The Money and Bond Markets in July

Interest rates in the money and bond markets generally declined in July, continuing the movement begun early in the preceding month. Following the modest easing in the Federal funds market, which emerged early in the month, rates on most money market instruments edged down. The rate decline paused shortly after midmonth but then resumed toward the month end. Reductions in commercial paper and other short-term market interest rates put downward pressure on the commercial bank prime lending rate, which was lowered late in the month by ¼ percentage point to 7 percent by a number of commercial banks. Early in August the 7 percent rate became widespread as most major banks joined in the reduction.

Yields on most intermediate- and long-term debt instruments edged down in July, although yields on Treasury coupon issues were little changed on balance. Market sentiment was buoyed by the decrease in money market rates and by continued moderation of price expectations. In addition, the forward calendar of new issues in the corporate and municipal debt markets became rather modest. There was strong interest in the Treasury's August financing, which was announced late in the month, and the favorable reception to the announcement lent support to the markets.

According to preliminary data, the narrowly defined money stock (M_1) increased appreciably in July following a decline in the previous month. Growth of the more broadly defined money stock (M_2) was also more rapid than in June. The bank credit proxy posted only a modest gain, as certificates of deposit (CDs) declined after a large increase in the preceding period.

THE MONEY MARKET AND THE MONETARY AGGREGATES

Interest rates on money market instruments declined somewhat further in July, after they had stabilized and then moved slightly lower in the previous month (see Chart I). The effective rate on Federal funds averaged 5.31 percent over the month as a whole, compared with a 5.48 percent average in June. Rates on 90- to 119-day dealer-placed commercial paper closed the period at 5⅜ percent, down ⅜ percentage point from the end of June, and average rates on 90-day bankers' acceptances fell about 33 basis points to 5.35 percent. By the end of the month, 90-day large negotiable CDs were trading in the secondary market at 5.35 percent, a decline of 38 basis points over the period. These lower rate levels, particularly for commercial paper, induced commercial banks to adjust their prime lending rate, and late in the month the prime rate was reduced by ¼ percentage point to 7 percent at several major banks, with most others joining in this action in early August. Excess reserves were unusually variable in July (see Table I), as banks built up large reserve surpluses over the July 4 holiday weekend. Because a portion of those surpluses could be carried forward into the next statement week, the initial holiday surplus had the effect of increasing the amplitude of the zigzag pattern of excess reserves in subsequent statement weeks.

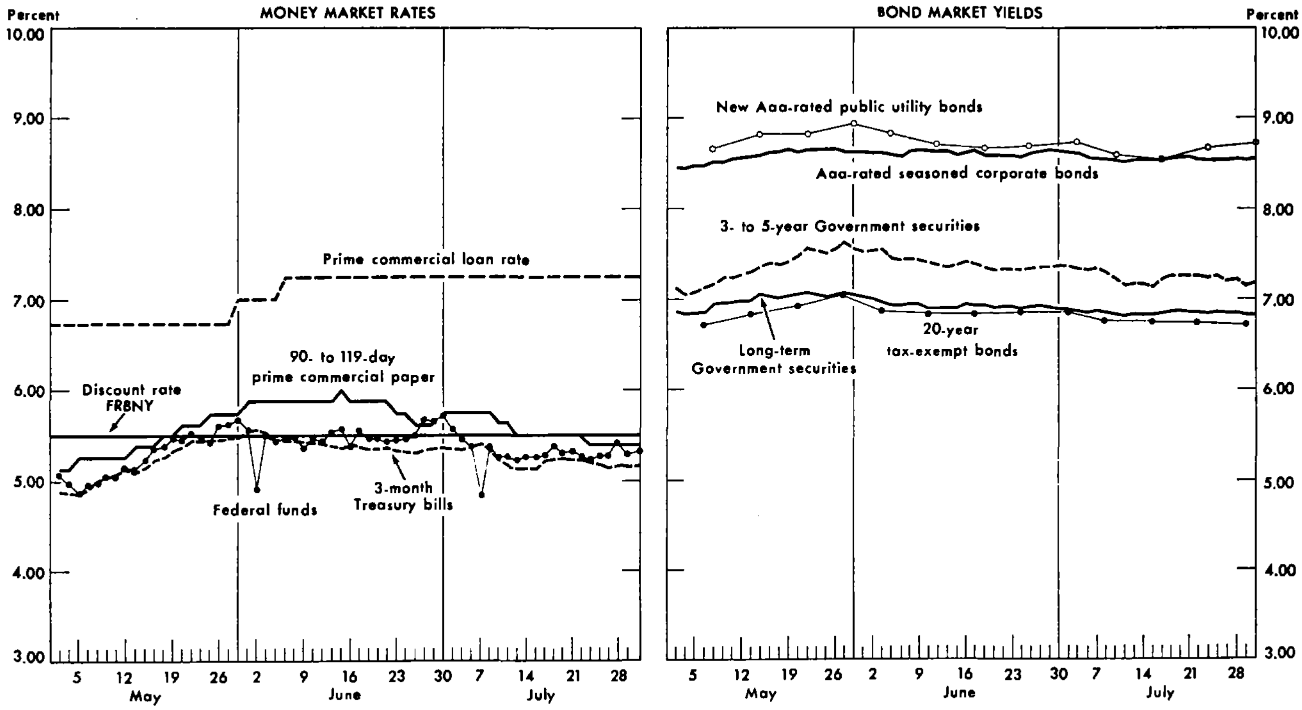
Demand for business loans remained weak in July, continuing the unusual pattern evident so far in the current recovery. Commercial and industrial loans at all weekly reporting banks, including loans sold to affiliates, fell by $1.6 billion over the four statement weeks ended July 28. This latest reduction brought the volume of outstanding loans $9.5 billion below their level of fifty-two weeks earlier. Among the factors generally cited for the persistent sluggishness of business loans are the strong cash flow position of firms allowing for internal financing, the large volume of corporate bond and equity offerings in the first half of 1976, and the relatively modest recovery in business spending to this point in the economic upturn. (For an analysis of these influences, see "The Weakness of Business Loans in the Current Recovery", beginning on page 208 of this *Review*.)

Following a slowdown in June, both M_1 and M_2 exhibited somewhat more rapid growth in July. Over a longer time horizon, however, growth rates for both aggregates continued in a moderate range. During the four-week period ended July 28, seasonally adjusted M_1—private demand deposits adjusted plus currency outside commer-

Chart I

SELECTED INTEREST RATES

May-July 1976



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.

cial banks—rose 4.0 percent at an annual rate from its average level of the four statement weeks ended thirteen weeks earlier. This brought the growth in M_1 over the past fifty-two weeks to 4.6 percent (see Chart II). Continued rapid expansion in consumer-type deposits at commercial banks boosted the expansion of M_2—M_1 plus commercial bank time and savings deposits other than large negotiable CDs—to a somewhat higher rate. During the four statement weeks ended in July, M_2 averaged 9.0 percent at an annual rate above its average during the four statement weeks ended thirteen weeks earlier and 9.3 percent above its average during the four weeks ended fifty-two weeks earlier. In testimony before the Congress on July 27, Federal Reserve Board Chairman Burns disclosed the latest long-run objectives for growth of M_1 and M_2. For the period extending from the second quarter of 1976 through the second quarter of 1977, the desired growth-rate range for M_1 is 4½ percent to 7 percent, identical with the range previously adopted for the four quarters ending with the first quarter of 1977. However, the upper boundary of the target range for M_2 was reduced by ½ percentage point, and the new M_2 growth range is 7½ percent to 9½ percent. According to the testimony, a slight slowing of M_2 growth is expected as a result of some moderation in savings inflows.

The adjusted bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—posted only a modest increase in July. The relatively slow growth of the proxy reflected a decline in the volume of CDs outstanding. Although CDs expanded very rapidly in the previous month, they have been on a downtrend for more than a year, paralleling the course of commercial bank lending to business.

THE GOVERNMENT SECURITIES MARKET

Rates on short- and intermediate-term Government securities moved down in July, while yields on longer term issues changed little over the month. Bolstered by conditions in the Federal funds market, lower dealer-financing costs, and investor demand, Treasury bill rates continued the decline of the previous month. At the last regular weekly auction in July, average issuing rates on the new three- and six-month bills were 5.19 percent and 5.50 percent, respectively (see Table II). These levels represented declines of 17 and 26 basis points from rates established at the final auction in June. Similarly, the 52-week bill was auctioned on July 21 at an average yield 19 basis points below that attained four weeks earlier. In a continued effort to restructure its debt, the Treasury sold during July $0.3 billion less in bills at the weekly auctions than maturing amounts. At the same time, $0.6 billion of new cash was borrowed at the auction of the 52-week bill. Overall, rates on most bills ended the month about 15 to 40 basis points below the levels that prevailed at the end of June.

Yields on most Treasury coupon issues closed the month slightly below end-of-June levels. The modest reduction in money market interest rates was viewed as a technical adjustment, which contributed to the limited price gains posted in the first part of the month. The Treasury raised $2.8 billion of new cash through the auction of two-year notes on July 21. The average issuing yield of 6.95 percent established at this auction was 4 basis points below that of a similar offering the month before. On July 28, the Treasury announced tentative borrowing plans for the remainder of the third quarter. Through September 30, the Treasury's cash borrowing requirements are estimated at between $15 billion and $17 billion. Of this amount, $5.5 billion was raised in July, and $6.1 billion was borrowed in conjunction with the August refunding. In this operation, $4.5 billion of maturing issues was replaced with $2 billion of three-year notes auctioned August 3 at a yield of 6.91 percent, $7.6 billion of 8 percent ten-year notes sold August 4, and $1 billion of 25-year bonds auctioned August 6 at a yield of 8.01 percent. The ten-year notes, the centerpiece of the Treasury's refunding effort, were sold on a subscription basis in minimum denominations of $1,000. The popular ten-year notes

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JULY 1976

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

Factors	Changes in daily averages— week ended				Net changes
	July 7	July 14	July 21	July 28	
"Market" factors					
Member bank required reserves	+ 363	+ 71	— 308	— 2	+ 124
Operating transactions (subtotal)	+1,016	+3,974	— 95	+ 173	+5,068
Federal Reserve float	+ 275	+ 940	— 795	— 239	+ 181
Treasury operations*	+1,374	+3,294	+1,514	— 588	+5,594
Gold and foreign account	+ 80	+ 2	— 27	+ 32	+ 87
Currency outside banks	— 686	— 535	— 542	+1,208	— 555
Other Federal Reserve liabilities and capital	— 27	+ 273	— 246	— 239	— 239
Total "market" factors	+1,379	+4,045	— 403	+ 171	+5,192
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	—1,554	—4,576	+ 575	— 22	—5,577
Outright holdings:					
Treasury securities	+ 35	—1,727	+ 184	— 194	—1,702
Bankers' acceptances	— 11	— 9	— 9	— 4	— 33
Federal agency obligations	—	—	—	—	—
Repurchase agreements:					
Treasury securities	—1,345	—2,266	+ 359	+ 168	—3,084
Bankers' acceptances	— 184	— 436	+ 29	— 11	— 602
Federal agency obligations	— 49	— 138	+ 12	+ 19	— 156
Member bank borrowings	— 42	+ 53	— 116	+ 98	— 7
Seasonal borrowings†	— 3	— 3	+ 1	+ 3	— 2
Other Federal Reserve assets‡	+ 423	— 106	+ 118	— 495	— 60
Total	—1,173	—4,629	+ 577	— 419	—5,644
Excess reserves‡§	+ 206	— 584	+ 174	— 248	— 452
	Daily average levels				**Monthly averages‖**
Member bank:					
Total reserves, including vault cash‡§	34,616	33,961	34,443	34,197	34,304
Required reserves	33,961	33,890	34,198	34,200	34,062
Excess reserves§	655	71	245	— 3	242
Total borrowings	124	177	61	159	130
Seasonal borrowings†	26	23	24	27	25
Nonborrowed reserves	34,492	33,784	34,382	34,038	34,174
Net carry-over, excess or deficit (—)¶	238	185	50	175	162

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 waivers or penalties for reserve deficiencies in accordance with the Regulation D change effective November 19, 1975.
‖ Average for four weeks ended July 28, 1976.
¶ Not included in data above.

were substantially oversubscribed, and the $7.6 billion of orders accepted by the Treasury represented a concession to its original plan to issue between $4 billion and $6 billion of the notes. The remainder of the Treasury's borrowing needs for the transition quarter will be accomplished through sales of 52-week bills in late August and September, a two-year note offering in late August, the sale of four-year notes in September, and the regular weekly sales of 13-week and 26-week bills. Fiscal year 1977 for the Federal Government begins October 1, 1976.

Some further price improvement on Federal agency securities was posted in the secondary market in July, and new issue activity quickened in comparison with the light volume of the previous month. In the largest agency financing of the month, the Federal Land Banks issued $600 million of fifteen-month bonds with a yield of 6.70 percent and $416.2 million of nine-year bonds with a yield of 7.95 percent. The issue was very well received. Near midmonth, the Federal Intermediate Credit Banks placed $717.0 million of consolidated bonds maturing May 2, 1977 at 6.10 percent, raising $77.0 million in new cash. The Banks for Cooperatives issued $565.0 million of short-term consolidated bonds maturing February 1, 1977 at 5.80 percent. On July 15, the Government National Mortgage Association issued $302.1 million of mortgage-backed thirty-year securities. Of this amount, $125.7 million of 7¼ percent pass-through securities was issued at 8.21 percent, $100.0 million of 8 percent pass-through securities was sold at 8.30 percent, and $76.4 million of 7½ percent pass-through securities obtained a yield of 8.24 percent. The Department of Housing and Urban Development placed $223.1 million of notes to finance urban renewal projects at an average interest rate of 3.236 percent, the highest rate for such a financing since December 1975.

Table II

AVERAGE ISSUING RATES
AT REGULAR TREASURY BILL AUCTIONS*

In percent

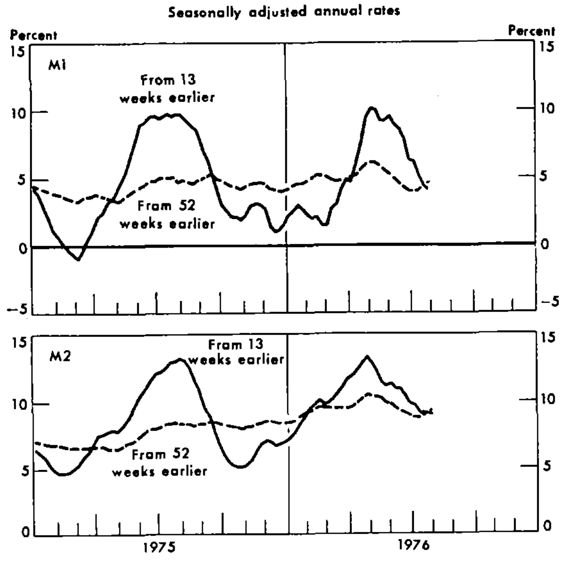
Maturity	Weekly auction dates—July 1976			
	July 2	July 12	July 19	July 26
Three-month	5.412	5.190	5.226	5.194
Six-month	5.768	5.430	5.536	5.497
	Monthly auction dates—May-July 1976			
	May 26	June 23	July 21	
Fifty-two weeks	6.309	6.081	5.887	

* 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

GROWTH OF SELECTED MONEY STOCK MEASURES

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 July 28, 1976.

M1 = Currency plus adjusted demand deposits held by the public.

M2 = M1 plus commercial bank time and savings deposits held by the public, less negotiable certificates of deposit issued in denominations of $100,000 or more.

Source: Board of Governors of the Federal Reserve System.

OTHER SECURITIES MARKETS

Yields in the corporate and municipal bond markets declined moderately in July. Developments in the money market and the smaller than expected increase in wholesale prices combined with generally light forward calendars to improve the atmosphere in both markets.

The improvement in the corporate market was reflected in the successful distribution of an Aa-rated utility issue early in the month at a yield 25 basis points below a similar issue offered two weeks earlier. The $60 million of new thirty-year bonds provided an 8.75 percent return. However, a similar $100 million issue marketed around midmonth sold slowly at 8.67 percent. Investors were unwilling to concede this much of a premium for the somewhat more highly regarded bonds, and a substantial amount of the issue remained in underwriters' hands. Price restrictions were removed, and the issue subsequently traded about 10 basis points higher in the secondary market. The improvement in the corporate market was limited by the relative attractiveness of United States Government securities, reflected in the rather narrow yield spread between corporate and Government bonds, and by investor expectations that the Treasury's August financing would contain a new supply of long-term bonds. Much of the volume of fixed-income obligations placed by underwriting syndicates during the month consisted of medium-quality issues, evidencing further relaxation of previous insistence by investors on prime-quality debt.

Paralleling the movement in yields for government and corporate debt in July, returns on Aaa-rated issues of state and local governments edged downward in the first part of the month but stabilized and retraced part of the earlier declines in the second half. Early in July the State of Minnesota marketed \$62 million of Aaa-rated bonds with yields ranging from 3.20 percent in 1977 to 5.60 percent on the 1996 issues. The yields on these securities were up to 15 basis points lower than on an issue with a similar rating offered in mid-June. Later in the month, the State of Texas Water Development Board offered \$40 million of general obligation Aaa-rated bonds which were well received when priced to yield 4.20 percent in 1982 to 5.75 percent in 1996. The yield on the twenty-year maturity was 15 basis points higher than on the Minnesota issue offered two weeks earlier. Rate declines over the month as a whole were reflected in The Bond Buyer Index of twenty bond yields on twenty-year tax-exempt bonds which closed the month at 6.73 percent, down 14 basis points over the period. The light calendar of new issues allowed dealers to make some progress in reducing inventories, as measured by the Blue List, which fell \$103.4 million to \$756.3 million over the month.