The Money and Bond Markets in July

Interest rates generally drifted slightly lower in July. At the beginning of the month, it had been widely expected that the upward trend exhibited in June would continue. However, increases in interest rates during the month were generally small and were later reversed. In consequence, most interest rates closed a bit lower on balance. Late in July, rates were influenced by anticipations concerning the Treasury's refunding announcement. More uncertainty than usual preceded the announcement. On the one hand, the Treasury continues to enjoy an unusually comfortable cash position. On the other hand, the Treasury's longer run cash needs are believed to be quite large in view of the sizable Federal budgetary deficit expected in fiscal 1973.

The Treasury announced the terms of a massive refinancing operation after the close of business July 26. Along with the $2.3 billion of publicly held notes and bonds maturing August 15, an additional $17.4 billion of coupon issues maturing at later dates this year and at selected dates in 1974 and 1975 was eligible for the refunding. One of the Treasury's goals is to lengthen the maturity structure of the debt. The average maturity of marketable Federal debt outstanding had fallen from five years four months in 1965 to less than three years three months by mid-1972. The shortening of the debt occurred partly because the 4¼ percent interest rate ceiling on Treasury bonds had prevented the issue of new bonds from 1965 until the 1971 suspension of this ceiling, which permitted the Treasury to issue up to $10 billion of bonds at rates in excess of 4¼ percent. The new offering did not include a short-term note but instead consisted of 3½-year and 7-year notes and 12-year bonds. The offering was enthusiastically received, and an impressive $8.7 billion of new securities was subscribed. Because of the Treasury's currently strong cash position, no companion issue was offered for cash. In part, the strong cash position reflects the recent sale of special nonmarketable issues to foreign official institutions.

About $3.1 billion of special certificates of indebtedness was issued in July to absorb the large volume of dollars purchased by foreign central banks. This operation was one of the repercussions that followed the British decision in late June to allow the pound to float. Other governments quickly reaffirmed their determination to maintain the exchange rate structure established in the Smithsonian Agreement, but even so widespread speculation developed in favor of several continental European currencies. With exchange rates driven hard against their upper limits against the dollar, the foreign central banks were required to absorb large quantities of dollars, with which they in turn purchased both marketable and nonmarketable United States Treasury securities. On July 19, the Federal Reserve initiated a new line of operations by offering German marks in the New York exchange market. Federal Reserve Board Chairman Arthur Burns explained that the United States authorities "are now moving to play our part to restore order in foreign exchange markets and to do our part in upholding the Smithsonian Agreement". The Chairman said that such operations would continue on whatever scale and whenever transactions were deemed desirable, and he disclosed that the suspension on use of the Federal Reserve swap lines that went into effect last August 15 had been lifted. During the remainder of July, the exchange markets were quieter and dollar rates improved.

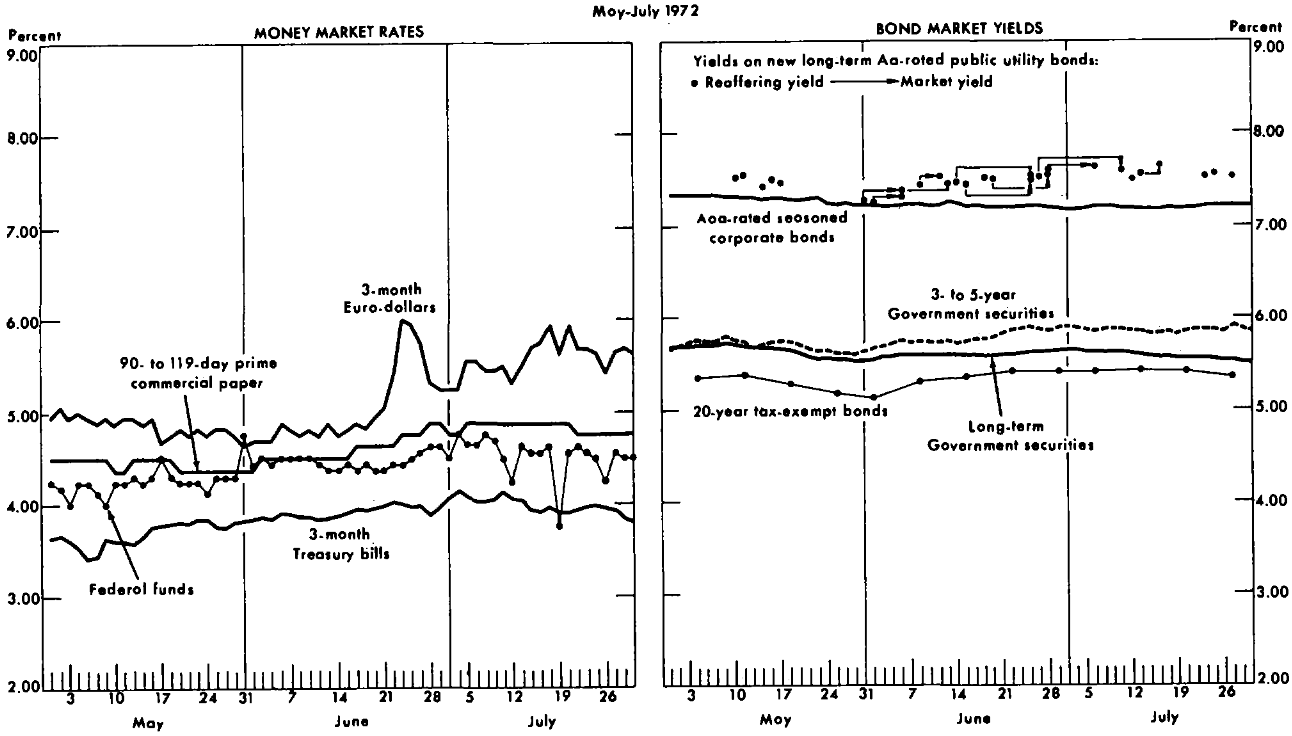
BANK RESERVES AND THE MONEY MARKET

Short-term interest rates generally declined slightly over the month of July. There were a number of minor upward movements early in the month, which were reversed as the month progressed. For example, rates on 90- to 119-day dealer-placed commercial paper increased ⅛ percentage point in the first week of July but fell back ⅛ point in the third week to 4¾ percent (see Chart I). Rates on most other maturities of commercial paper were also lowered ⅛ to ¼ percentage point during July. Secondary

Chart I

SELECTED INTEREST RATES

May-July 1972



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 four 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 Aa-rated public utility bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); 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, and The Bond Buyer.

market rates on large negotiable certificates of deposit (CDs) climbed about 20 basis points at the start of July but were reduced later in the month by as much as 30 basis points. Rates on bankers' acceptances were reduced by ⅛ percentage point late in July. Euro-dollar rates continued to be sensitive to uncertainties in the foreign exchange markets. The three-month Euro-dollar rate generally advanced through July 18. After that, some degree of calm was restored to the exchange markets partly in response to Federal Reserve sales of German marks. Euro-dollar rates subsequently declined and ended the month at 5⅜ percent, ⅜ percentage point above the opening rate. A few large banks raised their prime commercial loan rate to 5½ percent in response to previous increases in market rates. Most banks did not feel, however, that loan demand was sufficiently strong to justify such an increase, and therefore they retained a 5¼ percent prime rate. Effective July 31, in response to a drop in commercial paper rates, two major banks with floating prime rates reduced their prime rate from 5½ percent to 5⅜ percent.

The average effective rate on Federal funds in July was 4.55 percent, 9 basis points above the June level. For the statement week ended July 5, excess and borrowed reserves increased sharply (see Table I). However, in each succeeding week, excess and borrowed reserve levels were both reduced. Since excess reserves fell more rapidly, free reserves declined, becoming negative after the first statement week.

The growth in reserves available to support private nonbank deposits (RPD) accelerated in July to an estimated 9½ percent seasonally adjusted annual rate. By excluding reserves backing Treasury and net interbank deposits, which are not included in the money supply, the RPD series is more closely related to the money supply than is the total reserves series.

According to preliminary data for the period through July 26, the growth of the narrowly defined money supply (M_1)—adjusted demand deposits plus currency outside banks—also accelerated in July, to an estimated 15 percent seasonally adjusted annual rate from its more restrained 5.3 percent pace in the second quarter. The acceleration took place during the first two weeks of July after which the money supply fell back slightly. As was indicated by Federal Reserve Board Chairman Burns in testimony before the Joint Economic Committee of the United States Congress, the System is still "in a favorable position to continue pursuing a path of moderate monetary growth". Despite the bulge in July, longer term growth rates, generally considered to be more meaningful in evaluating the impact of money supply behavior, show somewhat more moderate rates of advance. Over the three months through July, M_1 increased at an annual rate of about 8 percent (see Chart II). In the past year, M_1 grew by about 5½ percent.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JULY 1972

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

Factors	Changes in daily averages— week ended				Net changes
	July 5	July 12	July 19	July 26	
"Market" factors					
Member bank required reserves	— 638	+ 291	— 640	+ 192	— 795
Operating transactions (subtotal)	— 176	+ 336	— 28	+ 199	+ 331
Federal Reserve float	— 444	+ 714	+ 164	— 215	+ 219
Treasury operations*	+ 998	— 230	+ 66	— 143	+ 691
Gold and foreign account	— 98	+ 76	— 23	— 72	— 117
Currency outside banks	— 439	— 358	— 312	+ 633	— 476
Other Federal Reserve liabilities and capital	— 194	+ 134	+ 78	— 2	+ 16
Total "market" factors	— 814	+ 627	— 668	+ 391	— 464
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 827	— 698	+ 612	— 505	+ 236
Outright holdings:					
Treasury securities	+ 804	— 732	+ 300	— 72	+ 400
Bankers' acceptances	+ 2	— 2	— 1	— 3	— 4
Federal agency obligations	— 21	— 11	—	— 7	— 39
Repurchase agreements:					
Treasury securities	+ 40	+ 33	+ 247	— 329	— 9
Bankers' acceptances	— 4	+ 6	+ 45	— 58	— 11
Federal agency obligations	+ 6	+ 8	+ 21	— 36	— 1
Member bank borrowings	+ 183	— 85	— 51	— 4	+ 42
Other Federal Reserve assets†	+ 8	+ 51	+ 54	+ 41	+ 154
Total	+1,018	— 732	+ 614	— 468	+ 432
Excess reserves	+ 204	— 105	— 54	— 77	— 32
	Daily average levels				**Monthly averages**
Member bank:					
Total reserves, including vault cash	33,143	32,747	33.333	33,064	33,072‡
Required reserves	32,815	32,524	33,164	32,972	32,869‡
Excess reserves	328	223	169	92	203‡
Borrowings	312	227	175	171	221‡
Free, or net borrowed (—), reserves	16	— 4	— 6	— 79	— 18‡
Nonborrowed reserves	32,831	32,520	33,158	32,893	32,851‡
Net carry-over, excess or deficit (—)§	98	209	182	133	156‡

Note: Because of rounding, figures do not necessarily add to totals.
*Includes changes in Treasury currency and cash.
†Includes assets denominated in foreign currencies.
‡Average for four weeks ended July 26.
§Not reflected in data above.

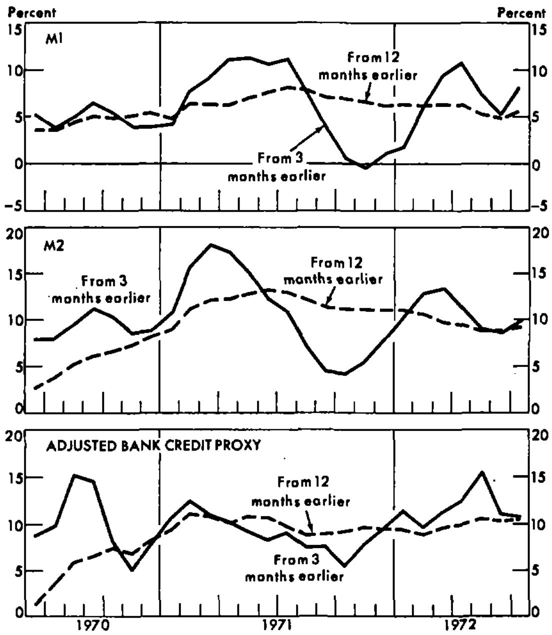
The broad money supply (M_2)—defined as M_1 plus time deposits other than large CDs—accelerated slightly in July to a 12 percent annual rate of growth from a 10½ percent rate in June. The acceleration in this aggregate resulted entirely from the speedup in M_1. Time deposits other than large CDs advanced more slowly than they had in June.

The adjusted bank credit proxy, consisting of member bank deposits subject to reserve requirements and certain nondeposit liabilities, advanced at an estimated 13 percent seasonally adjusted annual pace in July, quite close to the rate of growth of M_2. Treasury deposits and net interbank deposits at member banks, both of which are included in the proxy but not in the money supply, rose only slightly in July. However, large CDs, the other major element of the proxy excluded from the money supply, increased at a significantly faster pace than did other types of deposits so that, on balance, proxy growth paralleled that of the monetary aggregates.

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for July 1972 are preliminary estimates.

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.

THE GOVERNMENT SECURITIES MARKET

The market for United States Government securities was subject to conflicting sets of influences in July. Various news items indicating that the economy was experiencing a vigorous expansion, along with the concern about the impact of the large Federal budget deficit on the size of future Treasury financing needs, worked toward pushing up interest rates on Government securities. However, continuing turmoil in the foreign exchange markets tended to depress yields, particularly in the shorter maturities, as foreign central banks purchased Government securities with the dollars they acquired in support operations. Adding to the downward pressure in rates was the rather thin floating supply of securities, especially in certain intermediate maturity ranges. The Treasury had actually retired debt on balance in the second quarter and raised only a modest amount in July through weekly additions of $200 million to the maturing bills beginning July 13.

On July 26, the Treasury announced a major refunding operation. In the refunding, holders of the remaining five issues of notes and bonds maturing in 1972—on August 15, September 15, November 15, and December 15—were offered 5⅞ percent 3½-year notes priced to yield 5.96 percent, 6¼ percent 7-year notes priced at par, and 6⅜ percent 12-year bonds priced to yield 6.45 percent. In addition, the holders of notes and bonds due in November 1974 and February 1975 were given the opportunity to exchange those securities for either the 7-year notes or the 12-year bonds. The bonds were also offered for cash to individuals in amounts not to exceed $10,000.

Preliminary results of the refunding indicate that it was highly successful. Of the $2.3 billion of publicly held securities maturing August 15, $1.67 billion was exchanged for an attrition rate of 27.6 percent, somewhat lower than usually expected in refunding operations containing no new short-term issue. In addition, $3.3 billion of the $6.2 billion maturing between September and December 1972 and $3.1 billion of the securities due to mature in 1974 and 1975 were exchanged. The holders of issues maturing in 1972 purchased primarily the 3½-year notes, but the longer term issues sold well because of orders from holders of the 1974 and 1975 securities. Preliminary figures show subscriptions for $3.9 billion of the new 3½-year notes, $3 billion of the 7-year notes, and $1.1 billion of the 12-year bonds, including $22 million sold to individuals for cash.

Treasury bill rates were particularly sensitive to the foreign situation. With large dollar-support operations undertaken by foreign central banks, prices tended to be bid up in the bill market in anticipation of probable foreign official demand for bills. Although there was some upward pressure on bill prices from official foreign sources, it was smaller than it might have been because much of the foreign demand was channeled into special nonmarketable Treasury certificates of indebtedness. Over the month, the Treasury issued about $3.1 billion of special certificates to foreigners while marketable United States Government securities held by the Federal Reserve in custody for foreign official accounts increased by $670 million.

Against this background, three-month Treasury bill rates declined by about 15 basis points through July 19. During this period, several other short-term rates increased. Then, as speculative pressures eased in the foreign exchange markets, bill rates began to edge upward again. In the final days of the month, bill rates fell once more as the absence of a short-term issue in the refunding pointed to limited supply conditions. On balance, secondary market rates ended the month about 3 to 40 basis points below their opening levels.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—July 1972			
	July 10	July 17	July 24	July 31
Three-month	4.102	3.948	4.047	3.794
Six-month	4.605	4.455	4.585	4.298
	Monthly auction dates—May-July 1972			
	May 23	June 23	July 25	
Nine-month	4.367	4.754	4.731	
One-year	4.465	4.854	4.918	

* 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 weekly auction of three- and six-month Treasury bills that would normally have been held in the first week of July was pushed forward to June 30, since July 3 was a holiday for many. At that auction, interest rates had moved up somewhat—by 12 basis points on the three-month bills. Beginning with the first auction actually held in July, bill rates began to slide. At that auction, on July 10, three-month rates declined 4 basis points to an average 4.102 percent (see Table II). In the intervening week, purchases by foreigners were heavy and, at the auction held on July 17, three-month Treasury bill rates fell a further 15 basis points to an average of 3.948 percent. Bill rates climbed 10 basis points in the auction held on July 24 after foreign exchange jitters began to ease. In light of this turnaround, the monthly auction of nine- and twelve-month Treasury bills, held on July 25, exhibited mixed results. Yields on the nine-month bills averaged 2 basis points less than those on equivalent bills offered in June. On the other hand, the yield on the one-year bill climbed 6 basis points to 4.918 percent, the highest rate posted since last September. In the final auction of three- and six-month bills, held July 31, yields dropped substantially—to 3.794 percent on the three-month bills—in response to previous declines in secondary market rates.

Yields on intermediate-term Treasury issues declined early in July, but later these yields moved back up so that they were little changed over the month as a whole. Long-term Government bond yields edged lower through most of the month. Treasury bond issues have benefited in the last few months from the low level of new financing. Yields have remained significantly below the highest levels for the year established in April. On April 13, the average yield on Treasury bonds maturing in more than ten years reached 5.79 percent. By the end of July, however, the average yield had fallen to 5.52 percent, the lowest level of the year.

OTHER SECURITIES MARKETS

Corporate bond prices stabilized early in July, braking at least temporarily the decline of the previous month. During the remainder of July, the market was jostled by alternately favorable and unfavorable news, but it still managed to absorb an expanded volume of issues with little difficulty.

A particularly light calendar during the holiday-shortened Fourth of July week contributed to the early stabilizing of rates. In the succeeding two weeks, however, the volume of new corporate bonds placed on sale mushroomed to about $1.7 billion. On July 11, a utility issue rated Aa sold well at a yield of 7.60 percent, the same yield as another Aa bond which had been poorly received in late June. The next day, a much larger Aa-rated utility bond was offered to yield 7.50 percent. A surge of activity late in the day led to heavy sales. On the following day, however, a relatively small utility issue rated Aa by one rating service and A by another met with a poor reception despite its 7.55 percent yield.

In the week beginning July 17, market sentiment vacillated. Observers were generally glum at the beginning of the week, as several older issues were released from syndicate price restrictions on Monday and quickly climbed as much as 10 basis points in the secondary market. The next day the market regained some stability when a heavy demand greeted a finance company bond and two new industrial issues. But the succeeding day, optimism was dissipated as a two-part $250 million Aaa-rated offering by a Bell Telephone subsidiary met with a disappointing reception in spite of a 7.45 percent yield on the 38-year debenture, the same rate that was offered on a similar Bell System obligation in June which had sold well. This bond was released from syndicate price restrictions on the following Tuesday, and the yield quickly climbed 4 basis points in the secondary market.

In the final July week, the volume of corporate financing slackened. In that week, two utility issues rated Aa and priced to yield 7.55 percent and 7.52 percent, respectively, attracted only lukewarm interest initially but sold well on Friday following the announcement of prime rate reductions by two banks.

Prices on most tax-exempt securities were relatively stable over the month of July. The Bond Buyer index of twenty municipal bond yields remained unchanged at 5.43 percent for three weeks through July 6. During the next two weeks the index fluctuated slightly, then declined at the end of the month to 5.35 percent. The volume of tax-exempt securities was light in the first and third weeks, but heavy in the second and fourth weeks. Dealers were able to reduce their inventories somewhat, with the Blue List of dealers' advertised inventories declining by $80 million to $674 million during the month. New York City offered $267.2 million of securities on July 12. These bonds, rated Baa-1, were priced to yield from 4.25 percent in 1974 to 6.80 percent in 2013. By comparison, a similar New York City offering in April was priced to yield 6.90 percent on the longest maturity. Most of the new issue was reported sold the first day. Other tax-exempt securities marketed the same week did not fare quite so well, but in the maturity ranges considered to be generously priced the securities stimulated substantial interest. The final week's sizable volume of offerings met with generally favorable receptions despite instances of aggressive pricing.