

FEDERAL RESERVE BANK OF NEW YORK



MONTHLY REVIEW

NOVEMBER 1972

Contents

The Business Situation	274
Monetary and Bank Credit Developments in the Third Quarter	278
The Money and Bond Markets in October.....	282

Volume 54

No. 11

The Business Situation

Recent business statistics indicate that the economy is continuing to move ahead briskly. Real gross national product (GNP) increased at an annual rate of 5.9 percent in the third quarter. While this gain was smaller than the exceptionally large advance in the preceding quarter, the reduction in the rate of growth was confined mainly to inventory investment and defense spending and does not seem to indicate any weakening in the underlying economic situation. Consumers, businesses, and state and local governments all vigorously expanded their demands for goods and services. Surveys of consumer sentiment, moreover, suggest a marked improvement in confidence in recent months. New orders for durable goods, capital appropriations, and plans for investment in plant and equipment further point the way to continued robust economic activity. Indeed, a large gain in employment occurred in October, although a similarly large increase in the labor force held the unemployment rate unchanged at 5.5 percent.

On the price front, the course of inflation has apparently changed little recently, as prices continue to rise at comparatively moderate rates. The fixed-weight price deflator for total GNP increased at a 2.9 percent annual rate in the third quarter. The consumer price index, however, rose at a somewhat faster rate in the third quarter than in the first half of the year, reflecting in part the large September increase. Much of this acceleration was a result of the run-up in food prices. On the other hand, there was a noticeable easing in the rate of rise in wholesale industrial prices in the third quarter. The situation improved even further in October, when industrial prices actually fell slightly.

GROSS NATIONAL PRODUCT AND RELATED DEVELOPMENTS

Preliminary estimates prepared by the Department of Commerce indicate that the total market value of the nation's output of goods and services rose \$22.8 billion in the third quarter, an 8.3 percent seasonally adjusted annual rate of gain. Only about one fourth of this advance, moreover, was the result of higher prices. Valued in terms

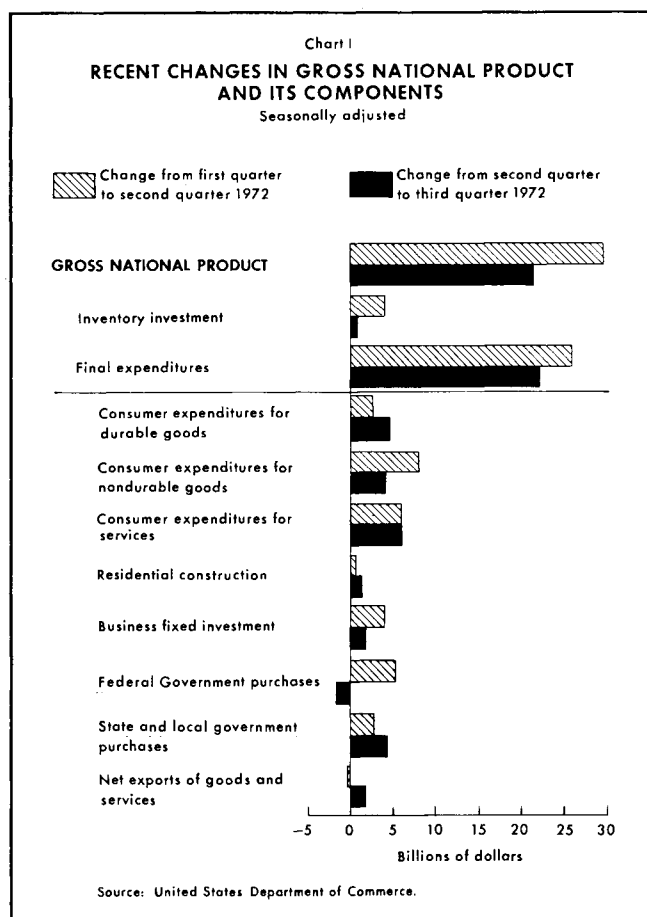
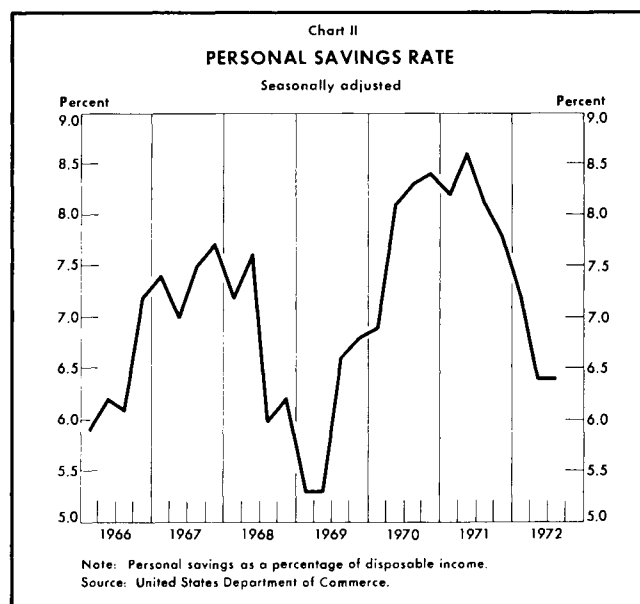
of 1958 prices, output of goods and services (real GNP) expanded at a 5.9 percent annual rate during the third quarter. This was still a sizable advance, even though it was overshadowed by the exceptionally large 9.4 percent rate of rise in real GNP in the preceding quarter. Over the last four quarters, the real growth has been an impressive 7.1 percent, slightly more than twice the average increase between 1953 and 1971.

The reduction in the rate of GNP growth in the third quarter was centered mainly in inventory investment and in defense spending by the Federal Government, both of which had shown quite large increases in the preceding quarter. Indeed, final expenditures on nondefense goods and services actually rose slightly faster in the July-September period than they had in the previous three months. This increase in final spending, moreover, was widely distributed throughout the economy (see Chart I).

Inventory investment is tentatively reported to have contributed a very modest \$0.7 billion to the increase in GNP in the third quarter, down markedly from the \$4.6 billion rise in the previous three months. This comparison, however, obscures the turnabout in inventory spending that has occurred in recent months. Nonagricultural businesses added \$5.3 billion worth of goods to their inventory stocks in the third quarter, following an only slightly smaller addition during the previous three months. The accumulations in these two quarters together exceeded those of the preceding four combined. To a considerable degree, this quickening in the pace of inventory spending has reflected developments within the manufacturing sector. After running down their inventories throughout 1971, manufacturers began to enlarge their stocks at the start of the current year, with the increment in each quarter exceeding that of the previous one. At the same time, wholesale and retail establishments have also been stepping up the pace of their inventory spending, albeit somewhat cautiously. Nevertheless, the increases in the book value of total business inventories have remained proportionately smaller than those in total business sales, and the inventory-sales ratio has continued

to trend downward. In August, the latest month for which data are available, this ratio declined to 1.48 months of sales, the lowest level since mid-1966.

Consumption spending again climbed vigorously in the third quarter. Personal consumption expenditures rose by a sizable \$14.7 billion over that period, a seasonally adjusted annual rate of increase of 8.5 percent. Although this was off somewhat from the advance during the first half of the year, it still constituted a healthy gain. Looking at the first nine months of the year as a whole, the rises in expenditures on consumer durables, nondurables, and services were all considerably larger than they had been in the preceding three quarters. Indeed, the rapid expansion in consumption spending this year has been a major underpinning of the faster pace of the recovery in economic activity. Moreover, results of the latest consumer surveys, which attempt to plumb consumers' attitudes directly, point to a marked improvement in confidence and buying plans in recent months.



The third-quarter moderation in the growth of personal consumption expenditures was accompanied by a leveling-off in the personal savings rate. After falling precipitously from its peak of 8.6 percent of disposable income in the second quarter of 1971 to 6.4 percent in the corresponding quarter this year, the savings rate was unchanged at this level in the July-September period (see Chart II). Inasmuch as disposable income tends to be rather closely linked to GNP, the decline in the savings rate underscores the important role that the growth of consumption has played in the overall expansion in economic activity during the year. It should be noted, however, that the overwithholding of personal income taxes may be artificially depressing the savings rate to some extent. Some estimates have placed the amount of overwithheld taxes at around \$8 billion, and some individuals may be treating these funds as a form of saving.

Expenditures on residential construction edged up \$1.4 billion in the third quarter. Though this increase was a bit larger than that of the previous quarter, it remained well below the gains of the preceding year and a half. This apparent leveling-off in the growth of spending on residential structures, which had been widely anticipated, reflected a peaking-out in the rate at which new homes were begun in earlier months of the year. Since work progresses on a new housing unit for some time after construction is begun, expenditures tend to continue upward even after housing starts have turned downward. During the opening

three months of the year, housing starts soared to a new record, averaging 2.5 million units at a seasonally adjusted annual rate. While starts in each of the succeeding six months were below the first-quarter average, they remained quite strong by historical standards. In the third quarter, for example, the average number of housing units started was only 7 percent below that of the January-March period.

Business expenditures on fixed investment goods rose by \$1.9 billion in the third quarter, well below the \$4.3 billion increase averaged in the preceding nine months. Over the first three quarters of the year, these outlays have grown at a 14 percent seasonally adjusted annual rate, up from the 11.5 percent rise recorded in 1971. These expenditures data, moreover, understate somewhat the strengthening in the demand for fixed investment goods, as they usually do during an extended upswing. This arises because of the lags separating decisions to begin new investment projects, the initiation of work on these projects, and final completion of the projects. Quarterly data on capital appropriations and expenditures of the nation's 1,000 largest manufacturers collected by The Conference Board are available through the second quarter of this year. During the first half of the year, these companies expanded their net new appropriations at close to a 40 percent annual rate, adding substantially to the backlog of unspent appropriations. Similarly, Commerce Department data indicate that the growth in new orders for nondefense capital equipment has outpaced that of shipments of these goods over the first nine months of the year, and consequently the backlog of unfilled orders for these goods has risen. Recent survey data suggest that this substantial demand for fixed investment goods will extend into next year as well. The latest Lionel D. Edie & Company Inc. survey of intended plant and equipment spending in 1973 calls for a 10 percent increase above the 1972 level, while the McGraw-Hill survey indicates an 11 percent increase in expenditures planned for 1973.

Government purchases of goods and services contributed only \$2.5 billion to the rise in current-dollar GNP in the third quarter, the smallest gain in over a year. At the Federal level, a large decrease in defense spending swamped spending increases for other goods and services and fully accounted for the slowdown in total government expenditures. State and local governments, on the other hand, raised their expenditures by a sizable \$4.4 billion in the third quarter. The recent passage of revenue sharing may further bolster spending by state and local governments in coming quarters, though some Federal funds may be used to replace other financing by the local authorities and would not lead to additional spending.

PRICE DEVELOPMENTS

The various price indicators continue to show mixed—though, on balance, encouraging—results. In general, it appears that prices have been rising in recent months at much slower rates than during the period preceding the inauguration of the Economic Stabilization Program in August 1971. At the same time, however, there is no clear-cut evidence that inflation has lately slowed further from the rates that had prevailed earlier this year.

According to preliminary estimates, the implicit price deflator for total GNP advanced at a 2.2 percent seasonally adjusted annual rate in the third quarter. This rise was a bit higher than that registered in the preceding three-month interval, but it was still a considerable improvement over the experience of the past several years. However, the recent performance of the implicit price deflator understates to some extent the ongoing pace of inflation. During both the second and third quarters of this year, the composition of real output shifted toward goods whose prices have risen relatively slowly. While the GNP implicit deflator is constructed with current-quarter weights, the Department of Commerce also computes a fixed-weight price index for GNP based on the composition of real output in 1967. This fixed-weight price index rose at a higher 2.9 percent annual rate in the third quarter, though still slightly below the second-quarter pace and well under the increase of most recent years.

Consumer prices turned in a less encouraging performance in the third quarter. Indeed, in September, large increases in food and apparel prices combined to boost the total consumer price index at a 5.5 percent seasonally adjusted annual rate. Based on quarterly averages of monthly data, the consumer price index advanced at a 3.6 percent annual rate during the third quarter. This was higher than the rise in the preceding quarter or, indeed, in the year that ended with that quarter. A spurt in food prices accounted for much, though not all, of the acceleration.

Large increases in agricultural prices similarly pushed up wholesale prices at a faster rate in the third quarter than in the preceding three-month period. At the same time, however, the rate of rise in wholesale industrial prices eased somewhat. Based on quarterly averages, these prices rose at a 3.8 percent annual rate in the quarter, down almost 1 percentage point from the previous quarter's advance. For the most part, this slowdown was centered in prices of producers' durable equipment and of intermediate materials, excluding foodstuffs. This easing became even more pronounced in October when seasonally adjusted wholesale industrial prices were reported

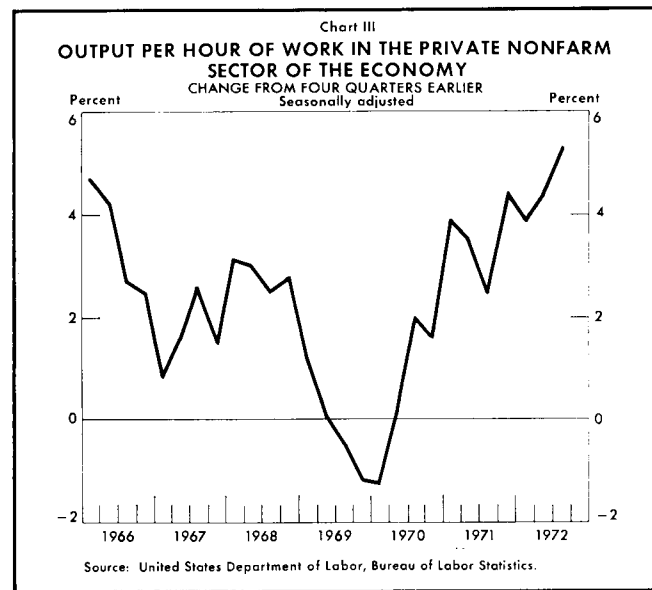
to have fallen at a 1.1 percent annual rate. A smaller than usual rise in new automobile prices along with a downward price adjustment for quality improvements in the new models accounted for the decline in the seasonally adjusted index of wholesale industrial prices. However, even excluding the prices of passenger cars, wholesale industrial prices still remained virtually unchanged in October. At the same time, there was only a small advance in wholesale agricultural prices on a seasonally adjusted basis, following several months of rapid increases.

WAGES AND PRODUCTIVITY

The rate of growth of wages was also relatively moderate in the third quarter. Within the private nonfarm sector of the economy, employee compensation per hour of work rose at a 5.9 percent seasonally adjusted annual rate in the July-September period. This advance was about equal to the average of the preceding three quarters and well below the growth rates experienced in recent years. Similarly, the mean first-year increase in wages and fringe benefits provided by new major contract settlements negotiated over the first nine months of the year, though still high at 8.5 percent, was considerably below the 13 percent mean rises recorded in 1970 and 1971.

Productivity in the private nonfarm sector turned in a strong performance in the third quarter, as seasonally adjusted output per hour of work rose at a 6.3 percent annual rate. This measure of productivity has been on a generally upward path since the beginning of 1970 (see Chart III). Over the last four quarters, output per hour of work has increased 5.3 percent. The third-quarter advance in productivity again outpaced the rise in compensation per hour of work, so that, for the second consecutive quarter, labor costs per unit of output in the private nonfarm sector registered a slight decline.

The pace of wage increases appears to have accelerated in the past two months. According to upward revised figures for September and preliminary data for October, average hourly earnings of nonsupervisory personnel in the private nonfarm sector, adjusted for overtime hours in manufacturing and for interindustry shifts in employment, rose at an 8.2 percent seasonally adjusted annual rate in these months. In contrast, the growth in these earnings had been an unexpectedly slow 3.5 percent annual rate between April and August of this year. While the September-October acceleration was widely distributed throughout the private nonfarm sector, the wage hikes of workers in both the services and the finance, insurance, and real estate categories were especially big,



exceeding 10 percent. However, even with this latest surge, the pace of wage increases has shown considerable moderation since wage controls were instituted. Thus, during the fourteen months since August 1971, average hourly earnings grew at a 6.2 percent annual rate, down almost a percentage point from the rate of growth experienced over the first eight months of 1971.

EMPLOYMENT

Further gains in employment were recorded in October. The poll of households conducted by the Bureau of Labor Statistics indicated that an additional 260,000 workers found employment in that month. While this was somewhat greater than the growth averaged in earlier months of the year, it was almost matched by an increase in the civilian labor force. As a result, the seasonally adjusted unemployment rate was unchanged in October at 5.5 percent. In its separate survey of employers, the Bureau of Labor Statistics found that employment in the private nonfarm sector expanded at a 5.3 percent annual rate in October, well above the 3.5 percent increase averaged over the first nine months of the year. In large part, this acceleration reflected the unusually rapid rise in manufacturing employment. At the same time, no change was reported in the workweek in either the manufacturing sector or the private nonfarm economy.

Monetary and Bank Credit Developments in the Third Quarter

The third quarter of 1972 was marked by somewhat faster growth of most monetary and bank credit aggregates than their generally moderate growth in the second quarter. Most notably, the narrowly defined money supply (M_1) surged upward early in July, inflating the growth rate for that month and for the quarter as a whole, even though only moderate growth was experienced in August and September. The acceleration in July of the growth of the broadly defined money supply (M_2) was much milder because a temporary slowing in the growth of the time deposit component partially offset the advances in the demand deposit component. The adjusted bank credit proxy, a measure of member bank liabilities subject to reserve requirements, advanced at about the same pace in this past quarter as in the first half of the year.

The growth of reserves available to support private non-bank deposits (RPD) accelerated during the quarter. A major source of this advance was the increase in borrowings from the Federal Reserve Banks. Borrowings had fallen to a very low level last December as the Federal funds rate dropped well below the discount rate. The Federal funds rate remained below the discount rate until the end of June, making it more attractive for commercial banks to borrow from one another than from the Federal Reserve Banks. In the third quarter, however, restraint on the growth of nonborrowed reserves placed upward pressure on the Federal funds rate, and banks turned increasingly to the Federal Reserve discount window to meet their growing reserve requirements.

Bank credit also advanced at an accelerated pace in the third quarter. However, an unusually low reading in June, which may have resulted more from seasonal adjustment problems than from any underlying weakness, probably exaggerates the acceleration. Even so, bank credit experienced a strong advance in the quarter. An unusually large increase in loans, particularly in August, was the major element in this strength. Investment growth was reduced by a sharp decline in holdings of United States Government securities.

Interest rates on short- and intermediate-term market instruments climbed during the third quarter, as indeed they have since February. Long-term rates, on the other

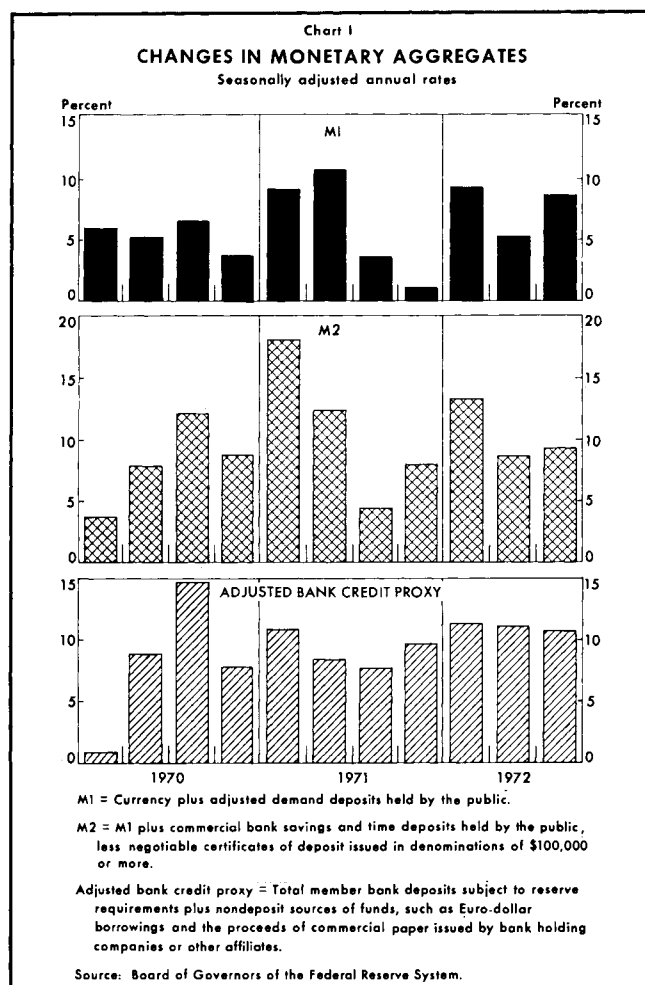
hand, continued the virtual stability that they have exhibited through most of the year. The stability of long-term interest rates in the face of higher short-term rates has resulted partly from the reduction in the rate of expansion of long-term debt this year relative to the record demands placed on the capital markets last year. Additionally, the considerable progress that has been made in moderating the pace of price increases during the past year may have reduced the inflation premium demanded by investors.

THE MONETARY AGGREGATES

The narrow money supply, M_1 —adjusted private demand deposits plus currency outside banks—grew at a sizable 8.5 percent seasonally adjusted annual rate in the third quarter of 1972 (see Chart I). Actually, most of the advance took place in the first two weeks of July when the money supply surged upward by nearly \$5 billion. After that bulge, the level of M_1 changed little during the remainder of the quarter. Seasonal adjustment problems around the midyear statement publishing date and Independence Day holiday may have exaggerated the early July growth in M_1 . Other factors that probably contributed to the increase in M_1 at that time were a temporary slowing of the advance of time deposits and an increase in Treasury disbursements which resulted in a transfer of funds from Treasury deposits at the Federal Reserve and at commercial banks (which are not included in M_1) to private deposits.

The sizable growth of M_1 in the third quarter, following the even more rapid advance in the first quarter and the moderate rise in the second quarter, resulted in a 7.8 percent annual rate of growth for the first nine months of 1972. This rate was almost the same as that of the first nine months of 1971. Last year, however, the fourth-quarter growth rate was a scant 1.1 percent. Consequently, over the twelve months that ended in September 1972, M_1 increased by a relatively moderate 6.2 percent.

M_2 —defined as M_1 plus time deposits other than large certificates of deposit (CDs)—grew in the third quarter at a 9.3 percent seasonally adjusted rate, only slightly

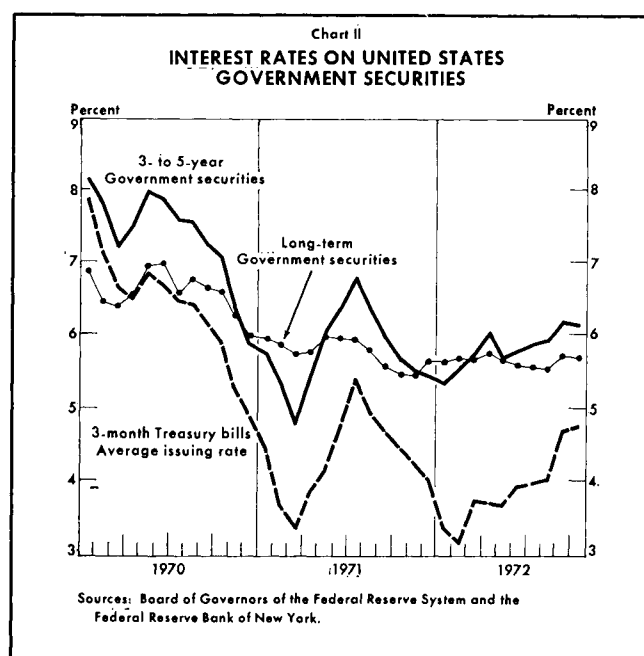


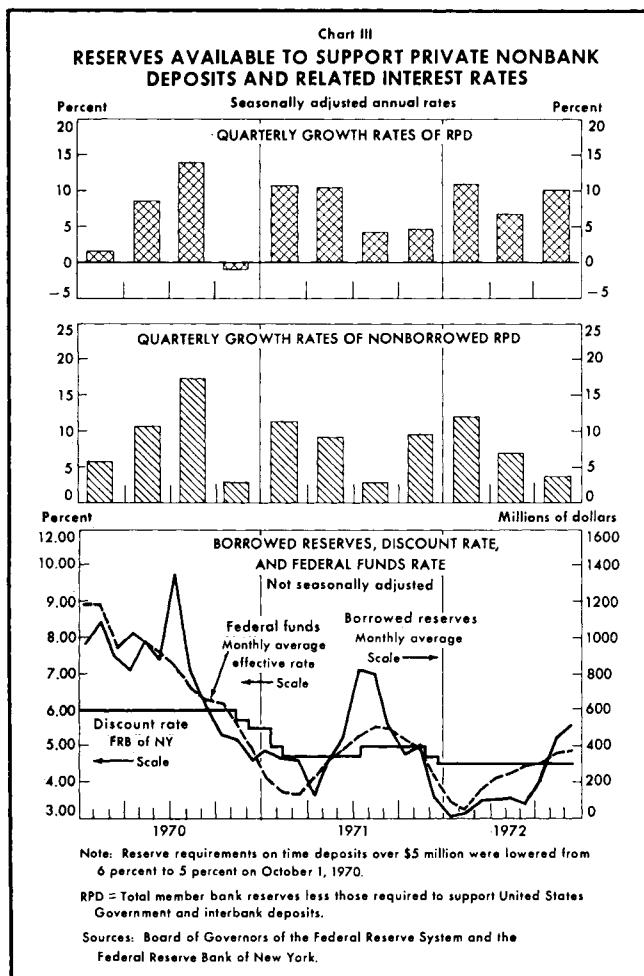
faster than the advance of the second quarter and significantly below the first-quarter pace. The growth of M_2 , like that of M_1 , slowed in August, reflecting the deceleration in demand deposit growth. The month-to-month variation in M_2 was less than that of M_1 , however, because fluctuations in time deposits other than large CDs partially offset the movements in demand deposits. The 10.1 percent annual rate of growth of small time and savings deposits in the third quarter represented a significant slowing from the rate of advance in the first half of the year, partly as a result of generally increasing short-term interest rates since February. Rates on three-month Treasury bills, for instance, had fallen from an average of 5.39 percent in July 1971 to 3.18 percent in February 1972. By September, they had climbed back to an average rate of 4.66 percent (see Chart II).

RPD also rose sharply in the third quarter, advancing

at a 10 percent seasonally adjusted annual rate compared with 7 percent in the second quarter (see Chart III). Total reserves, on the other hand, grew at a scant 3.6 percent rate, as reserves required against Treasury deposits declined. The sources of RPD changed as well. Banks increased their borrowings from the Federal Reserve in each month of the quarter. Borrowings jumped in part because the Federal funds rate increased from an average of 4.46 percent in June to an average of 4.87 percent in September. Therefore, it was frequently above the discount rate, which has remained at 4.50 percent since it was reduced last December. The increase in borrowings accounted for more than half of the advance in RPD in the quarter. The nonborrowed component of RPD—that is, RPD less borrowings from the Federal Reserve Banks—grew at a seasonally adjusted annual rate of only 3.8 percent in the third quarter, compared with 9.7 percent in the first half of the year.

The adjusted bank credit proxy, which is a measure of total member bank deposits subject to reserve requirements plus liabilities to foreign branches and bank-related commercial paper, has been growing at a fairly steady pace all year. It advanced at a 10.7 percent seasonally adjusted annual rate during the third quarter and at an 11.3 percent annual rate over the first nine months of 1972. While the increase in the entire series was about





the same in each quarter, the relative importance of its sources has varied. In the most recent quarter, the acceleration in demand deposits, combined with an increase in nondeposit liabilities, was counteracted by the slowdown in the growth of time deposits from the unusually brisk pace set earlier in the year. As indicated above, time and savings deposits other than large CDs grew slightly less in the third quarter than earlier in the year. Large CDs advanced at a rapid 35 percent annual rate, a slowdown only relative to the extraordinarily strong 44 percent rate of growth in the preceding quarter. While much of the expansion in these certificates in the second quarter occurred at banks outside New York City, recently the expansion has strengthened at New York banks. Banks have been bidding aggressively for these deposits for some time now as loan demand has improved.

BANK CREDIT

Total bank credit continued to advance rapidly in the third quarter of 1972. When adjusted for net loan sales to affiliates, it grew at a 13.7 percent seasonally adjusted annual rate in the three months ended in September, compared with a 12.8 percent rate in the first half of the year (see Chart IV). To an even greater extent than earlier, the growth of bank credit stemmed from strong demand for loans. Total loans adjusted for loan sales to affiliates advanced at an unusually fast 18.8 percent annual rate in the quarter, while total investments edged up at a 3.5 percent rate. This pattern of accelerating loan demand combined with sluggish growth in investments, particularly since the first quarter, is in sharp contrast to the pattern in 1971 when banks increased their investments much more than their loans. Such growing relative importance of loans in the banks' asset portfolios reflects the accelerated rate of economic recovery in 1972 after the relatively slow climb in economic activity during most of 1971.

The expansion in loans appears to have taken place in practically every category. Business loans advanced in the third quarter at a 12.8 percent annual rate after adjustment for loan sales to affiliates. In the first half of the year, business loans were generally increasing rapidly outside New York City but were relatively weak at New York City financial center banks. It is not unusual, however, for commercial loan demand at New York banks to pick up later than that in the rest of the country during a period of recovery from a recession. In July and August, commercial loan demand at the large New York City banks did begin to expand. However, loan demand again dipped at these banks in September, in part because corporations relied more heavily than usual on internal liquidity and less on bank loans to meet their September 15 tax obligations. Even the absence of a tax anticipation bill maturing in September did not seem to stimulate loan demand. On the other hand, large CDs fell by a record \$675 million at large New York banks in the week that included the tax payment date, indicating that maturing CDs were probably a significant source of funds for tax payments.

The prevailing prime rate at major New York City banks was raised from 5¼ percent in late June to 5¾ percent by the beginning of October, giving further indications of expanding commercial loan demand. However, most of the changes were initiated by banks with floating prime rates, suggesting that advances in market rates were at least as important as stronger loan demand in determining the prime rate increases. Most commercial paper rates, for instance, rose ¾ percentage point over the quarter.

Loans in several categories continued to expand at

roughly the same rates as in the first half of the year. Three categories—consumer loans, loans to nonbank financial institutions, and securities loans—actually accelerated from the already brisk paces set earlier. The latter two categories, of course, are subject to rather large month-to-month and even quarter-to-quarter variations but nonetheless have been exceptionally strong for the year as a whole. The growth of real estate loans slowed slightly from earlier in the year but nevertheless remained rapid.

The slow advance in bank investments reflected primarily the sharp declines in bank holdings of United States Treasury securities in both July and August. Treasury financing needs were considerably lighter in the third quarter than they had been in the corresponding year-earlier period because of a smaller deficit during the most recent

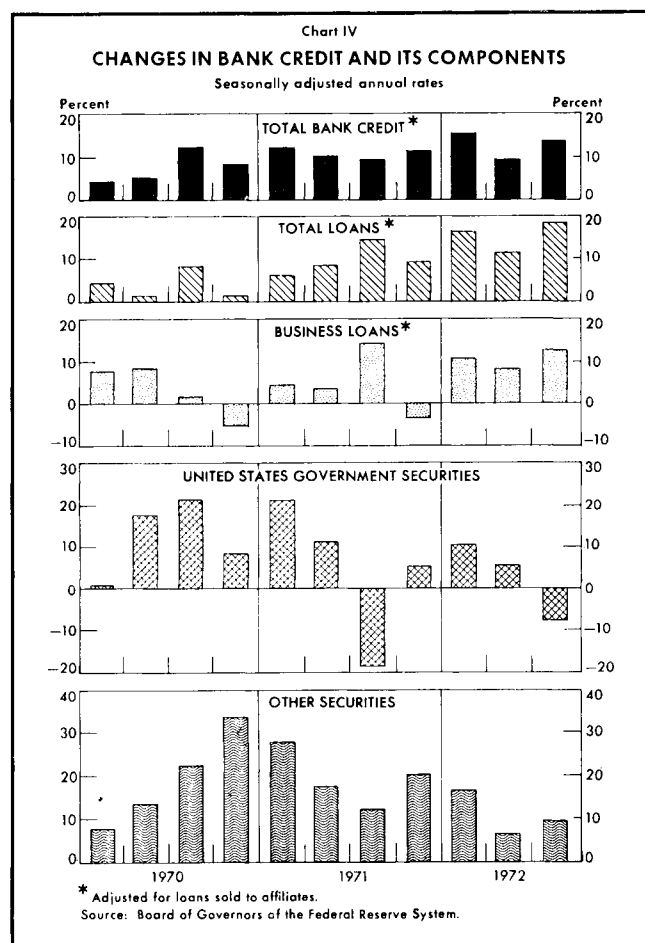
quarter and a higher initial level of balances in Treasury accounts. In 1971 an occasional dip in holdings of Treasury securities was usually overshadowed by a large increase in other securities, predominantly tax-exempt issues of state and local governments. This year, however, holdings of these securities have increased at a more moderate 11.2 percent annual pace, or about half of the 1971 growth rate. Yields on tax-exempt securities have remained relatively stable thus far this year despite the slowing in the rate of bank acquisitions of these issues.

THRIFT INSTITUTIONS

Funds flowed into thrift institutions in the third quarter at a slightly faster pace than that of the preceding quarter. The 15.6 percent seasonally adjusted annual rate of advance, however, remained below the extraordinary rates experienced in the first quarter of this year and during 1971. Some slowing in thrift deposit growth was to be expected because short-term interest rates have generally been increasing since February, while the interest paid on most types of thrift institution deposits has remained at the legal ceiling rates throughout the year.

Thrift deposits began to accelerate during the 1970 recession, and such savings have continued to expand rapidly throughout the recovery period. In fact, the most recent three-month period marks the eighth consecutive quarter that thrift deposits have grown at an annual rate in excess of 12 percent. Of course, thrift institution deposits have experienced strong rates of growth in the past. In the ten years from 1955 through 1965, for instance, these deposits increased at a compound annual rate of 10 percent. During the second half of the 1960's the rate slowed to about 6 percent, while over the two years ended in September the compound average growth rate was an unusually strong 15.7 percent.

Mortgage lending continued to expand at a very rapid pace in the third quarter, particularly at savings and loan associations where loans outstanding advanced at an 18.3 percent rate. Indeed, in the second and third quarters, mortgage credit actually rose at a somewhat greater pace than deposits at these institutions. At mutual savings banks, on the other hand, mortgages expanded at a more moderate 8.4 percent rate in July and August. This is in line with the pattern of the preceding year and a half when mortgage portfolios advanced at a 7.5 percent rate at mutual savings banks but at a 17.3 percent rate at savings and loan associations.



The Money and Bond Markets in October

Short-term interest rates changed little on balance during October. The rate on Federal funds fluctuated from week to week, averaging somewhat above the September level. Other short-term rates rose early in October, but some later retreated to the levels prevailing at the beginning of the month. Average member bank borrowings from the Federal Reserve Banks were little changed from September, while the monetary aggregates grew at relatively moderate rates.

Yields on Treasury securities were affected by plans for meeting the large cash needs of the Federal Government. After raising \$2 billion through an auction of notes early in October, the Treasury disclosed that it expected to need to raise an additional \$12 billion through the early weeks of January. Part of this need was met by the sale of \$3 billion of intermediate-term notes at the beginning of November. In addition, the Treasury began adding \$200 million to its weekly bill auctions starting on October 30. Rates on bills due within three months rose during most of the month, but those on longer term bills and coupon issues edged downward.

The bond market responded to increased diplomatic activity directed toward settlement of the Vietnam conflict, and prices edged higher. Underwriters encountered some investor resistance to higher prices, however. Sales of new corporate and municipal issues were slow in many cases, and dealer inventories increased substantially. Toward the end of the month, a more confident tone gradually emerged throughout the securities markets, and the rally gained momentum early in November.

BANK RESERVES AND THE MONEY MARKET

Money market conditions fluctuated irregularly during October. The average effective rate on Federal funds was 5.04 percent, up 17 basis points from the level in September. The supply of nonborrowed reserves was sufficient to meet the growth in required reserves over most of the month, and member bank borrowings from the Reserve Banks declined slightly to an average level of \$543 million in the four weeks ended October 25. Net borrowed reserves averaged \$323 million during this period (see

Table I), compared with \$332 million in the four preceding weeks. Reserves available to support private nonbank deposits (RPD) increased at an annual rate of 4 percent in October.

The money market tightened appreciably late in the first statement week of October, as some banks sought to cover accumulated reserve deficiencies. Federal funds traded as high as 6 percent on the settlement day, and banks borrowed heavily at the discount window. In the next two weeks, banks managed reserve positions more cautiously, but reserve deficiencies occurred again in the fourth statement week. These were run over the Veterans Day weekend and not covered until the weekly reserve settlement day, October 25. On that day, member bank borrowings from the Reserve Banks rose to a record \$3.2 billion and Federal funds traded up to 8 percent.

Most short-term interest rates moved irregularly higher early in October, but some declines were recorded in the final week of the month. The rate on 90- to 119-day commercial paper sold through dealers was raised $\frac{1}{8}$ percentage point in the first week of October but returned to a level of $5\frac{1}{8}$ percent at the end of the month (see Chart I). Rates on most other maturities of commercial paper were unchanged to $\frac{1}{8}$ percentage point higher, while those on bankers' acceptances were raised by $\frac{1}{4}$ percentage point. Two large banks with floating prime lending rates linked to the cost of funds raised their rates $\frac{1}{8}$ percentage point to $5\frac{7}{8}$ percent, effective October 16. The rest of the industry, however, retained the $5\frac{3}{4}$ percent rate established at the beginning of the month, and the banks with floating prime rates returned to that level early in November.

According to preliminary estimates, the narrowly defined money supply (M_1)—adjusted private demand deposits plus currency outside banks—increased at a seasonally adjusted annual rate of about 5 percent during the three months ended in October (see Chart II). This was markedly below the rate of growth of M_1 over the third quarter, which had been inflated by an unusually sharp rise in July. Over the twelve months that ended in October, M_1 grew by a relatively moderate $6\frac{1}{2}$ percent.

The growth of the broad money supply (M_2)—defined as M_1 plus time deposits at commercial banks other than

large negotiable certificates of deposit (CDs)—continued in October at about the same pace as in the two preceding months. This brought the growth rate of M_2 to about 8 percent over the three months ended in October and to 10 percent over the twelve months ended then.

The adjusted bank credit proxy—which consists of daily average member bank deposits subject to reserve requirements and certain nondeposit liabilities—also advanced in October at roughly the same pace as in the two preceding months. For the three-month period ended in October, the growth rate of the adjusted proxy was about 10 percent. Over the past twelve months, the adjusted proxy rose by 11½ percent.

On October 24, the Board of Governors of the Federal Reserve System announced that the amendments to Regulations D and J would be put into effect beginning November 9.¹ Implementation had been scheduled for September 21 but was delayed by court action. On October 19, however, the United States District Court for the District of Columbia denied a motion for a preliminary injunction sought by some nonmember banks. The new effective date was selected in order to give commercial banks time to make necessary adjustments to the revised regulations. The net release of reserves will occur in phase with seasonal reserve needs. The change in Regulation D, which restructures reserve requirement ratios, is expected to reduce member bank required reserves by about \$3½ billion in two steps. The change in Regulation J, which governs the payment schedule for users of Federal Reserve check-clearing facilities, is expected to withdraw about \$2 billion from the reserves of the banking system. The revisions are intended to be neutral with respect to monetary policy.

THE GOVERNMENT SECURITIES MARKET

Yields on Government securities responded to varied pressures during October. Treasury decisions about the timing and methods of finance affected rates on shorter term issues, which ended with mixed changes. Persistent rumors of progress in the Vietnam peace negotiations encouraged optimism on the part of dealers and investors, and prices of most coupon issues rose over the month.

Market rates on short-term Treasury bills rose sharply at the beginning of October. Part of this movement was

caused by uncertainty about the Government's financing plans. Dealers attempted to reduce inventories of outstanding bills to prepare for a possible increase in the

Table I
FACTORS TENDING TO INCREASE OR DECREASE
MEMBER BANK RESERVES, OCTOBER 1972

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

Factors	Changes in daily averages— week ended				Net changes
	Oct. 4	Oct. 11	Oct. 18	Oct. 25	
"Market" factors					
Member bank required reserves	- 485	+ 149	- 635	+ 584	- 387
Operating transactions (subtotal)	- 287	- 508	+ 833	- 722	- 684
Federal Reserve float	- 372	+ 227	+ 840	- 25	+ 670
Treasury operations*	+ 287	- 188	+ 490	- 427	+ 162
Gold and foreign account	+ 6	-	- 7	- 22	- 23
Currency outside banks	- 75	- 493	- 571	- 199	-1,338
Other Federal Reserve liabilities and capital	- 133	- 54	+ 81	- 49	- 155
Total "market" factors	- 772	- 359	+ 198	- 138	-1,071
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 993	+ 337	- 428	- 180	+ 716
Outright holdings:					
Treasury securities	+ 558	+ 620	- 269	- 379	+ 530
Bankers' acceptances	+ 4	+ 7	+ 1	+ 1	+ 13
Federal agency obligations	- 8	- 11	-	- 1	- 20
Repurchase agreements:					
Treasury securities	+ 384	- 269	- 115	+ 181	+ 181
Bankers' acceptances	+ 28	- 3	- 25	+ 10	+ 10
Federal agency obligations	+ 27	- 7	- 20	+ 2	+ 2
Member bank borrowings	- 114	+ 99	- 102	+ 334	+ 217
Other Federal Reserve assets†	+ 86	+ 52	+ 83	+ 66	+ 287
Total	+ 965	+ 487	- 447	+ 213	+1,218
Excess reserves	+ 193	+ 128	- 249	+ 75	+ 147
<hr/>					
	Daily average levels				Monthly averages
<hr/>					
Member bank:					
Total reserves, including vault cash	33,731	33,710	34,096	33,587	33,781‡
Required reserves	33,501	33,352	33,987	33,403	33,561‡
Excess reserves	230	358	109	184	220‡
Borrowings	436	535	433	767	543‡
Free, or net borrowed (-), reserves.....	- 206	- 177	- 324	- 583	- 323‡
Nonborrowed reserves	33,295	33,175	33,663	32,820	33,238‡
Net carry-over, excess or deficit (-)§.....	44	107	183	68	101‡

Note: Because of rounding, figures do not necessarily add to totals.

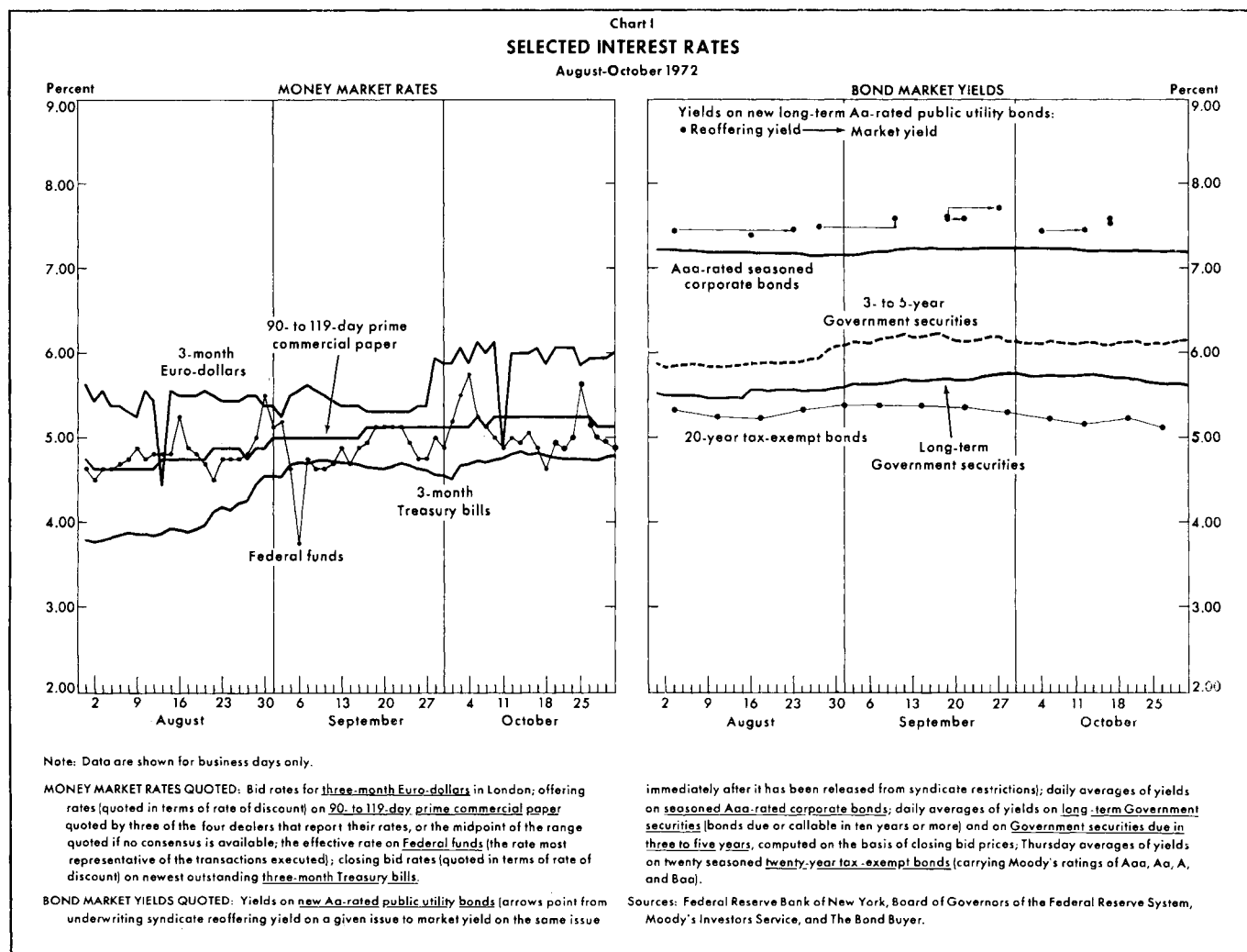
* Includes changes in Treasury currency and cash.

† Includes assets denominated in foreign currencies.

‡ Average for four weeks ended October 25.

§ Not reflected in data above.

¹ A summary of the amendments to Regulations D and J appeared in this *Review* (July 1972), page 154. For a discussion of the issues involved, see this *Review* (August 1972), pages 201-7.



supply of new issues. On October 5, the Treasury announced the sale at auction of \$2 billion in 6 percent notes maturing on September 30, 1974. This decision removed immediate supply pressure from the bill sector, but lack of investor interest pushed rates on short-term bills higher over most of the month.

Investor behavior also influenced the results of the weekly bill auctions. The average issuing rate on new three-month bills rose from 4.60 percent on October 2 to 4.82 percent on October 16 (see Table II). At the next auction, advanced to October 20 because of the Veterans Day holiday, the rate declined. However, this movement was reversed after the Treasury announced, on October

24, plans to increase offerings of new three- and six-month bills by \$100 million each. The first such increment was sold at the October 30 auction, and the average issuing rate on the three-month bills was 4.77 percent, 13 basis points higher than at the end of September.

Market yields on longer maturities of Treasury bills edged lower during most of October, and this pattern was little affected by the announcement of new supplies. At the regular monthly auction, the average issuing rate on the 52-week bill was 5.32 percent, 21 basis points below the rate set in the previous month.

The auction of the two-year notes was held on October 11. It represented the second recent action by the Treasury

to raise new cash, and a favorable response by investors produced an average issuing rate of 5.86 percent. Commercial banks were permitted to pay in full for their awards by crediting Treasury Tax and Loan Accounts and therefore bid aggressively. The Treasury contemplates further issues of two-year notes, timed to mature at quarterly intervals.

On October 25 the Treasury announced the terms of its November financing. In accordance with this plan, an additional \$3 billion of 6¼ percent notes maturing November 15, 1976 was sold at auction on November 1. Aggressive bidding produced an average yield of 6.20 percent. Payment will be made on November 15, and \$1.3 billion of the proceeds will be used to pay off notes maturing on that date. Commercial banks were permitted to pay for up to 75 percent of accepted tenders by credit to Treasury Tax and Loan Accounts. This auction provided one quarter of the \$12 billion that the Treasury expects it will need to raise through early January. The \$200 million weekly addition to the bill auctions will also fill part of the Treasury's cash needs. In addition, the Treasury indicated that it expects to sell about \$2 billion more of notes in December or early January and that at least the bulk of its remaining near-term cash needs will be met by sales of tax anticipation bills maturing in April and June 1973.

Government agency financing was quite active during October. The pricing of many of the issues offered competitively was somewhat aggressive in relation to market appetites. For example, \$225 million of Government-guaranteed bonds of the Washington Metropolitan Area Transit Authority, D.C., sold slowly when reoffered on October 10 to yield 7.30 percent. One week later, a \$150 million issue of Tennessee Valley Authority bonds priced to yield 7.37 percent also encountered a cool reception from investors. However, both issues eventually sold out and rose to slight premiums when the underwriting syndicates disbanded late in the month. During the week of October 30 to November 3, the General Services Administration auctioned a total of \$196.6 million of thirty-year participation certificates in five segments to finance construction of Federal buildings in various cities. The issues, which are guaranteed by the Federal Government, were well received at declining yields ranging from 7.40 percent to 7.19 percent.

OTHER SECURITIES MARKETS

Prices of corporate and municipal securities were greatly affected during October by the prospects for a Vietnam settlement. Dealers raised prices when the political outlook improved and made some reductions when

peace negotiations seemed stalled. The calendar of new issues was moderately heavy, but the near-term supply appeared to be small. Underwriters were therefore willing to retain the inventories left by selective investor demand.

The market opened the month at the end of one rally based on rumors of progress toward peace. The first A-rated utility bond was reoffered on October 4 to yield 7.45 percent. This was about 15 basis points below the return established in September, and initial sales were slow. When the issue was released from syndicate on October 12, its yield rose 4 basis points. One week later, comparable issues were priced to yield 7.54 percent and 7.60 percent. Their reception was better, reflecting both the higher returns and the effects of renewed diplomatic activity.

These developments and a lighter calendar encouraged the aggressive pricing of a new telephone debenture rated Aaa by one service and AA by another. On October 24,

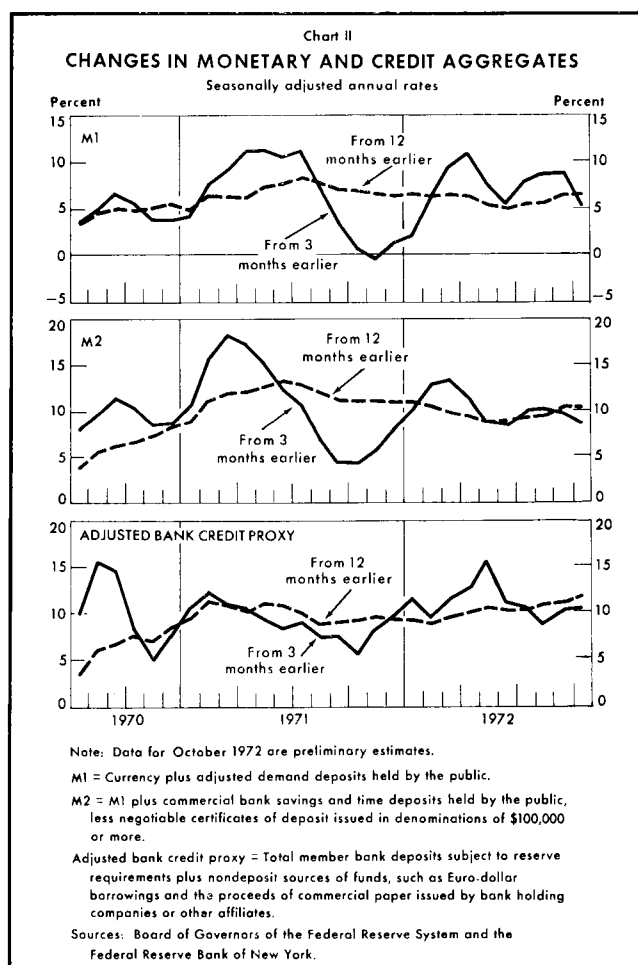


Table II
AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates — October 1972				
	Oct. 2	Oct. 6	Oct. 16	Oct. 20	Oct. 30
Three months	4.601	4.743	4.818	4.712	4.767
Six months	5.082	5.159	5.127	5.105	5.141
	Monthly auction dates — August-October 1972				
	Aug. 24	Sept. 26	Oct. 24		
Nine months	5.040	5.346	5.223		
Fifty-two weeks	5.178	5.529	5.318		

*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 issue was reoffered to yield 7.40 percent. Its reception was cool, since this was about 3 basis points below the returns obtainable on similar securities in the secondary market. However, this issue and several other slow-moving offerings sold out and rose to a premium in the early-November rally.

Prices of seasoned tax-exempt securities rose on balance over the month. The Bond Buyer index of twenty municipal bond yields declined from 5.30 percent on September 28 to 5.13 percent on October 26 and then fell further to 5.04 percent on November 2. The month's largest municipal bond flotation occurred on October 11, when New York City sold \$304 million of bonds at a net interest cost of 5.74 percent. Although the cost was well below the 6.17 percent the City paid last July, the bonds sold out quickly. As offering yields declined, sales of other new issues slowed during the month and the Blue List of advertised inventories increased by a substantial \$306 million over the month to \$922 million.

Subscriptions to the **MONTHLY REVIEW** are available to the public without charge. Additional copies of recent issues may be obtained from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045.

Persons in foreign countries may request that copies of the **MONTHLY REVIEW** be sent to them by "air mail-other articles". The postage charge amounts to approximately half the price of regular air mail and is payable in advance. Requests for this service and inquiries about rates should be directed to the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045.

Publications of the Federal Reserve Bank of New York

Distribution and charge policy: The following selected publications are available from the Public Information Department. Except for periodicals, mailing lists are not maintained for these publications.

The first 100 copies of the Bank's general publications and the first copy of its special publications are free on reasonable requests. Additional copies of general and special publications are free on reasonable requests for educational purposes to certain United States and foreign organizations. United States: schools (including their bookstores), commercial banks, public and other nonprofit libraries, news media, and Federal Government departments and agencies; foreign: central government departments and agencies, central banks, and news media. (Such additional free copies will be sent only to school, business, or government addresses.) Other organizations are charged for copies exceeding normal limits on free quantities (prices are listed with the publications).

Remittances must accompany requests if charges apply. Delivery is postpaid and takes two to four weeks. Remittances must be payable on their faces to the Bank in United States dollars collectible at par, that is, without a collection charge.

GENERAL PUBLICATIONS

MONEY: MASTER OR SERVANT? (1971) by Thomas O. Waage. 45 pages. A comprehensive discussion of the roles of money, commercial banks, and the Federal Reserve in our economy. Explains what money is and how it works in a dynamic economy. (15 cents each if charges apply)

GLOSSARY: WEEKLY FEDERAL RESERVE STATEMENTS (1972) 24 pages. A line-by-line explanation of the terms appearing in selected statistical releases of the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York. First of three sections. (20 cents each if charges apply)

SPECIAL PUBLICATIONS

ESSAYS IN DOMESTIC AND INTERNATIONAL FINANCE (1969) 86 pages. A collection of nine articles dealing with a few important past episodes in United States central banking, several facets of the relationship between financial variables and business activity, and various aspects of domestic and international financial markets. (70 cents each if charges apply)

THE VELOCITY OF MONEY (1970, second edition) by George Garvy and Martin R. Blyn. 116 pages. A thorough discussion of the demand for money and the measurement of, influences on, and the implications of changes in the velocity of money. (\$1.50 each if charges apply)

CENTRAL BANK COOPERATION: 1924-31 (1967) by Stephen V. O. Clarke. 234 pages. A documented discussion of the efforts of American, British, French, and German central bankers to reestablish and maintain international financial stability between 1924 and 1931. (\$2.00 each if charges apply)

MONEY, BANKING, AND CREDIT IN EASTERN EUROPE (1966) by George Garvy. 167 pages. A review of the characteristics, operations, and changes in the monetary systems of seven communist countries of Eastern Europe and the steps taken toward greater reliance on financial incentives. (\$1.25 each if charges apply)