The Money and Bond Markets in July

Both short- and long-term interest rates advanced during July, partly in response to a substantial buildup in the corporate and municipal bond calendars and the belief of market participants that some firming of monetary policy was under way. The sharp rise in yields on the Municipal Assistance Corporation's bonds when they began trading without price restrictions was an additional depressant in the municipal market since it rekindled concern over the financial problems confronting New York City and some other urban areas. During the month, Treasury borrowing also continued heavy, through sizable amounts of new cash raised at each weekly bill auction and through the sale of $1.5 billion of new notes. At the end of the month the Treasury auctioned $5.8 billion of coupon issues to refund August maturities and raise $1 billion of new cash.

In the money market, most rates moved upward in July for the second consecutive month. The rates at which Federal funds traded increased over the month to an average of 6.10 percent. Higher yields were also posted on all maturities of commercial paper and on large certificates of deposit (CDs). In addition, major commercial banks boosted their prime lending rate over the period by ½ percentage point to 7½ percent. This was the first increase in the prime rate since July 1974, when the rate reached a record 12 percent before falling steadily to 7 percent in June of this year.

According to preliminary estimates, the growth in both the narrow and broad money stock measures moderated considerably in July from the very rapid expansion of the previous two months. However, since consumer-type time deposits at commercial banks continued rising sharply, the slowdown in the growth of the broad money stock was less pronounced. The bank credit proxy fell somewhat in July, as declines in Government deposits at member banks and in CDs offset demand and consumer-type time deposit growth.

THE MONEY MARKET AND THE MONETARY AGGREGATES

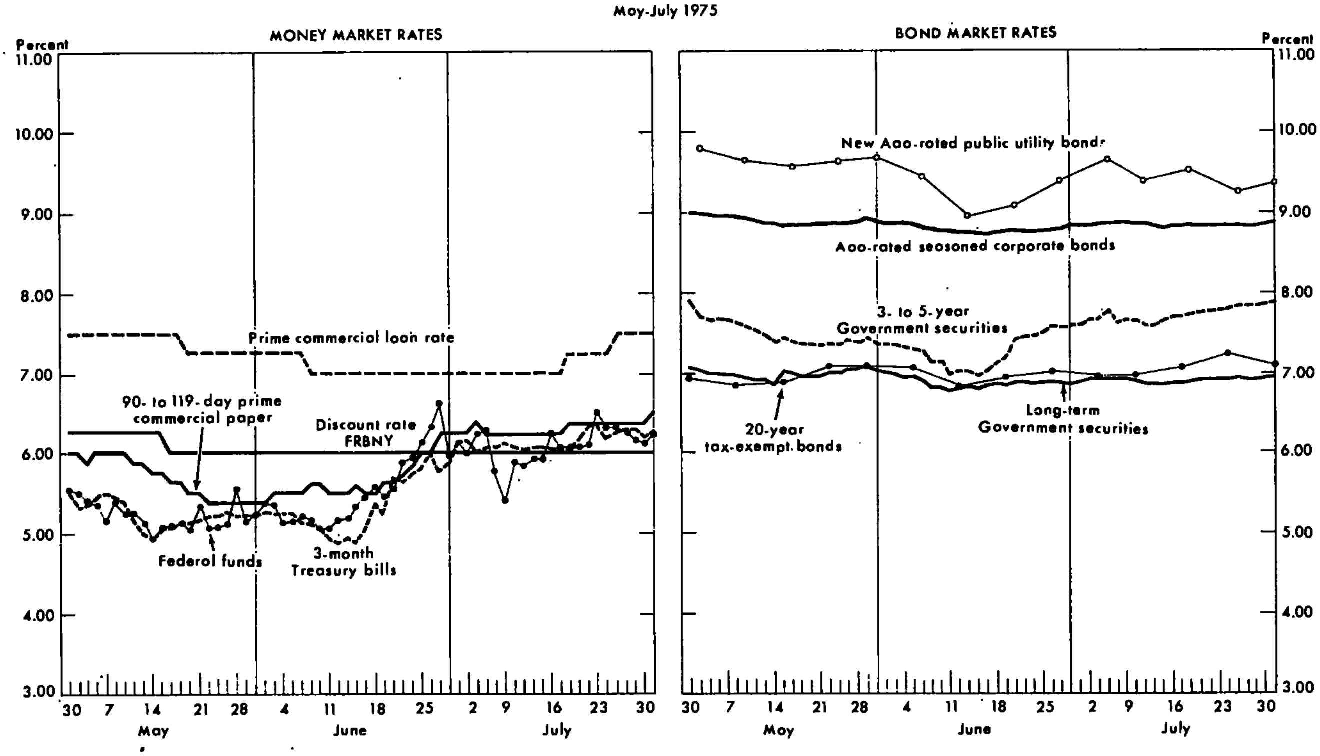
Interest rates on money market instruments rose further in July, following the sharp advances experienced in the preceding month (see Chart I). As the Federal Reserve absorbed reserves at progressively higher levels of the Federal funds rate, participants became convinced that a firming of monetary policy was under way. For the month as a whole, the effective rate on Federal funds averaged 6.10 percent, an increase of 55 basis points from the comparable figure for June. Rates generally increased ½ percentage point on directly placed commercial paper in July, while most maturities of dealer-placed paper registered a ¼ percentage point gain. The average yield in the secondary market on ninety-day CDs showed considerable fluctuation during July and closed the month at 6.55 percent, up 15 basis points from the end of June. In line with these increases in money market yields, the rate on prime business loans at most money-center banks was boosted in July in two ¼ percentage point steps to 7½ percent.

Business demand for short-term credit remained weak during July, as corporations apparently continued to lengthen the maturity of their liabilities. Over the first four statement weeks of the month, business loans at large commercial banks fell by $1 billion. This compares with increases of $2.7 billion and $2.3 billion over the comparable period in the two preceding years. In response to this weakness, banks allowed a further large volume of their CDs to run off in July. There was essentially no change in the amount of nonfinancial commercial paper outstanding during July when allowance is made for the usual seasonal pattern.

Preliminary data indicate that there was a sharp deceleration during July in the growth of the narrow money supply (M_1)—private demand deposits adjusted plus currency outside commercial banks. On an annual basis, the average seasonally adjusted level of M_1 in the four weeks ended July 23 was 1.8 percent above the average for the four weeks ended June 25. Both in May and particularly in June, M_1 had grown at extremely rapid rates, in part due to the effects of tax rebates by the Treasury and special social security payments. As a result, the expansion in M_1 in the four weeks ended July 23 from its average level in the four weeks ended thirteen weeks earlier was a substantial 10.6 percent at an annual rate. Over the latest fifty-two-week span, however, M_1 advanced a moderate 5 percent (see Chart II).

Consumer-type time and savings accounts continued to grow strongly in July, as rates on these deposits remained attractive. The broad money stock (M_2)—which includes these deposits plus M_1—thus grew at an 8.4 percent seasonally adjusted annual rate in the four weeks ended July 23, compared with the average four-week level in the period ended June 25. Over this same period the average levels at commercial banks of United States Government deposits and negotiable CDs declined substantially on a seasonally adjusted basis. As a result, there was a decrease in the adjusted bank credit proxy, a measure which includes all deposits at member banks subject to reserve requirements plus certain nondeposit sources of funds. On an annual basis, the average seasonally adjusted level of the proxy in the four weeks ended July 23 was 5.6 percent lower than its average level in the preceding four-

Chart I
SELECTED INTEREST RATES
May-July 1975



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.

week period. Member banks made somewhat heavier use of the discount window during July, when borrowings averaged $386 million (see Table I), compared with $97 million in June.

THE GOVERNMENT SECURITIES MARKET

Yields on Treasury securities increased on balance during July, initially in response to uncertainty about the course of monetary policy and later in response to what participants interpreted as a firming of this policy despite the upcoming August refunding. A lack of significant investor demand was also evident at various times. In addition, the Treasury's large financing needs engendered a cautious tone, given the less than enthusiastic investor interest exhibited from time to time during the month.

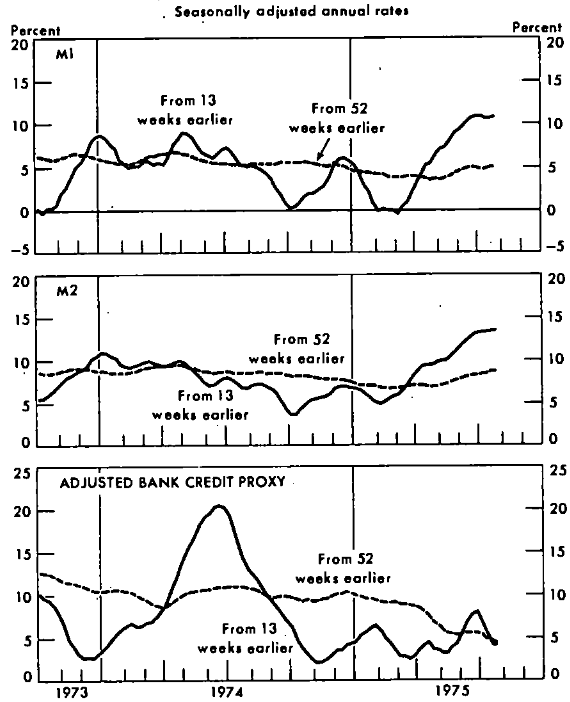
Rates on coupon issues generally edged higher during the first week of the month in light, pre-Fourth of July holiday trading. In the wake of the rise in rates at the end of June, investors tended to wait on the sidelines in uncertainty about the near-term course of interest rates, and some unloading of holdings also took place. Then, in the following week, the Federal funds rate receded from its higher midyear level which had partly reflected seasonal pressures. In addition, declines in M_1 and in business loans, coupled with better than expected demand in the July 14 weekly bill auction, also contributed to an improved tone in the Treasury coupon market at that time. Market participants responded favorably, and yields on notes and bonds moved down over the remainder of the first half of July.

As the month progressed, growing concern developed about investor acceptance of the $1.5 billion of Treasury notes scheduled for auction on July 17 and the terms and amount of the August refinancing which were to be announced after the market's close on July 23. Response to the $1.5 billion of two-year notes auctioned at mid-month turned out to be favorable, with tenders from the public totaling $5.4 billion. The notes were sold at an average yield of 7.52 percent. Following this auction, rates increased in the wake of lackluster secondary market interest in the new notes and in anticipation of the yields which would be required to complete successfully the Treasury's August refinancing. The terms of the refinancing were announced as expected on July 23. To refund $4.8 billion of publicly held notes maturing August 15 and to raise $1 billion in new cash, the Treasury auctioned $3 billion of 2¾-year notes, $2 billion of seven-year notes, and $0.8 billion of twenty-five year bonds at the end of July. Also, the Treasury sold $2.6 billion of notes and bonds at the average price of accepted tenders

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 23, 1975.

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.

to Government accounts and Federal Reserve Banks, which held $2.9 billion of maturing notes. The public's initial response to the August refinancing was quite favorable. On July 29, the Treasury received $5.6 billion in tenders for its $3 billion of thirty-three-month notes and the average issuing rate was set at 7.94 percent. The following day the Treasury received tenders of more than $3.7 billion for its $2 billion of seven-year notes. The average issuing rate for the notes was 8.14 percent. Investors also tendered $2 billion for the final part of the sale, the $800 million of twenty-five-year bonds which were auctioned on July 31 at an average yield of 8.44 percent.

At the time of the refunding announcement the Treasury also disclosed its projected new cash borrowing for the last half of 1975. It was estimated to be $41 billion,

$3 billion higher than the amount estimated in mid-June. An additional $3.5 billion to $4 billion will be borrowed in late August and early September through issues of two-year and four-year notes, and there will also be additions to the regular bill auctions totaling $3 billion to $3.5 billion between mid-August and mid-September. From then to the end of October, cash needs will be about $9 billion, but no details were given for raising that amount.

Over the month as a whole, the index of yields on intermediate-term Government securities rose 32 basis points to 7.88 percent. However, the index of long-term bond yields rose only 7 basis points to 6.93 percent.

The Treasury bill market responded in similar fashion to many of the factors which affected Government coupon securities during July. Rates moved higher as the month began, in response to the less than enthusiastic bidding in the final weekly auction in June. Although investor interest emerged at the higher yield levels, participants remained cautious because of their uncertainty about the future trend in interest rates. Reflecting this atmosphere, the average issuing rates on the three- and six-month bills at the first weekly auction in July were 19 and 25 basis points higher than a week earlier. Then, over the next several days, rates on bills declined in response to the lower level of Federal funds trading and expanded investor and professional demand. As a result, the average issuing rate on the three- and six-month bills declined by some 15 basis points at the July 14 auction (see Table II), and rates edged even lower following the sale.

After midmonth the tone in the bill market became more cautious, as the rate on Federal funds began to rise and the Federal Reserve absorbed reserves on several occasions. Although some investor demand was evident for selected maturities from time to time, bill rates increased on balance and, over the month as a whole, yields on most Treasury bills rose 29 to 59 basis points.

Rates on Federal agency issues also rose during July, and some new offerings encountered investor resistance. On July 17, two farm credit agency offerings were marketed at yields about 1¼ percentage points higher than were provided on similar issues in June. At these yield levels, the bonds were given a good reception. New securities offered by the Federal Land Banks and the Government National Mortgage Association (GNMA) encountered some initial problems. Early in July the Federal Land Banks priced $464 million of 7½-year bonds to yield 8.20 percent and $650 million of fifteen-month bonds to yield 7.20 percent. The longer bonds sold quickly, but the shorter ones did not because the yield was so close to that on comparable Treasury issues. The GNMA offering on July 15 was also in two parts: $154 million of thirty-year securities yielding

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JULY 1975

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

Factors	Changes in daily averages—week ended: July 2	July 9	July 16	July 23	July 30	Net changes
"Market" factors						
Member bank required reserves	— 466	+ 584	— 306	+ 106	— 25	— 107
Operating transactions (subtotal)	—1,620	+2,471	+1,851	— 667	+ 192	+2,227
Federal Reserve float	— 95	+ 362	— 100	— 294	— 415	— 542
Treasury operations*	—1,538	+2,396	+2,244	— 160	— 449	+2,493
Gold and foreign account	— 31	+ 10	— 32	+ 56	— 22	— 19
Currency outside banks	— 8	— 604	— 220	— 228	+1,188	+ 133
Other Federal Reserve liabilities and capital	+ 47	+ 307	— 41	— 40	— 111	+ 160
Total "market" factors	—2,086	+3,055	+1,545	— 561	+ 167	+2,120
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+1,832	—2,692	—1,600	+ 505	— 128	—2,083
Outright holdings:						
Treasury securities	+ 400	— 360	—1,210	+ 587	— 240	— 823
Bankers' acceptances	+ 8	— 1	+ 4	— 6	— 1	+ 4
Federal agency obligations	—	— 1	—	—	— 1	— 2
Repurchase agreements:						
Treasury securities	+1,184	—2,008	— 298	— 90	+ 126	—1,086
Bankers' acceptances	+ 124	— 152	— 81	+ 11	+ 2	— 96
Federal agency obligations	+ 116	— 170	— 15	+ 3	— 14	— 80
Member bank borrowings	+ 683	— 648	— 21	+ 180	— 129	+ 65
Seasonal borrowings†	+ 5	— 2	+ 3	+ 3	+ 1	+ 10
Other Federal Reserve assets‡	— 156	— 3	+ 43	+ 72	+ 121	+ 77
Total	+2,359	—3,343	—1,578	+ 757	— 136	—1,941
Excess reserves‡	+ 273	— 288	— 33	+ 196	+ 31	+ 179

Member bank:	Daily average levels: July 2	July 9	July 16	July 23	July 30	Monthly averages§
Total reserves, including vault cash‡	35,471	34,599	34,872	34,962	35,018	34,984
Required reserves	35,077	34,493	34,799	34,693	34,718	34,756
Excess reserves	394	106	73	269	300	228
Total borrowings	871	223	202	382	253	386
Seasonal borrowings†	15	13	16	19	20	17
Nonborrowed reserves	34,600	34,376	34,670	34,580	34,765	34,598
Net carry-over, excess or deficit (—)‖	71	226	97	20	79	99

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 30, 1975.
‖ Not reflected in data above.

8.42 percent and $70 million of twenty-five-year securities priced to yield 8.44 percent. The larger issue in particular sold quite poorly, and yields on both parts rose by 9 basis points when the securities were released from syndicate two days later.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—July 1975			
	July 7	July 14	July 21	July 28
Three-month	6.203	6.045	6.247	6.318
Six-month	6.510	6.344	6.626	6.719
	Monthly auction dates—April-July 1975			
	April 30	May 28	June 24	July 24
Fifty-two weeks	6.400	5.803	6.292	6.782

* 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 OTHER SECURITIES MARKETS

Yields moved higher in both the corporate and municipal markets over the month of July in the face of heavy calendars and some concern among participants as to the near-term course of interest rates. Early in the month there was a decline in both The Bond Buyer index of twenty municipal bond yields and the Federal Reserve Board's index of yields on recently offered corporate securities. However, in response to the pressure of additional new offerings and the increase in short-term rates, the pattern was soon reversed and the indexes rose steadily over most of July.

By far the dominant factor in the tax-exempt market during the month was the $1 billion offering of New York Municipal Assistance Corporation (MAC) bonds. The two-day sale of this issue occurred on June 30 and July 1 and was generally considered successful at that time, although there was reportedly little demand for the bonds among out-of-state investors despite their very high yields. As the month progressed and the bonds remained under syndicate price restriction, speculation arose as to the actual success of the sale. When the bonds were finally freed to trade on July 21, their prices dropped sharply, increasing the yields substantially. Since MAC was planning to raise an additional $2 billion by the end of September in order to aid New York City, its difficulties with the initial sale generated concern about the fate of its future offerings. With some $790 million of New York City notes maturing in August, the municipal market was once again confronted with the depressing possibility of a default by the city.

In contrast to MAC's and New York City's problems, the next largest tax-exempt issue, the New York State Power Authority's $200 million offering of top-rated promissory notes, sold out immediately at midmonth. These consisted of $150 million of 7¼ percent notes due in three years and $50 million of 7½ percent notes with a five-year maturity. Priced at par, the issue provided generous yields when compared with another authority offering a month earlier. Two issues totaling $275 million were postponed during July, and some large new offerings in the last half of the month sold somewhat slowly. However, an improved tone developed as the month drew to a close, in part because of renewed interest in the MAC bonds as signs of some progress in New York City's fiscal problems emerged. The Bond Buyer index rose 22 basis points from the end of June to a record 7.22 percent on July 24 and then declined to 7.09 percent the following week. The Blue List of dealers' advertised inventories fell by $13 million and closed the month at $547 million.

The corporate bond market experienced a record volume of new issues during the first half of 1975, and offerings continued heavy in July, a normally slow month. Most of the large new issues were given a good reception in July, albeit at higher yields. The largest taxable offering during the month was $500 million of International Bank for Reconstruction and Development Aaa-rated debt which was sold on July 9. Almost all of the $200 million of ten-year notes was sold the first day at a yield of 8.6 percent, but the second part of the offering, $300 million of five-year notes paying 8.3 percent, moved somewhat more slowly. The next day brought the marketing of two additional large offerings: $300 million of Standard Oil Co. of California's Aaa-rated debentures and a $250 million Aa-rated package from Ford Motor Credit Co. Both were well received. The thirty-year oil company bonds were priced to yield 8.83 percent, 36 basis points more than a similarly rated oil issue offered a month earlier. The two-part offering from the credit company, $100 million in ten-year notes and $150 million in twenty-five-year debentures, was also attractively priced to yield 8.85 percent and 9.73 percent, respectively. Reflecting the general rise in rates on corporate issues during July, the Bell Telephone Co. of

Pennsylvania's Aaa-rated offering of forty-year debentures was priced to yield 8.8 percent at midmonth, up from 8.65 percent on a similar issue marketed in June. These bonds sold quickly on their first day and were followed by the successful sale of $250 million of eight-year Aa-rated utility company notes yielding 8.46 percent the following day. Corporate bond issues marketed over the remainder of the month were more modest in size and were generally well received. The Board's index of yields on recently offered Aaa-rated corporate securities rose 16 basis points from June 26 to July 17 but then declined somewhat over the remaining two weeks. For the month as a whole, the index showed a 4 basis point rise.

Some record-breaking and unusual developments occurred in the taxable bond market during July. Citicorp successfully marketed a record volume of publicly offered convertible securities during the period, and the American Telephone & Telegraph Company, which normally borrows domestically, reported the placement of a $100 million note with the government of Saudi Arabia. In addition, Standard Oil Co. (Ohio) and British Petroleum Co. Ltd., through a jointly owned subsidiary, privately placed a huge $1.75 billion debt issue to conclude the financing of their 49 percent portion of the Alaskan pipeline. Sohio/BP Trans Alaska Pipeline Finance, Inc., received commitments from some seventy-five institutions for purchase of this record-breaking amount of its 10⅝ percent notes.