The Money and Bond Markets in July

After rising rather steadily over the preceding four months, interest rates were mixed in July. In the money market, enlarged credit demands over the quarter-end statement date and turbulence in the foreign exchange and Euro-dollar markets pushed rates up to record levels early in the month. The pressures on the short end of the market abated as the month progressed, and by the end of the period most short-term rates had receded substantially from the highs recorded early in July. Some rates, notably those on commercial paper, finished July below the levels posted at the end of June.

In contrast, yields on Government securities, while highly volatile, generally rose over the month. Thin supplies of issues interacted with shifting market assessments to produce marked price changes. Yields moved up early in the month, and then dipped during a midmonth rally in response to optimistic interpretations of banking and monetary data. However, upward pressure on yields resumed when the optimistic expectations were discouraged by several developments, including the failure of Mideast money to help reduce the size of the Treasury's refunding operation. By the end of the month, yields were rising sharply.

In the corporate and municipal bond markets, unseasonally heavy supplies of new issues exerted downward pressure on prices at the same time that record-high interest rates provoked cancellations of issues and rejections of bids. Investors continued to show preference for high-quality issues, and the interest rate spread between medium-grade bonds and high-grade bonds was far larger than usual. Underwriters were also cautious about bidding on competitive offerings, while negotiated offerings fared better in an unsettled market. At midmonth, the decline in money market rates contributed to the emergence of a better atmosphere in the bond markets and a number of new issues were successfully sold. Yields were again rising sharply as the month drew to a close.

Preliminary data indicate that the growth of the money supply measures slowed in July after the acceleration of June. M_1—private demand deposits adjusted plus currency outside commercial banks—and M_2—which also includes time deposits other than large negotiable certificates of deposit (CDs)—both showed much slower growth in the four weeks ended July 24 in comparison with the four weeks ended June 26. CD growth, however, remained very rapid.

THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

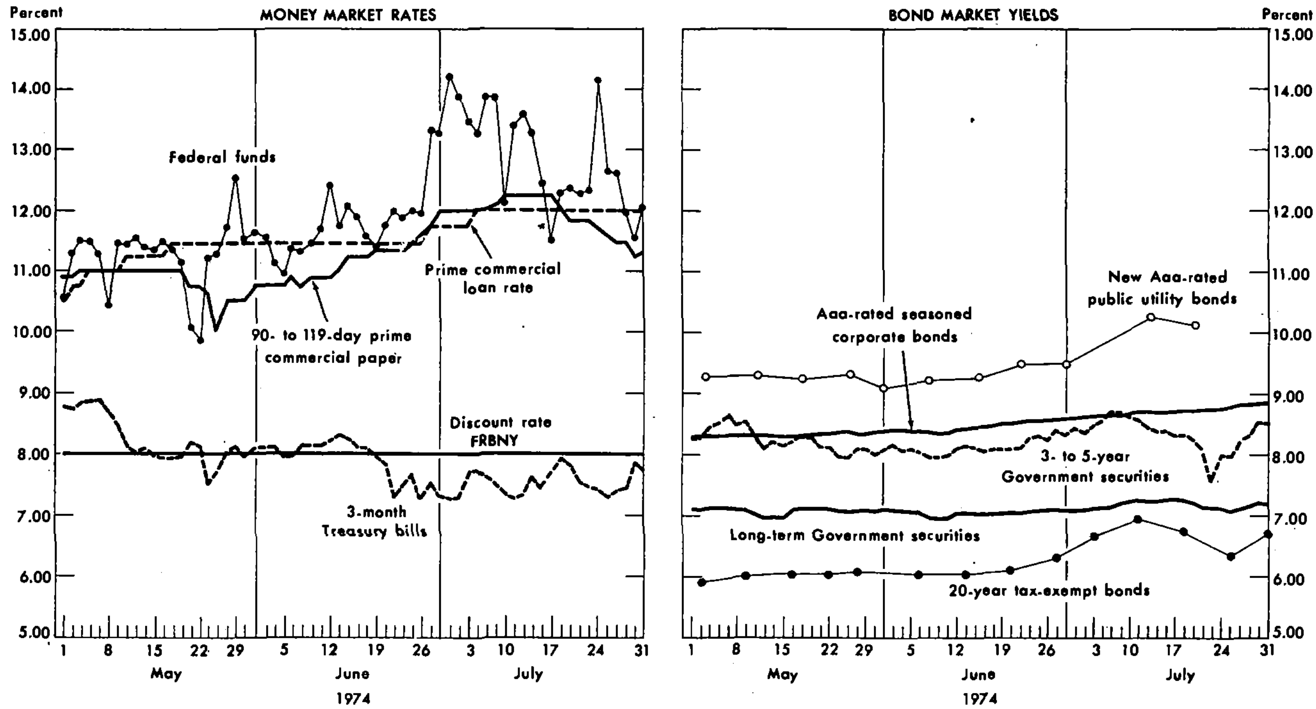
The money market was extremely tight at the beginning of the month, but conditions relaxed by midmonth and most short-term interest rates began to decline. Subsequently, some rates backed up but remained well below the record levels observed earlier in the period. The effective rate on Federal funds fell from the highs reached early in July (see Chart I), although for the month as a whole it averaged a record 12.92 percent, 99 basis points above the previous record of 11.93 percent in June. Rates on three-month CDs in the secondary market moved as high as 12.80 percent by midmonth before falling back to about 12 percent. Similarly, offering rates on dealer-placed 90- to 119-day prime commercial paper moved up early in the month by ¼ percentage point to 12¼ percent and then dropped to 11⅜ percent by the close of the period. Rates on bankers' acceptances generally followed the pattern of other short-term rates and were among those that moved back up at the month end. Dealers in bankers' acceptances seemed to prefer setting rates on a negotiated basis, and one dealer announced it was terminating operations, putting considerable pressure on the acceptance market. In contrast to the movement in other money market rates, the prime lending rate for large business borrowers at most commercial banks remained at 12 percent, after increasing from 11¾ percent very early in July. Several banks which tie their lending rates directly to past market rates also held their prime rates at 12 percent, even though their formula guidelines called for rates in the range of 12¾ to 13 percent at midmonth.

One of the factors responsible for the turnaround in most short-term rates was a moderation in the growth of business loans as the month progressed. During the first six months of the year, business loans at commercial banks increased by a seasonally adjusted \$18.4 billion, only slightly less than the extraordinary \$19 billion gain in the

Chart I

SELECTED INTEREST RATES

May - July 1974



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.

first half of 1973 and more than three times the growth experienced in the corresponding period in 1972. In July, business loans at all weekly reporting banks in the first statement week alone spurted by $1.9 billion, seasonally adjusted, but then registered more modest gains during the remainder of the period.

At the July 16 meeting, the Federal Open Market Committee raised the maximum amount of bankers' acceptances that can be held outright by the System. The ceiling was increased to $500 million from the $125 million maximum which had been in effect for the last ten years. In explaining its decision, the Committee noted that the volume of bankers' acceptances outstanding has grown sharply from $3.25 billion in 1964 to nearly $12 billion at present. Earlier in the month, dealers were notified that the Federal Reserve Bank of New York would no longer require dealers to endorse acceptances sold outright to the System and its customer accounts.

According to preliminary data, the growth of most monetary aggregates slowed appreciably in July relative to the gains experienced in June. M_1 advanced at only a 1.4 percent seasonally adjusted annual rate for the four weeks ended July 24 from its average level over the four weeks ended June 26. The growth of M_1 from the corresponding period thirteen weeks earlier to the four weeks ended July 24 was 4.2 percent—the lowest quarterly growth rate this year (see Chart II). The growth of M_2 decelerated to a seasonally adjusted annual rate of 4.6 percent in the four weeks ended July 24 over the first four statement weeks in June, while the growth of the adjusted bank credit proxy fell to 11 percent. However, banks continued to support their loan expansion with rapid increases in large negotiable CDs, which advanced at a 34.5 percent annual rate during the same period. Most of the CD growth was concentrated in the banks in New York City and Chicago. Member bank borrowings from the Federal Reserve averaged $3.3 billion during the month (see Table I), well above the record level set in June. Tight money market conditions and continued reliance by Franklin National Bank on the discount window were prime factors behind the high level of borrowings.

THE GOVERNMENT SECURITIES MARKET

An uneasy atmosphere prevailed in the market for longer term Treasury securities as the month began. The market was weighed down by concerns about the high level of short-term rates, bulging business loan demand, and deteriorating conditions in the corporate and tax-exempt bond markets. By midmonth, however, intermediate-term Treasury issues rallied briefly in response to the improved sentiment in the money and bond markets and the month's initial price declines were reversed. The market for long-term Treasury issues did not respond so quickly as the market for the intermediate-term issues, mainly because of the lingering weakness in the corporate bond market where investors remained unwilling to commit funds to longer maturities, given increased uncertainty over the future course of inflation. Toward the end of the month, prices of Treasury coupon securities began to fall again, owing in part to the anticipation of the August Treasury refunding. For the month as a whole, yields on three- to five-year securities were 12 to 20 basis points higher and yields on long-term Treasury securities were 7 to 28 basis points higher.

In contrast to the early-month rise and subsequent decline in most money market rates, Treasury bill rates did not display a pronounced pattern. Investor preference for securities with no default risk served to insulate the bill sector from pressures felt in other securities markets and also kept bill rates in July relatively low, compared with rates on other short-term securities. In the middle of the month, for example, the spread between three-month bill rates and rates on CDs in the secondary market with the same maturity exceeded 5 percentage points, far wider than the more usual 1 to 2 percentage points experienced in recent years. For the month as a whole, Treasury bill rates were 30 basis points lower to 37 basis points higher.

In most weekly bill auctions held during the month, deal-

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JULY 1974

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

Factors	Changes in daily averages— week ended					Net changes
	July 3	July 10	July 17	July 24	July 31	
"Market" factors						
Member bank required reserves	— 468	+ 315	—1,259	+ 535	+ 279	— 598
Operating transactions (subtotal)	— 197	+ 338	— 404	— 447	— 182	— 892
Federal Reserve float	+ 135	+ 761	— 510	— 320	+ 305	— 305
Treasury operations*	— 110	— 158	+ 605	— 355	— 500	— 518
Gold and foreign account	— 7	+ 61	— 14	+ 20	— 10	+ 50
Currency outside banks	— 94	— 538	— 309	+ 257	+ 808	+ 124
Other Federal Reserve liabilities and capital	— 121	+ 212	— 170	— 48	— 114	— 241
Total "market" factors	— 665	+ 653	—1,663	+ 88	+ 97	—1,490
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 197	+ 45	+ 811	— 462	— 202	+ 389
Outright holdings:						
Treasury securities	+ 307	+ 91	+ 274	+ 403	— 630	+ 445
Bankers' acceptances	+ 3	+ 4	+ 16	+ 50	+ 44	+ 117
Federal agency obligations	+ 307	+ 253	+ 333	+ 136	+ 8	+1,037
Repurchase agreements:						
Treasury securities	— 442	— 222	+ 100	— 589	+ 248	— 845
Bankers' acceptances	+ 76	— 16	+ 67	— 223	+ 71	— 25
Federal agency obligations	— 54	— 65	— 39	— 239	+ 57	— 340
Member bank borrowings	+ 647	— 795	+ 534	+ 465	+ 48	+ 899
Seasonal borrowings†	— 7	+ 11	+ 15	+ 3	+ 8	+ 30
Other Federal Reserve assets‡	+ 92	+ 6	+ 61	+ 76	+ 37	+ 272
Total	+ 935	— 744	+1,406	+ 80	— 118	+1,559
Excess reserves‡	+ 270	— 91	— 257	+ 168	— 21	+ 69

	Daily average levels					Monthly averages§
Member bank:						
Total reserves, including vault cash‡	37,274	36,868	37,870	37,503	37,203	37,344
Required reserves	36,905	36,590	37,849	37,314	37,035	37,139
Excess reserves	369	278	21	189	168	205
Total borrowings	3,433	2,640	3,176	3,641	3,689	3,316
Seasonal borrowings†	126	137	152	155	163	147
Nonborrowed reserves	33,841	34,228	34,694	33,862	33,514	34,028
Net carry-over, excess or deficit (—)‖	88	140	200	23	104	111

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 five weeks ended July 31, 1974.
‖ Not reflected in data above.

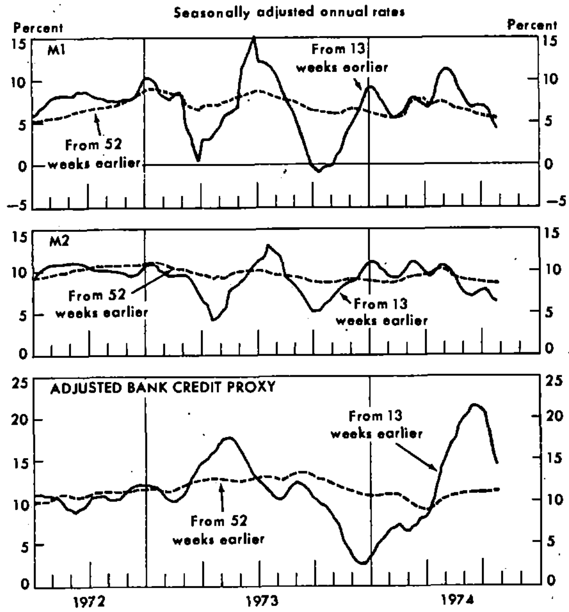
ers showed concern about rising interest rates and were reluctant to build inventories because of the large cost of carrying securities. On July 1, the average issuing rates were 7.81 percent for the three-month bill and 8.06 percent for the six-month bill, rates which were well above those on outstanding comparable issues. The cautious bidding continued, for the most part, at the other weekly auctions. In the monthly auction of 52-week bills on July 24, the average issuing rate was 7.84 percent (see Table II).

On July 18, the Treasury announced that it would auction $1.5 billion of tax anticipation bills on August 1 for payment on August 7. The bills will be due on September 20, and commercial banks may make payments for their own and their customers' accepted tenders by crediting Treasury Tax and Loan Accounts. On July 31, the Treasury announced the terms for refunding the $4.3 billion of notes held by the public, maturing on August 15. The Treasury will auction $2.25 billion of 9 percent 33-month notes, $1.75 billion of 9 percent six-year notes, and $400 million of 8½ percent bonds due in 1999. In addition to refunding maturing issues, the operation will provide $100 million to cover a portion of the Treasury's short-term cash needs. The Treasury also announced that it would increase the size of the weekly bill auction on August 5 by $200 million to a total of $4.7 billion.

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 July 24, 1974.

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.

On July 23, the Federal Financing Bank held its first auction and sold $1.5 billion of eight-month bills priced to yield 8.05 percent. The bills, which have the same characteristics as Treasury bills, were auctioned with full commercial bank Tax and Loan Account privileges. The Financing Bank, which began operations this year, will coordinate the borrowing activities of several Federal agencies that provide loan and loan-guarantee programs, thereby reducing their financing costs. The proceeds of this offering will be used to pay back the $1.4 billion already borrowed by the Financing Bank from the Treasury and advanced to some of the agencies.

In the market for Federal agency issues, the Federal Land Banks borrowed $1.3 billion in the first week of July, paying rates of 9.20 percent on eighteen-month bonds, 9.15 percent on four-year bonds, and 9.10 percent on seven-year bonds. In the following two weeks, the Federal Home Loan Banks and two farm credit agencies marketed over $2 billion in securities, with yields in the 9.45 to 9.55 percent range. During this period, the Tennessee Valley Authority (TVA) canceled its sale of $100 million power bonds and its regular monthly auction of short-term notes because of high interest rates and weak market conditions. This was the first time in eight years that the TVA failed to hold a monthly auction.

THE OTHER SECURITIES MARKETS

As July began, a very heavy prospective calendar of over $4 billion in offerings—coupled with investor concerns over double-digit inflation and a preference for quality debt issues—exerted extreme pressures on the corporate and municipal bond markets. Even record rates on some issues were not sufficient to attract investors. Issuers moved toward shorter maturities and longer call protection in their efforts to sell bonds, but still many offerings were postponed, canceled, or reduced in size.

A substantial portion of the corporate bond calendar was comprised of a $650 million issue of floating-rate notes by Citicorp, the holding company of the First National City Bank. Several features of the fifteen-year notes, such as the $5,000 minimum purchase after which the notes may be traded in $1,000 denominations, periodic redemption opportunities, and a listing on the New York Stock Exchange, seemed designed to appeal to relatively small investors. After some modifications and a reduction in the size of the offering from $850 million to $650 million, the Citicorp notes were issued on July 24. The notes, which will be redeemable semiannually beginning in 1976, will pay an initial interest rate of 9.70 percent for the first year and then will pay an interest rate 1 percentage point above the average yield on three-month Treasury bills. Several other bank holding companies, a savings bank, and a large oil company have announced plans to sell over $500 million floating-rate notes in August.

Investor preference for high-quality corporate debt was evident throughout the month. Consequently, the spread between the interest rates on new issues of Aaa-rated bonds and A-rated bonds was far wider than the usual spread of roughly ½ percentage point. In the industrial sector, a very large spread was evident on securities issued two days apart. On July 16, Ford Motor Company sold twenty-year Aaa-rated debentures with an interest rate of 9.25 percent. On July 18, the International Telephone and Telegraph Company issued eight-year notes with an A-rating which carried an interest rate of 11 percent. Although some portion of the 175 basis point spread is attributable to the difference in maturities, both issues carried similar call protections. As in June, new medium-grade electric utility bonds carried substantially higher interest rates than high-grade telephone debt. An Aaa-rated forty-year debenture offering of the Bell Telephone Company of Pennsylvania priced to yield 9.65 percent was sold on July 15. Two days later, an A-rated Consumers Power Company first-mortgage bond was sold with an interest rate of 11.38 percent, over 170 basis points higher than the telephone issue even though its maturity was only twenty years and the call protection was ten years, or twice as long as the telephone bond.

The terms of the Consumers Power Company's offering were typical of the electric utilities' attempts to make their debt issues more attractive to investors. The power companies have paid record-high interest rates, shortened maturities to twenty years from thirty years, and increased the call protection to ten years from five years to overcome the depressing impact of higher fuel prices on their ability to raise capital. Even these new features did not guarantee success. A $130 million A-rated offering of the Georgia Power Company did not receive any valid bids in a competitive auction despite provisions for a coupon rate as high as 11⅝ percent. However, other companies were more fortunate in negotiated offers. The Virginia Electric and Power Company sold $100 million of A-rated bonds priced to yield 11 percent.

In the tax-exempt market, many new issues were postponed and bids on over $600 million in offerings were rejected in the first half of July, in reaction to the high interest rates and because of statutory interest limitations. The only sizable offering awarded early in the month was the $125 million issue of the state of Oregon, which was divided into $100 million five- to fifteen-year veterans welfare bonds, priced to yield 5.90 to 6.40 percent, and $25 million six- to thirty-year highway bonds, priced to yield 6 to 6.80 percent. In the latter half of the month, several previously postponed or rejected offerings returned to the market. For the month as a whole, the total volume of municipal bond awards fell slightly short of the nearly $1.4 billion in offerings projected for July. One of the largest issues to return was the $325 million New York City offering on July 30 (scaled down from the $438 million issue on which the City had earlier rejected the sole bid submitted). The net interest cost of the two- to forty-year bonds was 7.69 percent, 23 basis points below the 7.92 percent rate rejected on July 9 but still above the previous high of 7.57 percent for New York City. On August 1, The Bond Buyer index of municipal yields was 6.70 percent, 37 basis points above the level on June 27. It had reached as high as 6.94 percent on July 11. The Blue List of dealers' advertised inventories fell $125 million to $455 million.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—July 1974				
	July 1	July 8	July 15	July 22	July 29
Three-month	7.808	7.892	7.702	7.604	7.698
Six-month	8.055	8.480	7.876	7.700	8.055

Maturity	Monthly auction dates—May-July 1974		
	May 29	June 26	July 24
Fifty-two weeks	8.248	8.256	7.836

* 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.