The Money and Bond Markets in September

Bank reserves and the money market were affected by special factors in September, and the Federal funds rate moved irregularly higher. The rundown in the Treasury's balances at the Federal Reserve Banks before the September 15 corporate tax date necessitated large-scale Federal Reserve action to absorb reserves. However, when legal action forced postponement of the changes in reserve requirements and check collection procedures that had been scheduled to go into effect on September 21, the Federal Reserve supplied a large volume of reserves.

The market for Government securities adjusted gradually during September to the expectation of higher rates that had emerged late in August. Interest rates on Treasury issues, which had risen abruptly at the end of August, rose further through mid-September but stabilized thereafter. Contributing to the upward rate pressures were dealer efforts to distribute coupon issues acquired in the Treasury's August financing, the Treasury's addition to the supply of one-year bills, the firm tone of the Federal funds market, and the Federal Reserve's need to absorb reserves because of a sharp rundown in the Treasury's cash balances. Investor interest appeared at the higher yields, and dealers' inventories declined. In addition, the rebuilding of the Treasury's balances at the Reserve Banks and the postponement of scheduled changes in Regulations D and J brought the Federal Reserve in as a buyer of securities. By the end of the month, a better market atmosphere prevailed and interest rates on Treasury issues were below the month's highs.

Corporate bond yields tended a bit higher during September, while tax-exempt yields were generally steady. In the face of investor resistance, corporate bond syndicates disbanded quickly, but the subsequent rise in yields was generally small. Prices rose in both markets near the end of the month on hopes of progress in the Vietnam peace negotiations.

BANK RESERVES AND THE MONEY MARKET

Money market conditions became somewhat firmer in September, with the effective rate on Federal funds averaging 4.87 percent, up 7 basis points from August. The Federal Reserve supplied nonborrowed reserves somewhat grudgingly in relation to the growth in required reserves over the month, so that member bank borrowings from the Reserve Banks rose $193 million to an average of $564 million in the four statement weeks of September. Net borrowed reserves averaged $331 million in the four weeks of September (see Table I), compared with $193 million in the five preceding weeks.

The money market was very tight as the month opened, and Federal funds traded up to 5¼ percent on the eve of the Labor Day weekend. Banks borrowed heavily at the discount window in anticipation of needs which failed to materialize. The resulting reserve excesses later pushed the Federal funds rate as low as ⅛ percent on Wednesday, September 6. For the week as a whole, excess reserves remained abnormally high, boosting total reserves and reserves available to support private nonbank deposits (RPD).

In the following statement week, the large excess reserve carry-over, in addition to an unusually large increase in float and the rundown in the Treasury's balances at the Federal Reserve, imparted a comfortable tone to the money market. Both the Federal funds rate and discount window borrowings dropped despite the $2 billion of reserves absorbed on average by Federal Reserve open market operations.

The Treasury's balances at the Reserve Banks were rebuilt after the September 15 tax date. Despite injections of reserves, banks found themselves quite short of meeting their requirements late in the statement week, and borrowings at the discount window bulged to $1¾ billion on the September 20 settlement day. Subsequently, the money market eased somewhat, in part because of the unusually low level of excess reserves at "country" banks.

The general upward movement in short-term interest rates that had begun in August persisted in September, but the pace was less rapid than in the previous month. The rate on 90- to 119-day commercial paper sold through dealers increased ⅛ percentage point in the third week of September (see Chart I) and closed the month at 5⅛ percent. Rates on most other maturities of commercial paper were raised ⅛ to ¼ percentage point during the month, while those on bankers' acceptances were increased by ⅛ percentage point. Secondary market rates on large negotiable certificates of deposit (CDs) advanced by some 15 to 25 basis points during September.

Two large banks with floating prime lending rates linked to the cost of funds raised their rates early in the month, thereby joining the majority of banks at the 5½ percent rate established in the last week of August. Later in September, three banks announced a further increase of ⅛ percentage point, and at the end of the month one quoted a 5¾ percent prime rate. Most large banks moved to that rate early in October.

Growth of the monetary aggregates was quite strong in the third quarter, primarily because of the very rapid advance in July. According to preliminary estimates, the seasonally adjusted annual growth rate of the narrowly defined money supply (M_1)—adjusted private demand deposits plus currency outside banks — in September was about the same as the 5½ percent recorded in August. This brought the growth rate for the third quarter to 8½ percent (see Chart II), while for the nine months ended in September it was 8 percent.

The growth rate of the broad money supply (M_2)—defined as M_1 plus time deposits at commercial banks other than large negotiable CDs—increased in September to about 8½ percent from 8 percent in August. The growth of consumer-type time and savings deposits continued strong. Over the third quarter, M_2 advanced at a 9½ percent rate. For the first nine months of the year, the seasonally adjusted annual rate of growth was about 10½ percent.

The adjusted bank credit proxy—which consists of daily average member bank deposits subject to reserve requirements and certain nondeposit liabilities—grew at an 11 percent rate in September, compared with 9½ percent in the previous month. During the three months ended in September, the proxy rose at an estimated rate of 11 percent, while the rate over the three quarters was 11½ percent. The growth rate of CDs slowed somewhat but remained the strongest of the proxy's components.

For the month as a whole, RPD grew at a rate of 14 percent. Part of this growth was attributable to the build-up of excess reserves, primarily in the week ended September 6.

Two developments connected with the Federal Reserve's regulatory functions occurred in September. On September 7 the Board of Governors proposed a reduction in the reserve requirements ratio on Euro-dollar borrowings from the 20 percent established in 1970 to 10 percent and elimination of the reserve-free base. A reserve requirement was imposed on these liabilities of Federal Reserve member banks to their foreign branches in 1969 for two related reasons. The Federal Reserve wished to moderate short-term dollar flows between the United States and other

Table I

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

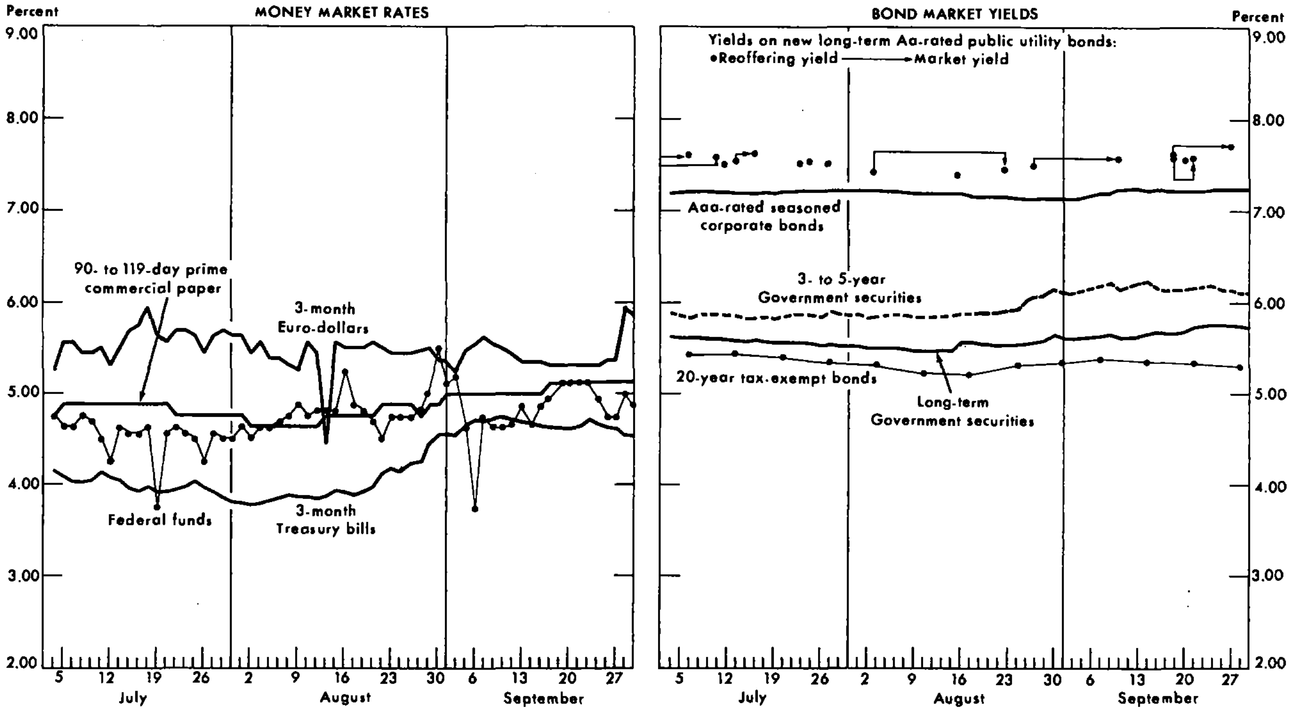
In millions of dollars; (+) denotes increase (—) decrease in excess reserves

Factors	Changes in daily averages—week ended Sept. 6	Sept. 13	Sept. 20	Sept. 27	Net changes
"Market" factors					
Member bank required reserves	+ 185	— 69	— 178	— 201	— 263
Operating transactions (subtotal)	— 16	+1,846	— 450	— 587	+ 793
Federal Reserve float	— 114	+ 727	+ 387	— 355	+ 645
Treasury operations*	+ 412	+1,071	— 517	— 945	+ 21
Gold and foreign account	+ 7	— 19	+ 6	— 9	— 15
Currency outside banks	— 230	— 179	— 283	+ 704	+ 12
Other Federal Reserve liabilities and capital	— 91	+ 246	— 44	+ 17	+ 128
Total "market" factors	+ 169	+1,777	— 628	— 788	+ 530
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	— 7	—2,048	+ 345	+ 635	—1,075
Outright holdings:					
Treasury securities	— 471	—1,454	+ 301	+ 705	— 919
Bankers' acceptances	— 1	— 6	— 5	+ 4	— 8
Special certificates	—	+ 5	— 5	—	—
Federal agency obligations	— 13	— 15	— 20	—	— 48
Repurchase agreements:					
Treasury securities	+ 398	— 473	+ 69	— 69	— 75
Bankers' acceptances	+ 25	— 33	+ 5	— 5	— 8
Federal agency obligations	+ 55	— 72	—	—	— 17
Member bank borrowings	+ 360	— 688	+ 570	— 168	+ 74
Other Federal Reserve assets†	+ 47	+ 48	+ 75	+ 83	+ 253
Total	+ 400	—2,688	+ 989	+ 549	— 750
Excess reserves	+ 569	— 911	+ 361	— 239	— 220

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash	33,362	32,520	33,059	33,021	32,991‡
Required reserves	32,566	32,635	32,813	33,014	32,757‡
Excess reserves	796	— 115	246	7	233‡
Borrowings	837	149	719	551	564‡
Free, or net borrowed (—), reserves	— 41	— 264	— 473	— 544	— 331‡
Nonborrowed reserves	32,525	32,371	32,340	32,470	32,427‡
Net carry-over, excess or deficit (—)§	130	293	52	139	154‡

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 September 27.
§ Not reflected in data above.

Chart I
SELECTED INTEREST RATES
July-September 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.

countries and also to lessen the attractiveness of this source of funds, which represented a potential offset to policy actions. The reserve requirement was initially set at 10 percent, but this applied only to borrowings in excess of a base-period figure. A proviso that this reserve-free base would be automatically reduced as Euro-dollar borrowings were repaid was intended to moderate the flow of such repayments in the short run. The present low level and minor activity of this account encouraged the proposed simplifications, which should have a minimal net effect.

The Board of Governors acted on September 20 to postpone the effective date of amendments to regulations concerning reserve requirements against demand deposits and bank payment for checks presented in the clearing process. Two associations, composed predominantly of nonmember banks, obtained a temporary restraining order against the amendment to Regulation J, which would have required all users of Federal Reserve check-clearing facilities to pay for checks drawn on them in immediately available funds on the day of presentment. This would reduce float and absorb reserves of banks. The accompanying restructuring of reserve requirements would release reserves to member banks, and the Federal Reserve was prepared to give nonmember banks access to the discount window for a specified transitional period. The Board decided to postpone both amendments because application of the amended Regulation J to member banks alone would have an adverse effect on the payments mechanism, while implementation of only the change in Regulation D would have an adverse monetary policy impact.

THE GOVERNMENT SECURITIES MARKET

A substantial change in near-term interest rate expectations was under way in the Government securities market as the month opened. Market participants interpreted the firmness in the Federal funds market as indicating a less accommodative stance on the part of the Federal Reserve. At the same time, moderate foreign-account selling of Treasury bills generated concern that these accounts might become a continuing source of supply, whereas they had been an important source of demand for some months. The view spread quickly in late August and early September that a further rise in interest rates would occur sooner rather than later.

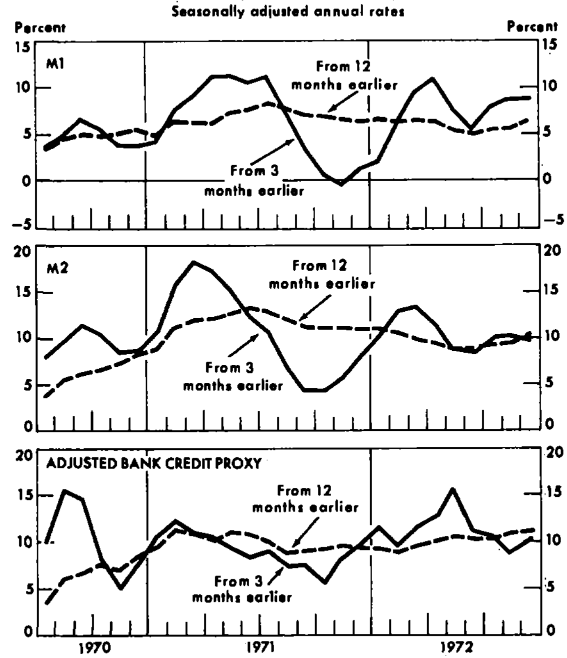
This shift in sentiment dislodged a sizable volume of securities from the trading positions of dealers and other market participants. There were notably heavy supplies in the market of the recently auctioned one-year Treasury bills, the volume of which the Treasury had just increased by $600 million. Also, sizable undistributed positions remained in the 6⅜ percent bonds of 1984, which the Treasury had issued in its August refunding. The pressure of these supplies on an unreceptive market led to a sharp rise in yields.

In addition, the Treasury bill market was unsettled in the first half of the month by the Federal Reserve's need to absorb the reserves being released by the Treasury's rundown of its balances at the Reserve Banks. The System accomplished a major part of this task through matched sale-purchase contracts. There was also a net supply of bills to the market by the Trading Desk of the Federal Reserve Bank of New York during the period from both the System's portfolio and foreign accounts. Between the weekly auctions of August 28 and September 11 the three- and six-month bill rates rose by 43 and 26 basis points, respectively.

After midmonth, the rebuilding of the Treasury's balances at the Reserve Banks and the postponement of the net release of reserves through regulatory changes necessitated sizable Treasury bill purchases by the System Account. The higher bill rates then prevailing attracted sizable investor demand as well, although investors were reluctant buyers of longer bills until the spread between short- and long-term issues had widened considerably. The spread between the three- and six-month bills, which had been 49 basis points in the August 28 auction, widened to 59 basis points on September 25 (see Table II). Over the month the market yields on three- and twelve-month bills rose by 4 and 21 basis points to 4.64 and 5.72 percent.

The prices of Treasury coupon issues were depressed during the month by the change in market expectations, in general, and the available supply of one-year bills and the 6⅜ percent bonds of 1984, in particular. The high yield available on one-year bills led to considerable switching into them from coupon issues maturing within four years, with a resultant upward pressure on their yields. At the same time the substantial supply of the 6⅜ percent bonds kept yields on longer issues under similar pressure. Investor demand was forthcoming as yields rose, however, so that trading inventories were reduced and a better atmosphere appeared toward the end of the month. Three- to five-year issues yielded 6.11 percent at the close, virtually unchanged for the month, while the 6⅜ percent bonds

Chart II
CHANGES IN MONETARY AND CREDIT AGGREGATES
Seasonally adjusted annual rates



Note: Data for September 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.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—September 1972			
	Sept. 1	Sept. 11	Sept. 18	Sept. 25
Three-month	4.569	4.759	4.633	4.644
Six-month	4.937	5.074	5.097	5.236

Maturities	Monthly auction dates—July-September 1972		
	July 25	Aug. 24	Sept. 26
Nine-month	4.731	5.040	5.346
One-year	4.918	5.178†	5.529

* 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.
† This was the first auction of a 52-week bill.

of 1984 yielded 6.67 percent, up 7 basis points. The yield on this issue had been 6.81 percent around midmonth.

Government agency issues accounted for about one fourth of the securities offered publicly in September, though part of this was in the short-term sector. A $250 million issue of capital debentures by the Federal National Mortgage Association was apparently well received at 7.40 percent, though its yield rose 4 basis points upon release.

OTHER SECURITIES MARKETS

Prices of seasoned municipal bonds showed little movement during September, but prices of older corporate issues suffered further erosion. Competitive calendars of new issues remained light during the month, but the prospective near-term supply exhibited signs of a seasonal increase. This fact reinforced investor desires for better yields on new issues, and underwriters were forced to offer more generous terms on some in order to clear the market. A better tone emerged at the end of the month, in part because of rumors of progress in the Vietnam peace negotiations.

The last Aa-rated utility bond of August had been reoffered to yield 7.50 percent and had not been well received. Price restrictions were removed on September 11, and the yield on this issue rose 8 basis points on the resale market. This adjustment set the climate for three comparable issues brought to the market during the next week. Conditions had changed even in this interval, however, and the yields of 7.57 percent to 7.60 percent drew a tepid response. One of the four issues was released during the end-of-the-month rally. Its yield still rose to 7.62 percent, about 20 basis points above the return on most comparable issues in August. One utility issue rated Aaa by one service and AA by another was reoffered to yield 7.47 percent on September 18 and released the next day, with a consequent 5 basis point increase in yield. On the other hand, another issue rated Aaa was reoffered to yield 7.47 percent on September 21 and sold out that day.

Prices of seasoned tax-exempt securities were virtually unchanged during much of September. The Bond Buyer index of twenty municipal bond yields declined from 5.39 percent to 5.37 percent in the first three weeks. The strong rally in the closing days of the month reduced the index to 5.30 percent on September 28, 8 basis points below the last figure for August. Dealers reduced the Blue List of advertised inventories by $170 million over the month, and most new issues seemed to be well received. Yields on these were about 10 to 15 basis points higher at the end of September than a month earlier.