The Money and Bond Markets in August

Bond yields declined in August, extending the trend begun in early June, while rates on money market instruments generally edged down following larger declines in July. By the month end, interest rates on most bonds were near and in some cases slightly below previous lows for the year recorded in April. Contributing to the decline in bond yields were reduced concern over the rekindling of very rapid inflation and expectations of continued slackening in the pace of debt financing in the Government and corporate markets. Treasury borrowing needs for the near term were scaled down after the early-August refunding raised more new cash than planned. In addition, the corporate calendar was fairly light during the month and announcements of forthcoming offerings were very modest in comparison with the recent past. Most new issues having somewhat lower yields than in recent months were well received. Underwriting syndicates broke through 1976 lows with a few new corporate and municipal bond issues, some of which encountered initial investor resistance.

Preliminary estimates of the narrowly defined money stock (M_1) and the more broadly defined money stock (M_2) indicate continued expansion at moderate rates. With the absence of any strong turnaround in business loan demand, banks continued to allow the volume of large negotiable certificates of deposit (CDs) outstanding to run off over the month. Consequently, the bank credit proxy declined in August.

THE MONEY MARKET AND THE MONETARY AGGREGATES

Interest rates on some money market instruments edged downward in August, while rates on others remained essentially unchanged. At the July 20 meeting of the Federal Open Market Committee (FOMC), it was agreed that the Federal funds rate would be permitted to vary within a 4¾ to 5¾ percent range until the next meeting on August 17. In fact, the effective rate on Federal funds remained in a fairly narrow trading range in the intermeeting period (see Chart I). For August the Federal funds rate averaged 5.29 percent, 2 basis points below the average of the previous month. The rate on 90- to 119-day commercial paper held near the level recorded late in the previous month and closed the period at 5.38 percent. Rates on 90-day bankers' acceptances fell about 7 basis points over the month. Reflecting the shrinking supply of CDs outstanding, rates on 90-day certificates in the secondary market declined further during most of the month and stood at 5.33 percent by the end of August. Subsequent to a ¼ percentage point reduction effective at the beginning of the month, the quoted rate commercial banks charge prime business borrowers remained at 7 percent.

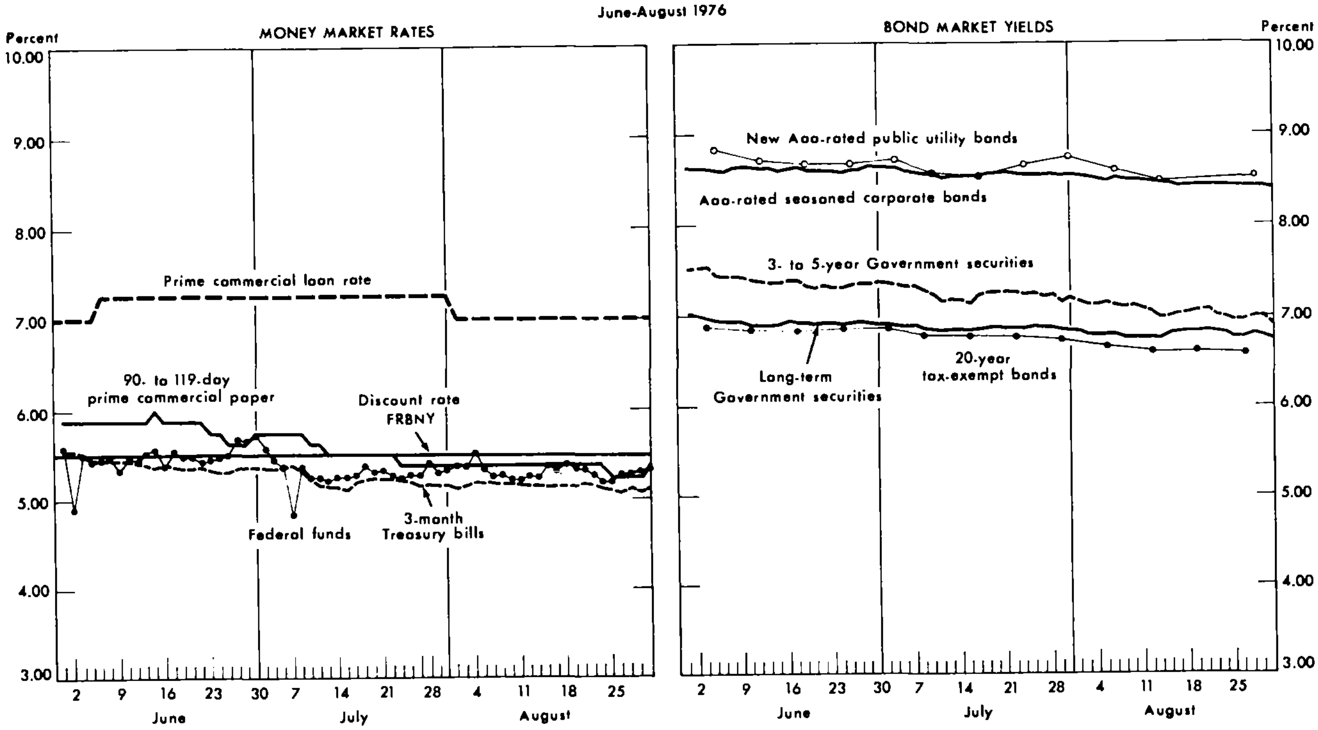
During August, Federal Reserve open market operations continued to be shaped, in part, by fluctuations in Treasury balances at the Federal Reserve Banks. The rise that usually begins around the middle of the month was enlarged substantially when the Treasury received the funds raised in its quarterly financing. Buyers were required to pay for the securities no later than August 16. As the amount of funds raised was larger than originally planned and not needed for expenditures until later, the Treasury kept these deposits at the Federal Reserve Banks. To offset the associated drain on commercial bank reserves, the Federal Reserve engaged in large acquisitions of Treasury securities in the final two weeks (see Table I).

Recovery in the demand for business loans has yet to materialize. Commercial and industrial loans at all weekly reporting banks, including loan sales to affiliates, fell by $884 million over the four statement weeks ended August 25. While business loans at weekly reporting banks have dropped about $8.7 billion from their level of fifty-two weeks earlier, most other major categories of loans have increased over the same period. For example, consumer instalment loans at weekly reporting banks have risen 7.9 percent, or $2.7 billion over this period, and real estate loans have gone up 4.3 percent, or $2.6 billion.

Chart I

SELECTED INTEREST RATES

June-August 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.

Preliminary data indicate that in August M_1 grew at about the same moderate rate as in the previous month, while expansion in M_2 slowed a bit from that of July. Over the four weeks ended August 25, M_1—private demand deposits adjusted plus currency outside commercial banks—averaged 7.3 percent at a seasonally adjusted annual rate above its average level in the four statement weeks ended eight weeks earlier. At the July meeting, the FOMC established a tolerance range of 4 to 8 percent for growth of M_1 over the two months ended with August. Tolerance ranges are short-run operating guides for the intermeeting period. They are set at each FOMC meeting and applied to the two-month period ending the following month. During the four statement weeks ended August 25, M_2—M_1 plus commercial bank time and savings deposits other than large negotiable CDs—averaged 11.1 percent at an annual rate above its average during the four statement weeks ended eight weeks earlier. The FOMC M_2 tolerance range for the two months ended August was 7½ percent to 11½ percent. Taking a longer perspective, over the 52-week period ended with the four-week averages through August 25, M_1 expanded 4.5 percent while M_2 rose 9.6 percent (see Chart II).

Following a modest increase in the previous month, the adjusted bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—declined in August. The drop

Table I

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

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

Factors	Changes in daily averages— week ended				Net changes
	August 4	August 11	August 18	August 25	
"Market" factors					
Member bank required reserves	— 62	+ 660	— 461	+ 358	+ 495
Operating transactions (subtotal)	—1,467	+2,301	—1,105	—4,474	—4,745
Federal Reserve float	— 5	+ 50	+ 260	— 377	— 72
Treasury operations*	—1,402	+2,271	— 637	—4,065	—3,833
Gold and foreign account	— 38	+ 64	— 128	+ 112	+ 10
Currency outside banks	— 75	— 436	— 509	+ 33	— 987
Other Federal Reserve liabilities and capital	+ 52	+ 351	— 92	— 175	+ 136
Total "market" factors	—1,529	+2,961	—1,566	—4,116	—4,250
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+2,061	—3,628	+2,665	+4,211	+5,309
Outright holdings:					
Treasury securities	— 407	— 559	+ 886	+1,286	+1,206
Bankers' acceptances	— 10	— 15	— 16	— 17	— 58
Federal agency obligations	—	—	—	— 4	— 4
Repurchase agreements:					
Treasury securities	+2,107	—2,634	+1,576	+2,596	+3,645
Bankers' acceptances	+ 327	— 345	+ 173	+ 252	+ 407
Federal agency obligations	+ 44	— 75	+ 46	+ 98	+ 113
Member bank borrowings	— 3	— 34	— 37	— 18	— 92
Seasonal borrowings†	— 5	+ 4	+ 4	—	+ 3
Other Federal Reserve assets‡	— 87	+ 219	— 652	— 201	— 721
Total	+1,971	—3,442	+1,975	+3,992	+4,496
Excess reserves‡§	+ 442	— 481	+ 409	— 124	+ 246

	Daily average levels				Monthly averages‖
Member bank:					
Total reserves, including vault cash‡§	34,706	33,565	34,435	33,953	34,165
Required reserves	34,262	33,602	34,063	33,705	33,908
Excess reserves§	444	— 37	372	248	257
Total borrowings	156	122	85	67	108
Seasonal borrowings†	22	26	30	30	27
Nonborrowed reserves	34,550	33,443	34,350	33,886	34,057
Net carry-over, excess or deficit (—)¶	— 4	191	— 23	152	79

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 August 25, 1976.
¶ Not included in data above.

in the proxy reflected a sharp fall in the volume of CDs outstanding. Since their peak in January 1975, CDs have declined in most months and, by the end of August, were almost $28 billion below their peak level of around $93 billion.

THE GOVERNMENT SECURITIES MARKET

Yields on Federal Government securities extended previous declines during the course of August. The Treasury raised over $6 billion of new cash early in the month, when it replaced $4.5 billion of maturing issues with $2 billion of three-year notes auctioned August 3 at an average yield of 6.91 percent, about $8 billion of 8 percent ten-year notes sold August 4, and $1 billion of 25-year bonds auctioned August 6 at an average yield of 8.01 percent. Available on a subscription basis in minimum denominations of $1,000, the ten-year notes were substantially oversubscribed and the orders accepted by the Treasury exceeded its original plan to issue between $4 billion and $6 billion of the notes. As a result, projections of future Treasury borrowings were lowered accordingly. Financing needs of the Federal Government remained substantial, however, and an additional $3 billion was raised through note auctions during the month. On August 19, $2.5 billion of two-year notes was sold at an average return of 6.67 percent, 28 basis points below that of a similar offering the month before. These replaced $1.4 billion of maturing securities. An auction of four-year notes on August 31 raised $2 billion. The average yield was 6.93 percent, down 78 basis points from a similar sale in early June.

With these operations accomplished smoothly and with the inflation outlook improving, rates on outstanding intermediate- and long-term issues continued the declines begun in early June. By the end of the month, they were only somewhat above the lows for the year recorded in April. Treasury bill rates generally edged down during the month. At the last regular weekly auction in August, average issuing rates on the new three- and six-month bills were 5.09 percent and 5.35 percent, respectively (see Table II). These levels represented declines of 10 and 15 basis points from rates established at the final auction in July. The yield on the 52-week bill auctioned on August 18 was about 25 basis points below that attained four weeks earlier. Rates on most bills ended the month from 5 to 25 basis points below levels at the end of July.

Prices also continued to rise in the Federal agency market. Early in the month, the Federal Home Loan Banks refinanced maturing securities through issuing $700 million of four-year bonds with a yield of 7.30 percent and

$500 million of eight-year bonds with a yield of 7.85 percent. At the same time, $200 million of 8⅜ percent Federal Home Loan Mortgage Corporation-guaranteed certificates with a thirty-year maturity was priced to yield 8.52 percent. These issues were well received. On August 18, $28 million of new cash was raised through sales of $436.1 million of 5.65 percent six-month Banks for Cooperatives bonds and $770 million of 5.85 percent nine-month Federal Intermediate Credit Bank bonds. The rates on these two issues were down 15 and 25 basis points, respectively, from similar issues sold a month earlier and were the lowest since April. Also, at midmonth the Department of Housing and Urban Development placed $287.3 million of tax-exempt notes to finance urban renewal projects at an average interest rate of 2.958 percent, down almost 28 basis points from a similar sale in the previous month. On August 25, the Federal National Mortgage Association issued $800 million of 54-month debentures at 7.35 percent and $400 million of ten-year debentures at 7.90 percent, raising $200 million of additional cash.

Table II

AVERAGE ISSUING RATES
AT REGULAR TREASURY BILL AUCTIONS*

In percent

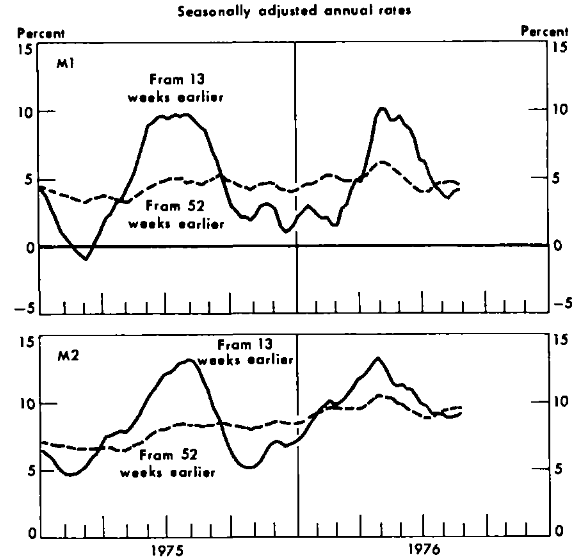
Maturity	Weekly auction dates—August 1976				
	August 2	August 9	August 16	August 23	August 30
Three-month	5.151	5.181	5.143	5.138	5.091
Six-month	5.473	5.422	5.390	5.380	5.351
	Monthly auction dates—June-August 1976				
	June 23	July 21	August 18		
Fifty-two weeks	6.081	5.887	5.633		

* 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 August 25, 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 bond market reacted to stable money market rates, a light calendar of new financing, and reports of slower economic expansion by extending the decline begun in June. By the month end, returns on outstanding issues were near lows for the year recorded in April. Municipal bonds also benefited from the improved tone of the debt markets generally.

New issue activity in the corporate sector was highlighted during the month by a key offering of Aaa-rated telephone debentures. The $175 million underwriting was offered to investors at a yield of 8.25 percent for forty years. This return was 43 basis points lower than a comparably rated telephone issue offered two months earlier and was the lowest on such an issue in two and one-half years. The terms were widely regarded as a test of the market's ability to pass through the April trough in interest rates. Initially, investors evidenced little interest in these terms and sales proceeded slowly, although the issue was reported sold by the end of the month. Providing further evidence of market improvement over the month, $70 million of an electric utility's A-rated thirty-year first mortgage bonds was successfully distributed at an 8.95 percent return, the lowest on a utility issue with this rating since April. The decline in yields on corporate debt also was exemplified in the $100 million sale of Baa-rated seven-year notes by the finance subsidiary of an industrial corporation. The return on these notes was 9.55 percent, while the same borrower had provided a 10 percent yield on five-year notes only two months earlier.

In the tax-exempt sector, a good reception was accorded Pennsylvania's $130 million offering of A-1/AA-rated (Moody's/Standard & Poor's) bonds priced to yield between 3 percent in 1977 and 6.7 percent in 1995-96. A similar issue by Pennsylvania sold in March at yields ranging from 3.25 percent in 1976 to 7.05 percent in 1995. However, investors considered yields from 4.1 percent in 1981 to 5.4 percent in 1994 on a $150 million Oregon issue unattractive. In some maturities, these Aaa/AA-rated bonds were down 20 basis points from a similar offering by Oregon in April, when municipal yields reached their previous lows for the year. The State of California's Aaa-rated bonds also sold slowly at prices scaled to yield 3 percent in 1977 to 5.5 percent in 1996, somewhat below the rates on an earlier California financing in March. Late in the month, however, underwriters easily distributed $111 million of Tennessee bonds rated Aaa/AA and yielding from 3 percent in 1977 to 5.7 percent in 1996. Reflecting the rate declines over the month as a whole, The Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds stood at 6.52 percent on September 2, down 21 basis points from the end of July and the lowest level for 1976. The Blue List of dealers' advertised inventories rose by $67.7 million to close the month at $824 million on September 1.

A novel development in the capital markets during August was a $367.2 million bond offering by the National Power Corporation, the government-owned public utility of the Philippines. A relatively large issue for a foreign governmental borrower in the United States, it consisted of $160 million of serial bonds yielding from 8.05 percent in 1987 to 8.2 percent in 1989 and $207.2 million of 8¼ percent sinking-fund bonds due in 1991. The bonds, which were unrated, were the first public offering in the United States to be guaranteed by the United States Government through the Export-Import Bank, which usually makes direct private loans. The bonds were sold at rates somewhat above United States Government agency securities of similar maturities.