The Money and Bond Markets in September

Short-term interest rates were little changed over the month, although some upward pressure emerged around the quarterly statement date. The continued moderate growth reported for the monetary aggregates reduced the concern of market participants over a near-term tightening of money market conditions by the Federal Reserve. Nevertheless, further signs of a strengthening economy and prospects of heavier credit demands weighed on market sentiment.

In the Government and corporate securities markets, opposing forces left yields somewhat higher on balance by the month end. Fears of renewed inflation deepened with news of the developing economic recovery. An announcement by the Treasury of enlarged borrowing needs with more emphasis on selling longer term issues to finance them also was a depressing influence. On the other hand, the consumer price index for August showed a low rate of increase, and substantial demand emerged in the auctions for Treasury securities. Developments in the corporate market were also greatly aided by a relatively small amount of new issues offered during the month and expected in the near future. This partly reflected the massive corporate debt financing earlier in the year and the cancellations or postponements of issues due to current levels of interest rates.

Meanwhile, yields in the municipal market rose sharply in September to record levels, as New York City's fiscal crisis continued to weigh heavily on this sector. Legislation to provide additional revenues for the city was passed by the New York State legislature early in September, but investors remained concerned over the financing needs of state and local government borrowers and their access to the market. Investor concern deepened at the close of the month when a section of the legislation which required the use of pension funds of state employees was declared unconstitutional by New York State's highest court.

According to preliminary data, which now reflect recent bench-mark revisions, growth in the narrow money stock (M_1) remained moderate in September for the third straight month. Growth of the more broadly defined money stock (M_2), though more rapid than that of M_1, was also moderate when compared with recent historical patterns. The bank credit proxy halted its recent decline and grew modestly during the month.

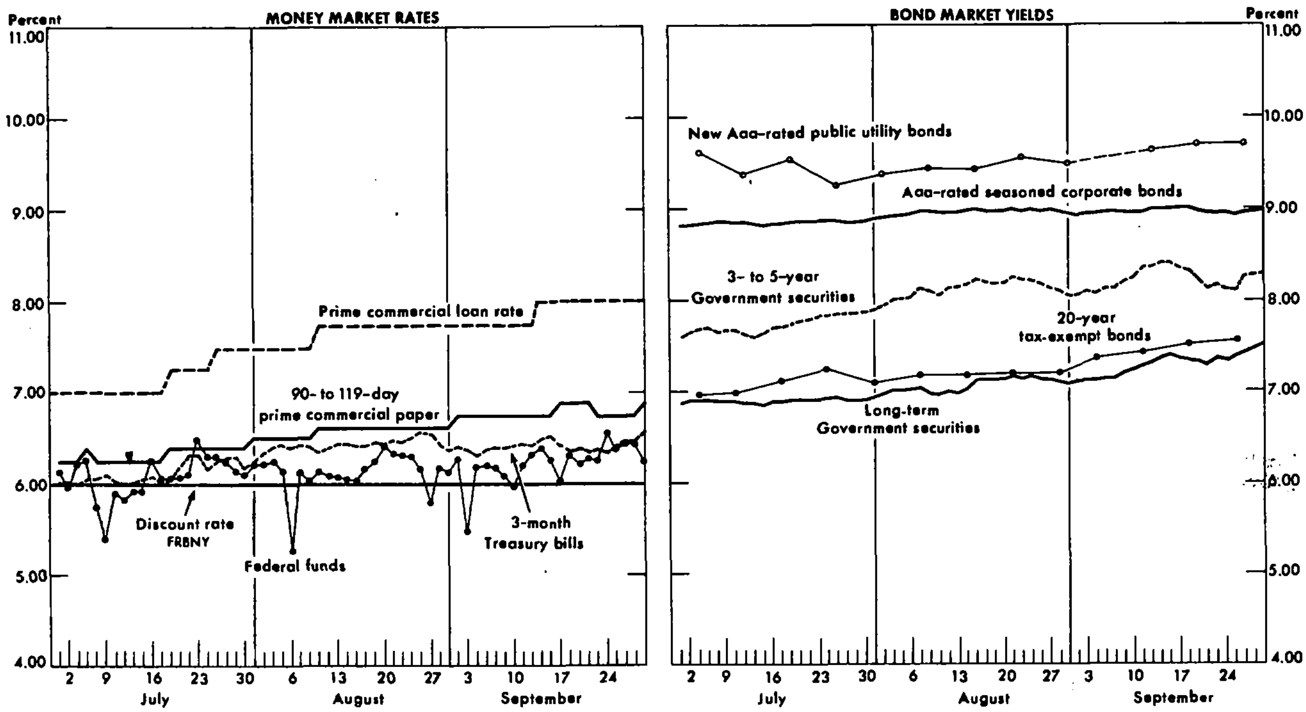
THE MONEY MARKET AND THE MONETARY AGGREGATES

The Federal funds rate and other short-term rates were stable over most of the month, although increased churning in the money market put some upward pressure on rates toward the month end (see Chart I). Many large banks apparently sought to add to certificates of deposit (CDs) before the quarterly statement publishing date, and rates on these instruments started rising around the middle of the month. For September as a whole, the effective rate on Federal funds averaged 6.24 percent, compared with a 6.14 percent average in August. Member bank borrowings from the discount window continued to be modest on average over the month (see Table I), as the rate on Federal funds remained only slightly above the discount rate. Rates on 90- to 119-day dealer-placed commercial paper were raised during the month ¼ percentage point to 6⅞ percent, while rates on bankers' acceptances were approximately unchanged. In the secondary market, the rate on large negotiable CDs maturing in ninety days closed the month at 7.03 percent, up 8 basis points from the end of August.

The demand for bank loans by businesses, in decline since last December, remained weak during September. Commercial and industrial loans at large commercial banks rose only $4 million in the first four statement weeks in September, compared with a $1,330 million average increase over similar periods in the previous four years. Nevertheless, most money center banks raised their prime lending rate ¼ percentage point to 8 percent.

During the month, the Board of Governors of the Federal Reserve System released revised estimates of the money stock measures for the period beginning January of this year for M_1—private demand deposits adjusted plus currency outside commercial banks—and beginning October 1974 for M_2—M_1 plus time deposits other than

Chart I
SELECTED INTEREST RATES
July-September 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.

large negotiable CDs. The revisions reflect data obtained from the April 16 call report for nonmember banks and from reports from foreign agencies and branches. The major effect of the revisions was to lower the average level of M_1 during 1975 by about $1 billion. As a result, growth of M_1 from 1974 has been lowered slightly. All money stock data in this article reflect these revisions.

Preliminary data indicate that growth in the monetary aggregates remained moderate in September. During the four-week period ended September 24, seasonally adjusted M_1 averaged 2.6 percent at an annual rate above its average during the four statement weeks in August. This brought the growth in M_1 from its average level in the four weeks ended thirteen weeks earlier to 3.0 percent at an annual rate (see Chart II). Consumer-type time and savings deposits at commercial banks continued to grow somewhat more slowly than their rapid pace in the first half of the year, partly in lagged response to the run-up in market interest rates in recent months. During the first four statement weeks of the month, these deposits averaged 6.9 percent at an annual rate above their level in the period ended four weeks earlier. Over the same period, M_2 increased at a 5.0 percent rate. CDs, reversing a steady decline since January, grew at a 3.3 percent annual rate in September. The bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—rose in September for the first time in three months.

Table I

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

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

Factors	Changes in daily averages— week ended				Net changes
	Sept. 3	Sept. 10	Sept. 17	Sept. 24	
"Market" factors					
Member bank required reserves	— 42	+ 118	— 188	— 293	— 405
Operating transactions (subtotal)	— 899	+1,153	— 257	—3,381	—3,384
Federal Reserve float	— 62	+ 546	— 194	+ 158	+ 448
Treasury operations*	— 607	+ 433	+ 245	—3,829	—3,758
Gold and foreign account	— 62	— 51	+ 26	+ 41	— 46
Currency outside banks	+ 9	— 115	— 73	+ 208	+ 29
Other Federal Reserve liabilities and capital	— 177	+ 339	— 262	+ 42	— 58
Total "market" factors	— 941	+1,271	— 445	—3,674	—3,789
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 748	—1,757	+ 677	+3,399	+3,067
Outright holdings:					
Treasury securities	+ 116	— 55	— 186	+1,907	+1,782
Bankers' acceptances	+ 10	— 20	— 7	+ 32	+ 15
Federal agency obligations	— 23	—	— 1	—	— 24
Repurchase agreements:					
Treasury securities	+ 474	—1,410	+ 783	+1,173	+1,020
Bankers' acceptances	+ 86	— 166	+ 51	+ 123	+ 94
Federal agency obligations	+ 85	— 106	+ 37	+ 164	+ 180
Member bank borrowings	— 50	+ 163	— 58	+ 68	+ 123
Seasonal borrowings†	+ 11	+ 3	+ 7	+ 3	+ 24
Other Federal Reserve assets‡	+ 265	+ 27	+ 88	— 35	+ 345
Total	+ 963	—1,567	+ 707	+3,432	+3,535
Excess reserves‡	+ 22	— 296	+ 262	— 242	— 254

	Daily average levels				Monthly averages§
Member bank:					
Total reserves, including vault cash‡	34,544	34,130	34,580	34,631	34,471
Required reserves	34,223	34,105	34,293	34,586	34,302
Excess reserves	321	25	287	45	170
Total borrowings	222	385	327	395	332
Seasonal borrowings†	51	54	61	64	58
Nonborrowed reserves	34,322	33,745	34,253	34,236	34,139
Net carry-over, excess or deficit (—)‖	177	170	4	108	115

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 four weeks ended September 24, 1975.
‖ Not reflected in data above.

THE GOVERNMENT SECURITIES MARKET

Yields on coupon-bearing Treasury obligations rose on balance during September, while rates of return on Treasury bills fluctuated in a narrow range. During the first half of September, investors became increasingly concerned about inflation and the financing needs of the Treasury. With these considerations weighing on the market, prices of longer maturity issues weakened substantially. After midmonth, some good news on the price front and massive retail interest in a Treasury auction precipitated a short rally, but most coupon issues ended the month with higher yields on balance. Relatively stable dealer financing costs supported the Treasury bill market and, with supply pressures potentially easing, rates were fairly steady over most of the month.

On September 10, the Treasury announced its overall cash needs for the remainder of the year and its financing plans for September. With expenditures continuing to run above earlier projections, with the possible suspension of oil import fees, and with a decision to maintain a higher average cash balance, the Treasury raised its estimates of needed financing. Borrowing requirements in the second half of 1975 are now expected to total \$44 billion to \$47 billion, up from the \$41 billion figure estimated in August. The Treasury also indicated that its financing plans would place less emphasis than previously on the bill market in order to minimize any disintermediation effects of the borrowing program. The September component of the Treasury's borrowing was \$4 billion in new cash raised by the auction of an additional \$1 billion of two-year notes (part of a \$3 billion financing) on September 16, by the addition of \$1 billion to the auction of 52-week bills on September 17, and by an auction of \$2 billion of 29-month notes on September 24.

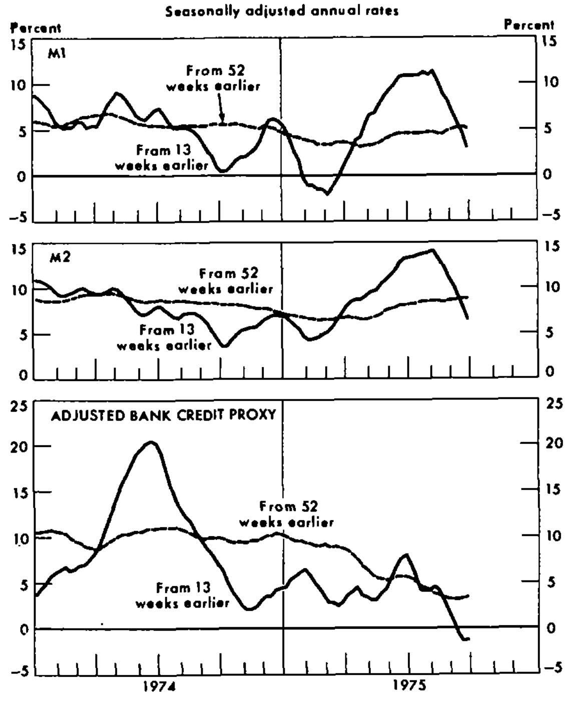
The Treasury announcement had a depressing effect on the coupon market which was still assimilating the news of a bulge in energy and food prices in July and August. However, in the September 16 auction of two-year notes, an unexpectedly large amount of noncompetitive tenders resulted in about 45 percent of the \$3 billion issue being purchased by individual investors and smaller financial institutions. At 8.44 percent, the average yield on these notes was less than anticipated although 19 basis points above the average yield at the auction of similar notes on August 14. The relatively small proportion of the issue taken by dealers left the notes in a favorable technical position. The improved market tone following the auction was reinforced on September 18 by the release of the consumer price index for August which rose at only a 2.0 percent annual rate, the smallest monthly increase in three years. In the auction of $2 billion of 29-month notes on September 24, aggressive bidding resulted in an average yield for the notes of 8.10 percent, with a sizable portion awarded to noncompetitive tenders.

In the final week of the month, the market resumed the downward course that had been followed during the first half of the month. Accompanying this decline was a request by Treasury officials, in testimony before the Congress, to extend to ten years the maturity on securities that can be issued without restrictions on the interest rate and to provide authority to sell longer term issues without regard to the interest rate ceiling. Over the month as a whole, the index of yields on intermediate-term Government securities rose 26 basis points to 8.28 percent. The yield on the 8½ percent Treasury bond of 1994-99 rose to 8.64 percent at the end of September, up 21 basis points from its level at the end of August. Lower coupon bonds showed a more pronounced trend. The yield on the 4¼ percent Treasury bond of 1987-92 rose to 6.42 percent, up 54 basis points from the end of August.

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 lastest statement week plotted is September 24, 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.

With short-term rates remaining relatively stable over most of the month, inventory financing costs did not apply significant pressure on Government securities dealers. In addition, the outlook for supply in the bill market was improved by the Treasury's stated intention to rely to a lesser extent on short-term issues to finance the deficit. As a result, bills traded in a narrow range until the last two days of the month when yields on three-month bills rose 15 basis points. At the weekly auction of September 29, the average yields on three- and six-month bills were 6.55 percent and 6.98 percent (see Table II), compared with 6.38 percent and 6.87 percent, respectively, in the last auction of August. Over the month as a whole, yields on most bills rose 10 to 29 basis points.

On September 4, the Treasury auctioned $1.5 billion of cash-management bills, with $800 million to mature on September 18 and $700 million to mature on September 25. Like a similar issue in August, these thirteen- and twenty-day bills were designed to dampen fluctuations in the Treasury's balances at Federal Reserve Banks.

In the major agency issue of the month, the Federal National Mortgage Association (FNMA) issued $400 million of four-year debentures at 8½ percent and $300 million of seven-year debentures at 8.60 percent. Both issues were well received. In August, FNMA had issued $650 million of five-year debentures at 8¾ percent.

THE OTHER SECURITIES MARKETS

Competition from the Treasury for long-term funds and uncertainty about the outlook for inflation dominated sentiment in the corporate bond market during September. Few new issues were brought to market, and the calendar was lightened further by postponements due to market conditions. Prices eroded steadily in light trading over the first half of the month. However, after midmonth the good reception in a Treasury note auction and the small increase in the consumer price index were viewed very favorably, and a short, sharp rally ensued. Some profit taking occurred later in the month, but corporate prices generally held steady as the forward calendar for new debt financing appeared manageable.

Developments in the corporate market in September were reflected in the bellwether financing of the month, a two-part offering of Aaa-rated telephone utility debt. The financing totaled $200 million: $75 million of six-year notes yielding 8.70 percent and $125 million of forty-year bonds yielding 9.70 percent. Although the return on the bonds compared very favorably with a similar issue yielding 8.80 percent when brought to market in mid-July, the market had deteriorated significantly before the offering date of September 17. Dealers encountered initial investor resistance to the terms set for the bonds. However, after the results of the Treasury auction became known, the bonds quickly sold out. With the additional impetus of the small increase announced for the consumer price index, the bonds traded above their issue price when released from syndicate restrictions on September 22. During the ensuing week, the market retreated again so that, at the month end, the price of the bonds was 1½ points below their high of the previous week.

The financial problems of New York City dominated the market for state and local government debt issues in September. During the first week of the month, the increasing difficulties in arranging a timely aid package for New York City caused price quotations on Municipal Assistance Corporation (MAC) issues to drop sharply. The tax-exempt market received some respite on September 9 when the New York State legislature provided additional funds for the city and established an Emergency Financial Control Board to oversee the city's fiscal operations. Under the legislation, the state would provide $750 million (to be financed by state borrowing) to the city by purchasing $250 million of MAC bonds and $500 million of city and MAC notes. Another $725 million was to have been obtained from city and state employee pension funds, with the remainder coming from tax prepayments, net new purchases or underwritings of $250 million of MAC issues by New York banks, and other sources.

Shortly after the enabling legislation passed, the 9 percent MAC bonds due in 1985, which had fallen to 84 at the end of the preceding week, rose to 89½. Nevertheless, considerable uncertainty still prevailed. On the day after the passage of the legislation, New York State, presumably because of the increased burden of its financial commitment to New York City, encountered investor hesitancy when it offered $755 million of short-term notes in a negotiated offering. Of those notes, $105 million due in December was offered to the public at a 6 percent yield, $400 million due in six months was offered to yield 7½ percent, and $250 million of one-year notes was priced to yield 8 percent. During the following week, two other New York State borrowers also encountered considerable reluctance from lenders and could borrow only at very high yields through private placements. Interest charges on one-year notes were reported to be 9.5 percent for the New York State Housing Finance Agency and 9¾ percent for the New York State Dormitory Authority.

At the close of the month, the highest court in New York State declared unconstitutional the mandated investment of state employee pension funds to aid New York City. The decision affected the use of $125 million of funds, which was part of the aid package passed earlier by the state legislature. In the wake of the court decision, price quotations on MAC issues plunged to new lows as concern developed over whether enough funds to stave off a default by the city would be forthcoming.

The problem of dwindling investor confidence extended to other state and local government borrowers as well. In mid-September, the Massachusetts Housing Finance Agency was able to sell about $128 million of bond anticipation notes only after the full faith and credit of the state was placed behind the notes, which were priced to yield from 5.75 percent for December 1975 maturities to 6.75 percent for September 1976 maturities. When marketed at the end of the month, $50 million of Aaa-rated bonds of the State of California encountered investor resistance despite generous yields. The Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds on October 1 rose to a record 7.67 percent from its level of 7.18 percent on August 28. The Blue List of dealers' advertised inventories rose by $4.5 million and closed the month at $635 million.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—September 1975			
	Sept. 8	Sept. 12	Sept. 22	Sept. 29
Three-month	6.389	6.444	6.316	6.547
Six-month	6.889	6.901	6.824	6.980

Maturity	Monthly auction dates—July-September 1975		
	July 24	Aug. 20	Sept. 17
Fifty-two weeks	6.782	7.331	7.388

* 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.