A-1 earlier in the month in view of the recent frequency of its offerings and the state's budget deficit. The issue was comprised of equal $90 million amounts maturing in 1976-80. It was priced to yield from 4.75 percent in 1976 to 5.8 percent in 1980 and was virtually sold out on the day it was offered. Among the other major municipal bond offerings of the month were $100 million offerings by the State of California and the State of Connecticut. The $100 million Aaa-rated California offering reached the market early in the month and incurred an average issuing cost of 5.84 percent for maturities running from 1976 to 1995. The bonds were reoffered by the underwriters to yield from 3.60 percent to 6.40 percent and were about 70 percent sold by the end of the first day of trading. The Connecticut issue, which was marketed a week later, fared better even though one of the rating agencies had lowered the rating of Connecticut's debt to Aa in view of the state's budget deficit. The issue was awarded at a net interest cost of 5.64 percent for the same maturity range as the California offering. The Connecticut issue was almost entirely sold on the first day of trading after it was reoffered to yield from 3.50 percent to 6.10 percent.

The largest corporate debt offering of the month was a $300 million issue of thirty-year bonds by Standard Oil Co. of Indiana, which came to market on June 12. The Aaa-rated issue carries an 8⅜ percent coupon and is protected for ten years against early redemption. When priced to yield 8.47 percent, the issue sold out quickly. In contrast, during May, Aaa-rated industrial offerings of the same maturity by Texaco Incorporated and Shell Oil Company were priced to yield 8.95 percent and 8.82 percent, respectively. The following week, Monsanto Company, whose debt securities carry an Aa rating, offered a package consisting of $175 million of twenty-five year bonds and $100 million of ten-year notes. The twenty-five year bonds, which carry an 8½ percent coupon and ten-year call protection, were offered to the public at 8.55 percent, just 8 basis points above the yield on the Aaa-rated Standard Oil issue. They were sold out by the end of the first day of the offering. The ten-year notes carry an 8 percent coupon and are protected for seven years against early redemption. They also sold out rapidly when priced at par.

Two Bell System bond issues came to market in June. Early in the month, a New England Telephone & Telegraph Co. offering of $175 million in thirty-five year notes carrying a 9½ percent coupon was marketed at a yield of 9.475 percent, a rate at which they sold out quickly. The relatively high yield on the issue reflected the diverse ratings accorded New England Telephone by the rating agencies. Moody's maintained the company's Aaa rating, but Standard & Poor's gave the company an Aa-1 rating in view of the company's relatively low debt-coverage ratio. The bonds are protected against call for five years. Later in the month, Northwestern Bell Telephone Company, whose debt has an Aaa rating, encountered stiff market resistance to a $150 million offering of 8⅝ percent bonds due in 2012. The issue, which is protected against call for five years, was apparently priced ahead of the market when reoffered by the underwriters to yield 8.65 percent. Only about 50 percent of the issue sold out on the day it was offered, and the supply overhang tempered the market rally.

Overall, the improved tone of the corporate and municipal bond markets brought the Federal Reserve Board's index of yields on recently offered Aaa-rated corporate securities down to 9.41 percent by the end of June, compared with 9.70 percent at the end of May. The weekly Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds dropped 9 basis points to 7 percent. The Blue List of dealers' advertised inventories fell $54 million from its level of $614 million at the end of the preceding month.