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Prospects and Problems for Monetary Policy

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An address before the forty-fifth annual midwinter meeting of the New York State Bankers Association in New York City on January 22, 1973.

Once again it is a pleasure for my associates and me to meet with our good friends of the New York State Bankers Association and to have this opportunity to exchange views on matters of mutual interest. I recall that when I saw you a year ago we were hopeful that 1972 would show substantial economic improvement over the preceding year. Clearly that hope has been fulfilled, and I think we can look forward to another year of substantial progress, although we shall still have plenty of difficult problems to wrestle with.

Before taking a closer look at the current economic and financial scene, I would like to spend a few moments on some matters having to do with the payments mechanism. A recent development in that area of considerable importance to the banking system was the change in Regulation J requiring payment for checks in immediately available funds on the day of presentment—a change which became effective November 9 of last year. The revision in the regulation has caused banks to give us a substantially larger volume of checks to collect for them. As a result, we experienced some transitional problems, and our transit service to our member banks dropped well below the standards of efficiency and speed that we have tried to maintain. Most of these difficulties are now behind us, I hope, and the banks and their customers are benefiting from earlier payment for checks received and from earlier knowledge of unpaid items.

We have also completed the conversion of the Clearing Bureau on Long Island to a full-fledged Regional Check Processing Center (RCPC), thus improving the payments system in that area. We are working with a committee of the Long Island Bankers Association on a study of establishing an Automated Clearing House, which would enable the banks there to reduce the volume of paper by using magnetic tape. They could then explore the feasibility of payroll deposit, point-of-sale terminals, and other SCOPE-type activities as market demands may suggest. As many of you know, our Buffalo Branch serves as a regional check center, processing and collecting overnight items drawn on all the banks in the Branch territory. In New Jersey, we are establishing a North Jersey RCPC; among the benefits to banks in New York State will be a much later deposit deadline and faster return of unpaid items.

Our next step, for which the analysis and planning are under way, will be the establishment of a regional check center in upstate Head Office territory. A preliminary study of check volume and flows, of transportation routes, and of available labor supply suggests that the center may be located in the vicinity of Utica, but it's still too early to be sure. As soon as we complete our study, and receive the suggestions of an advisory committee of bankers in the area affected, we will make an announcement of the place and the time we expect to begin operations.

As you can see, significant changes are taking place in the payments system. These changes will have important effects on the way banks and their customers do business, effects that will play a part in shaping the banking structure of the state.

Now I would like to offer a few comments on the state of the economy and some of the problems on the horizon for monetary policy. The present business situation is marked by considerable strength, with the economic expansion showing substantial forward momentum on virtually all fronts. Moreover, there is every prospect that this momentum will be sustained through this year. It is reasonable to expect some slowing in the current rapid rate of advance after mid-1973, although this becomes more uncertain as business optimism spreads. On this score, the achievement of peace in Vietnam could exert a stimulative influence on economic activity.

Employment has been growing very rapidly, and unemployment should drop further, although large increases in productivity and in the labor force may make progress here fairly slow.

Since 1965 inflation has been the most stubborn economic problem the nation has faced, but here too we have seen real progress in the past year. Wage and price increases moderated somewhat during 1972, and inflationary expectations were reduced. Moreover, the Administration is mindful of the fact that the anti-inflation fight is "unfinished business", and it is aware of the dangers that could lie ahead in the way of excessive stimulus from the Federal budget deficit.

Liquidity is ample, both among individuals and in the corporate sector, as well as in the banking system. Thus conditions are favorable for consumer buying and business investment, and the fears in some quarters of a credit "crunch" have receded in the face of credit demands that are likely to be manageable, partly reflecting this ample liquidity position. I would hope that this relatively well-balanced credit situation will continue. There is no cause for complacency, however. While rapid money and credit growth earlier in 1972 gave way to more desirable moderate gains in the late summer and fall, over the past month or so the rates of increase in the aggregates have again stepped up. Of course, the changes made last November in Regulations D and J have made it unusually difficult to interpret the data on aggregates since then, but the developing situation bears close watching.

As might be expected in a period of vigorous economic expansion, short-term interest rates tended gradually higher through much of the past year, with some more rapid increases toward the year-end and in early 1973. In recognition of this development the Federal Reserve System a week ago raised the discount rate ½ percentage point to 5 percent. Long-term rates, on the other hand, were notably steady through most of the year, doubtless in good part because of a lessening of inflationary expectations as well as some moderation in the demands for funds in the capital markets.

Faith in the dollar in international markets, while by no means fully restored, has improved markedly over recent months—primarily, I believe, because of the much better record in this country than abroad in combating inflation, but also as a result of the renewed spirit of economic cooperation among the major industrial nations.

On balance, I have probably painted a rather rosy picture so far; but like all central bankers I am paid to worry, and there are enough problems on the horizon to banish any feeling of complacency:

(1) Unemployment, even if reduced to less than 5 percent over the coming year, will remain sufficiently high to constitute a serious social problem and a source of strong continuing pressure for remedies. This will be true especially because of the very uneven distribution of unemployment by race, age, and geographic area. But this uneven distribution itself is one of the reasons why it is difficult to accept the popular notion that the remedy is to be found largely through expanding aggregate demand. Such a solution would be particularly dangerous as the use of resources approaches capacity and bottlenecks begin to show up in specific industries. The official goal of 4 percent unemployment originally set back in the early 1960's still commands widespread allegiance, despite the fact that changes in the age and sex distribution of the labor force would suggest a rather higher figure now if in fact 4 percent was appropriate a decade ago. Indeed, in the light of the experience of recent years, and given the present structure of the economy, it is clear that maintenance of a noninflationary environment at a 4 percent overall unemployment rate is not an easy matter. To say this is by no means to concede that the nation must passively accept socially undesirable levels of unemployment. It does mean, however, that much more vigorous and imaginative efforts are needed to attack "structural" unemployment through more efficient fitting of available workers to available jobs, better training, and perhaps measures such as modification of minimum wage requirements for young workers. Such reforms would provide much greater hope for a sustained reduction in unemployment than would excessive monetary stimulation leading to chronic inflation.

(2) The Federal deficit for fiscal 1973 seems to carry considerable risk of too much stimulus at a time when private demand is climbing rapidly and when unused resources, especially those of skilled labor, will probably be approaching a minimal level. The Administration is pledged to holding Government spending this fiscal year at or close to $250 billion, and I fully support that aim. Especially serious is the longer range budgetary outlook, because the automatic growth of existing programs—let alone any new spending commitments—will generate sizable increases in spending for the next several years. A reappraisal of national priorities to avoid straining our resources is overdue. Of course a reduction in military outlays would provide some room for important social programs, but I have no idea whether this is a likely

development. And it may well be that higher Federal taxes, reversing the trend of recent years, will have to come if we are to meet essential social needs and at the same time to escape a new cycle of escalating inflation and financial strains, with which monetary policy would find it difficult, if not impossible, to cope.

(3) Another significant uncertainty has to do with the effectiveness of the wage-price control program in Phase Three. I was heartened by the basic decision of the Administration to retain controls, and am hopeful that the program will bring further progress in dampening the forces of inflation. It has been my view right along that we should "play the string out" and maintain firm restraints until price and wage increases and inflationary expectations have been brought down to acceptable levels. Otherwise we may find that the past year's achievements in the way of dampening inflationary tendencies will simply have been thrown away, as demand pressures gather momentum. The prospect of a large number of major labor negotiations this year itself suggests the need for continuing surveillance. Of course no system of controls can be effective if aggregate demand pressures are allowed to get out of hand.

(4) The growth of bank loan commitments at a time when lending volume is already high is an area of concern that has important implications for System supervisory and monetary policy. Information that we have suggests that outstanding loan commitments to commercial and industrial firms at many banks have been expanding rather sharply. I recognize that it is natural for banks to expand their loan commitments during an economic recovery such as we have witnessed in the past two years. Yet, the ratio of unused commitments to total loans at many banks is probably high by historical standards, at a comparable stage of the business recovery.

Given the strength of business activity that we are likely to witness in coming months, we can expect to see some increase in the rate of borrowing against these commitments. Indeed, a number of bankers have indicated that they believe takedowns will accelerate over the course of 1973. While such a development may not be cause for concern, clearly an unexpected surge in the use of outstanding commitments could pose liquidity problems for some banks. Moreover, the efforts by banks to obtain funds to meet these commitments—as well as to accommodate other demands for credit—could create strains and pressures on financial markets. For this reason, we are focusing increasing attention on the volume of loan commitments extended by individual banks in relation to their ability to meet potential demands for funds.

I would add that restraint by the management of individual banks in extending loan commitments could serve to head off pressure for specific regulatory measures in the deposit or loan markets, and might also pave the way for removal of some of the existing constraints. I have indicated on numerous occasions that I would like to see the complete removal of Regulation Q ceilings on large-denomination certificates of deposit. Certainly, it would be easier to remove the ceilings if the System were confident that a scramble by banks for funds to meet loan commitments would not result in a sharp escalation of market rates. I think you will agree that self-restraint by bank managements in granting loan commitments is preferable to interest rate ceilings and other types of regulatory actions.

(5) Finally, current popular and political attitudes toward interest rates must give us pause. As I said earlier, pressures in the financial markets in recent months have been gratifyingly moderate. However, as the business expansion continues, it would be natural to expect increasing credit demands. Under such conditions, if the Federal Reserve acted to limit credit and money supply growth to a moderate pace, that might necessarily involve higher interest rates. If boom conditions develop, higher interest rates would have useful effects in themselves in providing a dampening influence on excessive spending.

Central bankers are not enamored of high or low interest rates as such. They are enamored, however, of rates that are free to fluctuate up as well as down to reflect underlying economic and financial conditions and an appropriate measure of credit availability. What is too often overlooked is that interest rates, because they fulfill this pervasive and essential overall economic function, are quite distinct from costs or prices of goods, services, and labor. Naturally certain interest rates are very significant costs to individuals as well as to corporations and governments. But if rising interest rates are regarded under all conditions as merely another sign of inflation and are opposed for that reason, their value as an equilibrating and moderating influence can be vitiated. There are situations when stable interest rates conflict with price stability. I am impressed by the wisdom of the Committee on Interest and Dividends in resisting pressures to subject interest rates in highly competitive financial markets to the same kind of control program that was applied to prices and wages. Perhaps it would be well to remember, too, that interest rates are unlike almost all wages and prices in that the latter tend to rise and seldom come back down to their earlier levels, whereas interest rates clearly move on a two-way street. This fact in itself should give comfort to those who find it hard to accept the usefulness of rising rates at a time of rapid economic expansion.

Another area in which interest rates can have significant effects is that of international flows of funds and the balance of payments. When we talk of better coordination of national monetary policies to help achieve a more stable international financial system, this means some degree of willingness to let comparative levels of interest rates among industrial nations have some influence on national monetary policy when domestic considerations permit. While domestic factors require high priority, this international aspect cannot be overlooked if monetary policy is to live up to its full potentialities.

I am quite aware that widespread antagonism to high or rising interest rates is a fact of life under almost any conditions, and of course especially during a period when wages and prices are subject to Governmental restraints. As I have already indicated, I think it is incumbent on all of us to make the wage-price program work. In these circumstances the exercise of responsible self-restraint by lenders with respect to interest rate increases is especially desirable. Bankers generally seem to have recognized the force of this argument.

Nevertheless, I believe that all of us who are deeply interested in the economy's functioning would do well to set as one of our primary long-run objectives an educational effort to persuade the public and political leaders that interest rates play a rather special role in the economy. Unless we succeed in making progress on this front, it will become increasingly difficult to maintain a soundly functioning central bank; and to the extent that monetary policy were impaired, the nation would be sacrificing its most effective and flexible tool for achieving the overall economic goals to which we all subscribe.

The Business Situation

The latest business indicators provide further confirmation that the domestic economy has expanded vigorously in virtually every sector in recent months. Real gross national product (GNP) surged ahead at a very rapid 8.5 percent annual rate in the fourth quarter, with both consumption and investment spending increasing sizably. Moreover, a recent Department of Commerce survey indicates a further acceleration in business investment in 1973. Industrial production increased strongly in December on the heels of even larger earlier gains. In view of the high rate of new orders for durable manufactured goods and the persistent rise in unfilled orders, further strong advances in output appear likely in the coming months. The unemployment rate declined in January to 5 percent, its lowest point in two and a half years, and further improvement appears likely.

The outlook for prices, on the other hand, is clouded by several factors. The effectiveness of the largely voluntary controls under Phase Three of the Economic Stabilization Program is yet to be tested. Consumer prices advanced only modestly in December, but prices of farm products and processed foods and feeds exploded at the wholesale level and it is likely that these increases will ultimately be passed on to the consumer. The fixed-weight price deflator for total GNP rose at a 3.4 percent annual rate in the fourth quarter. While still moderate, this was a more rapid rise than that experienced over the preceding six months. Recent compensation data suggest that there has been some acceleration in wage increases as well which, together with the large increase in social security taxes effective this year, could exert upward pressure on prices in coming months.

GROSS NATIONAL PRODUCT AND RELATED DEVELOPMENTS

According to preliminary estimates from the Department of Commerce, the market value of the nation's output of goods and services rose $31.8 billion to a seasonally adjusted annual rate of $1,195.8 billion in the fourth quarter of 1972. After adjustment for changes in the price level, real GNP expanded at a sharp 8.5 percent annual rate. Since the last quarter of 1971, real output advanced at an extremely rapid 7.7 percent rate, the fastest four-quarter increase in more than six years (see Chart I).

Tentative and incomplete data indicate that the advance in the rate of inventory spending contributed $2 billion to the growth of GNP in the fourth quarter (see Chart II), as inventory accumulation reached a $10 billion annual rate, its highest in five years. Notwithstanding this marked pickup in inventory spending, the ratio of inventories to sales for all business continued to fall in November, the latest month for which data are available, suggesting that further strengthening in this area may be in the offing.

The fourth-quarter rise in current-dollar final expenditures—GNP net of inventory accumulation—amounted to a substantial $29.8 billion, an annual rate of increase of over 10 percent. Among the components of final expenditures, consumer purchases and business fixed investment spending were particularly robust. State and local government purchases of goods and services also contributed strongly to boosting final demand.

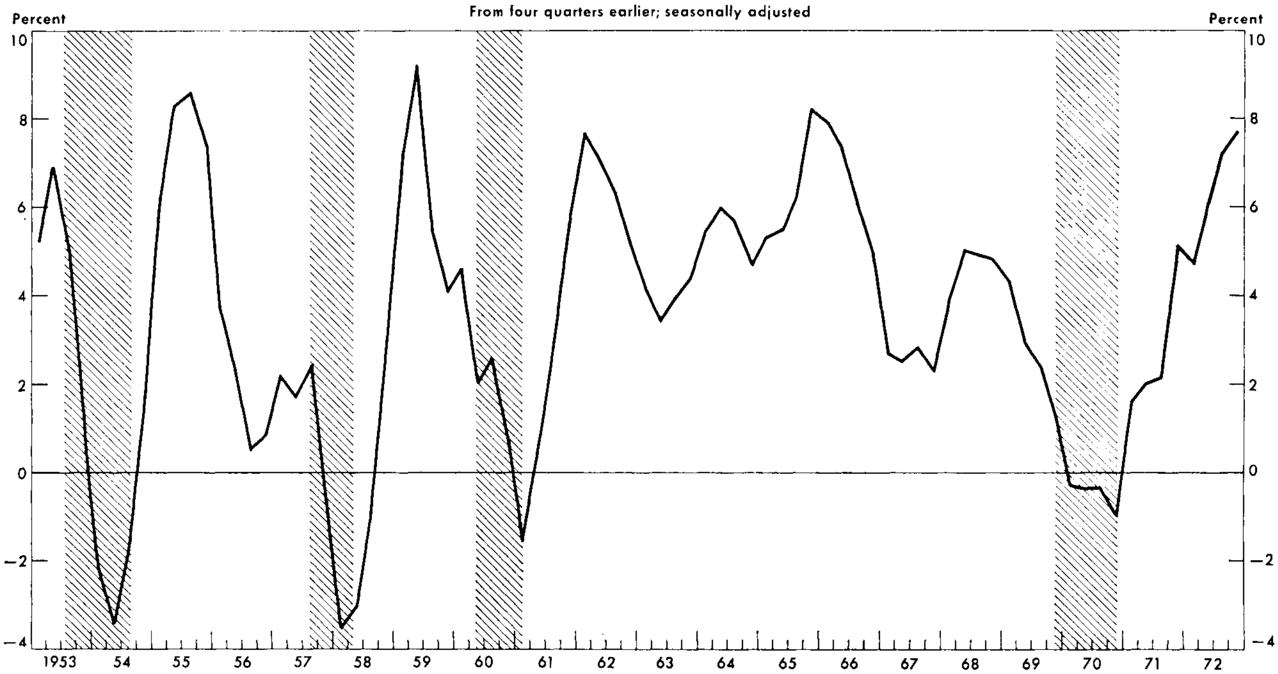
Personal consumption expenditures rose by a substantial $17.6 billion during the fourth quarter. The more than 9.5 percent growth of consumption over the year had not been matched since 1968. Outlays for nondurable goods and services posted strong gains in the final quarter, while the gain in durable goods spending moderated somewhat as the increase in unit sales of domestic and imported automobiles was less ebullient than during the July-September period.

The vigorous fourth-quarter expansion in consumer spending was accompanied by an unusually large $34.4 billion increase in personal income. However, the fourth-quarter jump stemmed in part from several nonrecurring factors, including the 20 percent increase in social security benefits which became effective in October and the substantial addition to railroad retirement and veterans' educational benefits in November. But, even if all trans-

Chart I

PERCENTAGE CHANGES IN REAL GROSS NATIONAL PRODUCT

From four quarters earlier; seasonally adjusted



Note: Shaded areas represent recession periods, according to the National Bureau of Economic Research chronology. The dates of the 1969-70 recession are tentative.

Source: United States Department of Commerce, Bureau of Economic Analysis.

fer payments are excluded from the third- and fourth-quarter totals for 1972, personal income still grew by a rapid $23.6 billion in the final quarter. Increases in wage and salary payments remained the cornerstone of this advance as a result of further gains in employment, earnings, and hours. Farm income also expanded rapidly in the last two months of 1972. The rate of savings out of disposable income jumped from 6.4 percent in the third quarter to 7.5 percent, thus reversing the generally lower trend shown by the savings rate earlier this year. Probably the fourth-quarter rise reflected the unusually large size of the increase in disposable income, since consumers generally seem to require some time to adjust consumption patterns to sudden advances in income. Nevertheless, because of the substantial tax refunds expected in the first half of 1973 as a result of the overwithholding of personal income taxes last year, the savings rate may well remain close to this level or climb somewhat further in the quarters immediately ahead.

Business fixed investment grew by $4.9 billion in the fourth quarter, with the gain divided between expenditures for producers' durable equipment and structures. Over 1972, such investment spending expanded at nearly a 14½ percent rate, compared with the 11½ percent increase recorded in 1971. Rising new orders for nondefense capital goods equipment point to continued strength in investment. In addition, the Federal Reserve Board's index of capacity utilization for the fourth quarter of 1972 reached its highest mark since early 1970. The latest Commerce Department survey indicates that intended outlays for plant and equipment (which does not include certain types of fixed investment such as trucks and buses) are expected to rise in 1973 by almost 13 percent, somewhat more than had been indicated by earlier surveys and substantially above the 9 percent increase posted for 1972. In particular, the Commerce survey suggests a 13½ percent rise in capital outlays in manufacturing industries and a 12½ percent advance in other sectors.

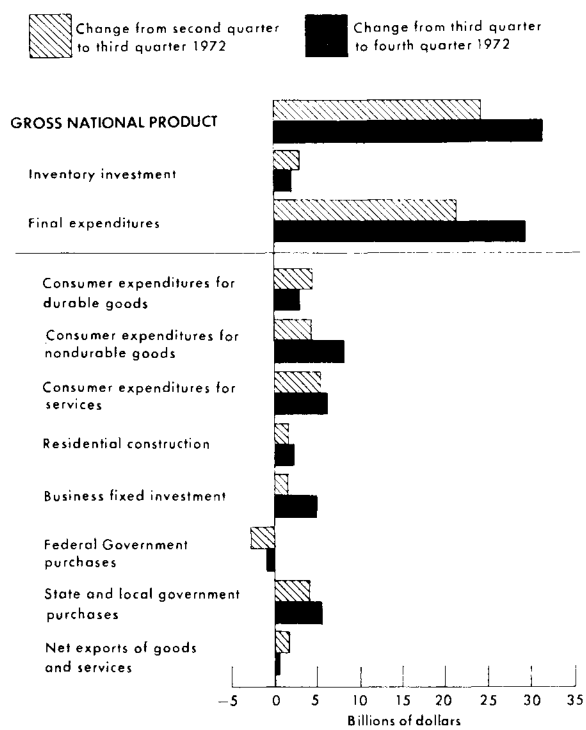
Residential construction expenditures increased by $2.4 billion in the October-December period, capping a strong year for home building. On a seasonally adjusted basis, home-building outlays were 20 percent greater in the fourth quarter than they had been a year earlier and were almost double their recession low of the second quarter of 1970. Underpinning this persistent strength, the pace of housing starts remained rapid during the last months of 1972. In addition, the number of newly issued building permits granted reached a record peak in December.

Expenditures of state and local governments climbed by a substantial $5.6 billion in the fourth quarter, primarily reflecting the stepped-up pace of their construction activity. With the enactment of revenue sharing and the favorable budget position of many states and localities, further sizable gains in spending may be in the offing. On the other hand, Federal purchases of goods and services declined by $0.9 billion in the fourth quarter, attributable to a $0.7 billion slowdown in defense spending following the even more substantial $3.5 billion third-quarter reduction.

Chart II

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted



Source: United States Department of Commerce, Bureau of Economic Analysis.

PRICE DEVELOPMENTS

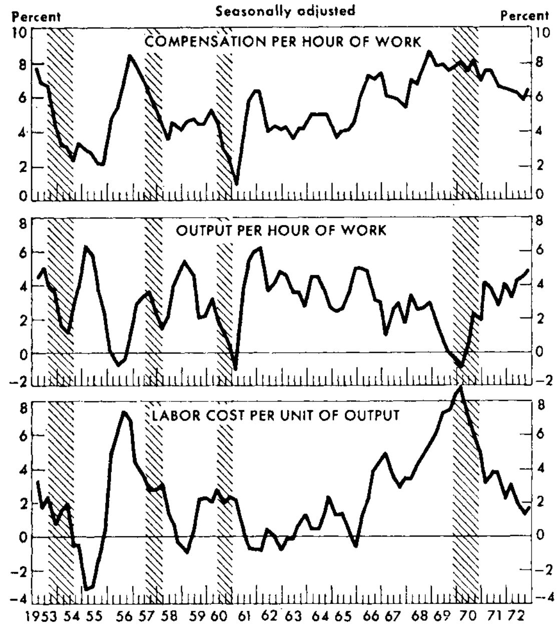
While inflationary pressures for most goods and services appeared to subside somewhat during Phase Two, the outlook for additional improvement on the price front is uncertain. The persistent and extraordinarily rapid run-up in prices of farm products and processed foods and feeds at the wholesale level is disturbing and should have an adverse impact on consumer food prices in early 1973. The liberalization of wage and price controls effected in Phase Three of the Economic Stabilization Program has added to the uncertainty. Adherence to the wage and price guidelines was made largely voluntary except in the food, health, and construction industries where controls remain mandatory. In addition, rent controls were abolished and the profit margin guidelines were liberalized somewhat. It is certainly too early to tell how this new strategy will affect prices in 1973, although some immediate bulge may materialize as some firms implement price increases that had previously been awaiting the approval of the Price Commission.

With the notable exception of food prices, the pace of inflation appears to have changed little in recent months. According to preliminary estimates, the implicit price deflator for total GNP advanced at a 2.7 percent annual rate in the fourth quarter, slightly above the 2.4 percent third-quarter increase. By the end of 1972, the GNP deflator had risen only 3 percent from four quarters earlier, its slowest pace in seven years. However, the implicit price deflator is affected by shifts in the composition of output toward either lower or higher priced goods. The fixed-weight deflator computed by the Department of Commerce corrects for this problem as it is based on the composition of real output in 1967. This fixed-weight price index showed an increase of over 3.9 percent during 1972. For the fourth quarter as well, the fixed-weight deflator rose more rapidly than the implicit GNP deflator.

Wholesale prices rose at a sharp 9.6 percent seasonally adjusted annual rate from September to December. This rapid increase was the result of an extraordinary rise in agricultural prices; by comparison, increases in wholesale industrial commodity prices have been moderate, rising only 2 percent over the quarter. Prices of farm products and processed foods and feed increased sharply in November and soared in December, climbing by 5.2 percent seasonally adjusted in that month alone. Of course, this gain is likely to be reflected in months to come in consumer food prices. The December surge in wholesale food and feed prices stemmed from large increases in prices of grains, oil seeds, and manufactured animal feeds as well as continued increases in egg and livestock prices. Heavy domestic and foreign demand underlies the strong upward movement in food and feed prices apparent since last spring. In particular, sales of wheat to the Soviet Union in 1972 accounted for about one fourth of the domestic wheat harvest. In addition, on the supply side, bad weather affected the harvesting of many crops in recent months. A number of steps have been taken to increase the supply of farm and food products. Among these are the elimination of meat import quotas and the increase in the allowable acreage for planting and grazing under Federal farm subsidy programs.

Consumer prices rose at an annual rate of only 2.6 percent in December, but prices of nonfood commodities and services showed gains somewhat above the monthly average for 1972. Over the last three months of 1972 consumer prices increased at an annual rate of 3.2 percent, bringing the increase for the year as a whole to 3.5 percent. During the fourth quarter, nonfood commodity prices increased at an annual rate of only 1 percent but food prices posted a rapid 5.2 percent rate of advance, largely because of a substantial jump in November. Somewhat surprisingly, seasonally adjusted food prices held steady in December, as declines in beef prices offset increases for eggs, cereals, and bakery products. At the same time, prices for services climbed at a 4.5 percent annual rate, a more rapid advance than that experienced overall in 1972.

Chart III
LABOR COMPENSATION, PRODUCTIVITY, AND UNIT LABOR COST IN THE PRIVATE ECONOMY
CHANGE FROM FOUR QUARTERS EARLIER
Seasonally adjusted



Note: Shaded areas represent recession periods, according to the National Bureau of Economic Research chronology.
Source: United States Department of Labor, Bureau of Labor Statistics.

WAGES, PRODUCTIVITY, AND EMPLOYMENT

During the fourth quarter, compensation per hour of work in the private economy increased at a 7.8 percent seasonally adjusted annual rate, compared with the 4.3 percent rate of increase posted in the previous three-month period. Despite this acceleration, a fundamental slowing in the rate of increase in compensation is apparent over the eight quarters since the cyclical trough at the end of 1970 (see Chart III). It is, however, uncertain that this improvement can be extended. Compensation per hour of work in the private nonfarm economy, which excludes the sometimes volatile farm sector, also posted a faster increase in the fourth quarter than in the third. Preliminary data indicate that average hourly earnings adjusted for interindustry shifts in employment and for overtime in manufacturing rose less rapidly in January than in the last quarter of 1972.

During the final three months of 1972, increases in wages and benefits under collective bargaining agreements covering 5,000 or more workers moderated further, thus continuing the improvement evident earlier in the year. For 1972 as a whole, first-year wage and fringe benefit increases averaged 8.4 percent, a significant slowing from the gain of around 13 percent for the preceding year. At the same time, however, contract duration decreased somewhat in 1972, as unions seemed reluctant to commit themselves to long-term settlements under Phase Two. Furthermore, new settlements covering some 900,000 workers were not included in the 1972 bargaining data since they had not received Pay Board approval at the end of the year. In any event, the collective bargaining schedule for 1973 is heavy, and further moderation in this area is essential if cost pressures are to be restrained.

Productivity, as measured by output per hour of work in the private economy, increased over the October-December interval at a 5.4 percent annual rate, up considerably from the pace of the previous quarter primarily because of a sharp improvement in the agricultural sector. Nevertheless, the 4.9 percent increase in productivity over the four quarters of 1972 was faster than in any year since 1965. As in previous periods of rapid economic expansion, the advance in unit labor costs has slowed considerably. Although fourth-quarter data indicate an expansion in unit labor costs at a 2.6 percent seasonally adjusted annual rate, over 1972 as a whole such costs rose only 1.7 percent. In contrast, unit labor costs climbed at rates of between 3.5 percent and 8.3 percent during 1966 through 1970 and at a 2.2 percent pace in 1971.

According to the monthly survey of households, the civilian labor force and employment declined in January after adjustment for seasonal variation. Much of the decline in employment took place in the agricultural sector. At the same time, the unemployment rate dipped to 5 percent from the downward revised 5.1 percent rate now reported for December. This brought the rate of unemployment to its lowest level since July 1970. The household series was revised back to 1967 as part of the annual updating of seasonal adjustment factors. Unemployment rates for most major groupings in January were similar to those posted in December, although the rates for workers under twenty-five years of age showed sizable declines. The January survey of establishments indicated a continued rise in nonfarm payroll employment in that month, with gains widespread among industries. (Discrepancies in the movement of the household and payroll series occur because of different survey coverage and seasonal adjustment techniques.) Based on preliminary data, sizable declines were posted in the average workweek in the manufacturing sector and the private economy as a whole in January, and overtime in manufacturing also fell for the first time in seven months. However, these data may be subject to some revision when the total payroll sample becomes available.

Monetary and Financial Developments in the Fourth Quarter

During the fourth quarter of 1972, the narrowly defined money supply (M_1) increased more rapidly than it had during the preceding three months. Most of this increase was attributable to a sharp acceleration of M_1 in December following the more moderate expansion in October and November. Although M_1 advanced rapidly, a mild slowdown of the large inflows to savings and consumer-type time deposit accounts at commercial banks held the growth of the broad money supply (M_2) about even with the third-quarter rate. The bank credit proxy expanded at a somewhat faster rate than in the third quarter. Furthermore, burgeoning loan demand brought larger increases in total bank credit. Reflecting the high rates of growth of the monetary aggregates, reserves available to support private nonbank deposits (RPD) in the fourth quarter climbed at a seasonally adjusted annual rate of 10.5 percent, a little more quickly than in the third quarter. As was the case in the preceding three months, much of this reserve expansion resulted from a rising volume of member bank borrowings at the discount window.

Interest rates at the short and long ends of the maturity spectrum moved in different directions during the final months of the year. Short-term rates rose briskly in response to the continuing business recovery and the rising demand for short-term funds in the economy. In contrast, long-term bond yields fell substantially in October and November, as the moderation of inflationary expectations was joined by a decline in the volume of new corporate flotations and easing credit demands by state and local governments. Long-term yields did rise in December, however.

This strength in the capital markets was further manifested in the continuing healthy performance of the nonbank depository institutions as suppliers of funds to the residential mortgage market. Although deposit inflows slowed from earlier 1972 levels, these inflows remained substantial and mortgage lending stayed at high levels. Mortgage yields rose somewhat in the final quarter of the year, but still were lower than those prevailing at the beginning of the year.

THE MONETARY AGGREGATES

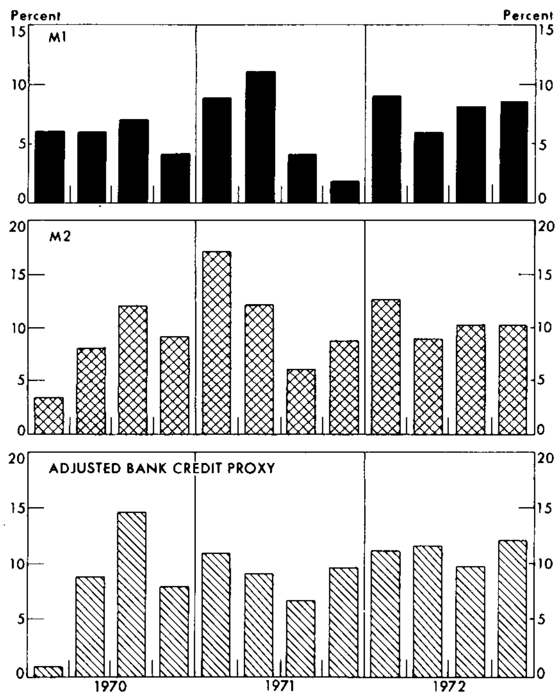
The narrowly defined money supply (M_1)—private demand deposits adjusted plus currency outside commercial banks—increased in the final quarter of 1972 at a rapid seasonally adjusted annual rate of 8.6 percent, 0.4 percentage point faster than the expansion of M_1 during the preceding three-month interval (see Chart I). This brought the growth of M_1 for the entire year to 8.3 percent, the largest yearly increase in the post-World War II era. The rapidity of M_1 growth during the fourth quarter reflected a 13.3 percent spurt during December. In contrast, during October and November M_1 increased at more moderate rates averaging 6.2 percent.

The impact of the December spurt in M_1 on the growth rate for the fourth quarter was similar to that of the major role played in the third-quarter expansion of M_1 by the quick jump in the money supply during July. Both the size of M_1 increases in July and December and their impact upon the quarterly growth rates illustrate the difficulty of influencing the monetary aggregates in the short run. The M_1 surge in December reflected to some extent a sharp increase in demand deposits of state and local governments, some of which were slow in investing their part of the $2.7 billion in Federal revenue-sharing payments that were disbursed in December. Moreover, the general demand for money has doubtless been increasing as a result of the gathering momentum of the economic recovery.

Chart I

CHANGES IN MONETARY AGGREGATES

Seasonally adjusted annual rates



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.

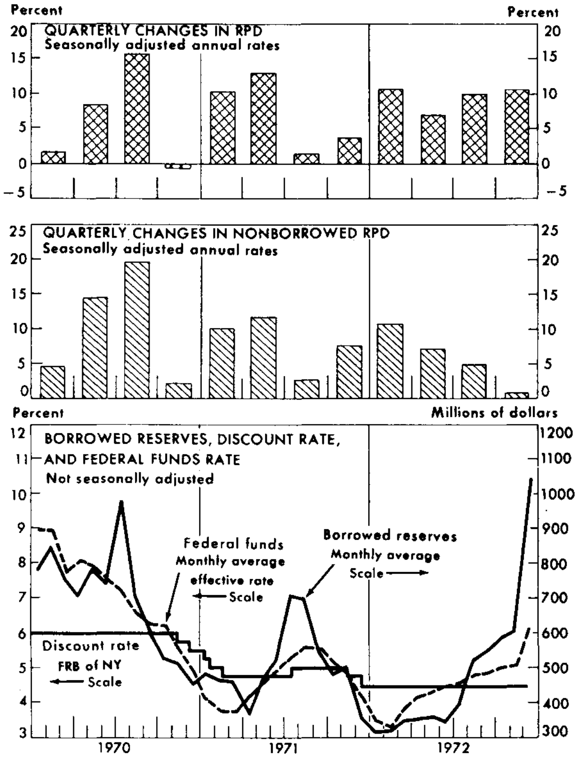
Adjusted bank credit proxy = Total member bank deposits subject to reserve requirements plus nondeposit sources of funds, such as Euro-dollar borrowings and the proceeds of commercial paper issued by bank holding companies or other affiliates.

Source: Board of Governors of the Federal Reserve System.

The broad money supply (M_2)—which adds to M_1 savings deposits and time deposits other than large-denomination certificates of deposit (CDs) at commercial banks—advanced at a seasonally adjusted annual rate of 10.2 percent in the fourth quarter, about the same as in the previous quarter. This steady growth of M_2 reflected the effects of moderating flows in the time deposit component of M_2 which offset the acceleration in the narrow money supply. The growth of large CDs also slowed in the fourth quarter as a whole, although the investment of revenue-sharing funds by state and local governments contributed to the December climb in CDs at the extremely rapid annual rate of 58 percent. 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, grew at a relatively steady pace throughout 1972. United States Treasury deposits and commercial paper issued by bank holding companies increased significantly in the October-December interval. On balance, the bank credit proxy advanced at a 12.1 percent seasonally adjusted annual rate during the fourth quarter, which brought the credit proxy to a level 11.6 percent above that at the end of 1971.

RPD expanded at a 10.5 percent annual rate in the fourth quarter, compared with 10 percent for the third quarter and for all of 1972 (see Chart II). As was the case in the third quarter, the principal source of RPD expansion was the rise in member bank borrowings from the Federal Reserve. On the basis of monthly averages of daily figures, borrowings rose from $514 million in September to $1,050 million in December. On the other hand, the nonborrowed component of RPD moved up only marginally at a 0.4 percent rate in the fourth quarter. Most member banks had not made frequent use of the discount window earlier in the year. The large increase in borrowings toward the end of the year reflected mounting pressure on bank reserve positions, occasional shortages of Federal funds in the market, and the rising cost of obtaining Federal funds in the market. The average Federal funds rate

Chart II
RESERVES AVAILABLE TO SUPPORT PRIVATE NONBANK DEPOSITS AND RELATED INTEREST RATES



Note: Reserve requirements on time deposits over $5 million were lowered from 6 percent to 5 percent on October 1, 1970.

RPD = Total member bank reserves less those required to support United States Government and interbank deposits.

Sources: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York.

rose from 4.87 percent in September to 5.33 percent in December, while the discount rate remained unchanged at 4.50 percent. Effective January 15, 1973 the discount rate was raised to 5 percent.

BANK CREDIT, INTEREST RATES, AND THE CAPITAL MARKETS

Total bank credit advanced rapidly in the fourth quarter of 1972, as loan demand continued strong in almost all categories. Adjusted to include net loan sales to affiliates, bank credit grew at a 14.4 percent seasonally adjusted annual rate in the fourth quarter, compared with a 13.6 percent rate for the third quarter and a 12.8 percent rate for the first half of the year (see Chart III). Total loans (adjusted for loan sales to affiliates) increased at an 18.7 percent annual rate in the October-December interval, about equal to the third-quarter advance but above the 14 percent growth rate of the first half of the year.

Business loans strengthened markedly in the fourth quarter, stimulated by a strong advance in business inventories as well as by accelerating economic recovery in general. Reflecting the economy's strength throughout the year, the growth rate of business loans (adjusted for sales to affiliates) during 1972 was 11.7 percent, well above the 4.8 percent expansion during 1971. Bank loans to consumers rose at a 19 percent rate in the fourth quarter, which was a continuation of the rising trend of consumer lending seen throughout 1972. Real estate loans maintained a high 17.6 percent growth rate in October-December, about equal to the third-quarter rate but somewhat below the rate during the first half of the year.

While loan demand was strong, growth of banks' portfolios of securities slowed in the fourth quarter of 1972. There was no change in bank holdings of United States Government securities despite very large issues of new Treasury securities during the quarter to finance the Federal deficit. In the third quarter, banks had reduced United States Government securities holdings at a 7.6 percent annual rate, and this pattern might have been repeated in the fourth quarter if the Treasury had not offered notes at the very end of the year which were particularly attractive to banks. For the full year 1972, United States Government securities holdings grew 2.1 percent, compared with 4.7 percent in 1971 and 12.6 percent in 1970. A similar though less pronounced declining pattern was seen in bank acquisition of other securities, principally state and local government issues. Expansion in holdings of these securities slowed to an 8.1 percent annual rate in the fourth quarter, compared with a 9.8 percent rate in the third quarter and 11.7 percent in the first half of 1972.

The vigorous bank loan demand and rising money market rates of the fourth quarter put pressure on the banks' prime lending rate. In early October the prime rate was raised from 5½ percent to 5¾ percent, and in late December the prime rate was increased again to 6 percent. The yield on three-month Treasury bills increased from a 4.66 percent daily average rate in September to a 5.07 percent rate in December. Similarly, in the October-December interval, rates on three-month CDs in the secondary market rose 29 basis points to 5.42 percent, four- to six-month commercial paper rates rose 31 basis points to 5.45 percent, and six-month Treasury bill rates increased 17 basis points to 5.30 percent.

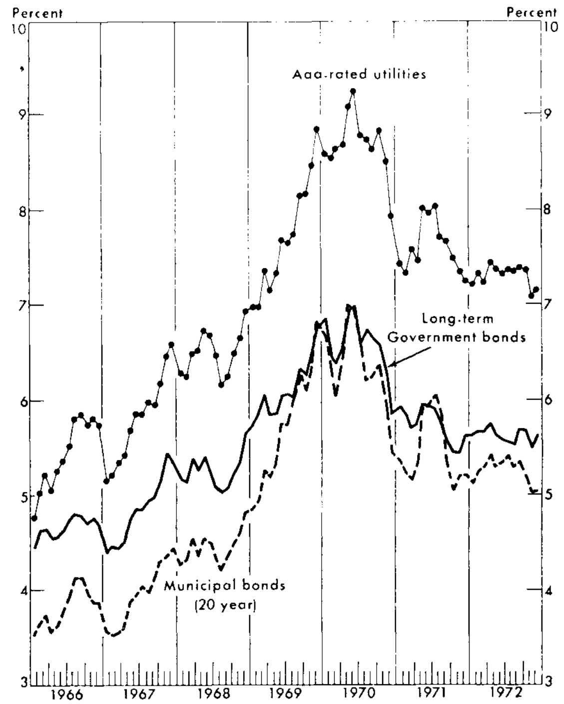
In spite of rising short-term rates, bond market yields declined. This reflected the apparent moderation of inflationary expectations, lower corporate demands for funds, and to some extent reduced state and local government demands. In the corporate bond market, total public and private placements were $6.5 billion in the fourth quarter of 1972, about 13 percent less than the same quarter of 1971. Offerings of state and local governments totaled $5.5 billion in the October-December 1972 interval, compared with $6 billion in the same period in 1971. Combined corporate and municipal bond offerings in 1972 were $50 billion, down more than 10 percent from the $56.4 billion raised in 1971. These lower credit demands stemmed from increased internal funds from improved corporate profits and large fiscal surpluses at state and local governments. During the fourth quarter the Federal Reserve Board's index of new-issue utility bonds adjusted to Aaa basis declined 25 basis points to an average rate of 7.15 percent in December, although this was an increase from the 7.09 percent recorded in November (see Chart IV). Yields in the long-term municipal market followed a similar path over the quarter as they also declined about ¼ percentage point to the 5 percent level.

The decline in the Federal budget deficit in calendar year 1972 helped to reduce Treasury new cash borrowings from $24.8 billion in 1971 to $15.3 billion in 1972. However, a large part of these borrowings occurred late in the year. During October-December 1972 they totaled $12.4 billion, almost identical to borrowings in the same interval of 1971. Federally sponsored agency net borrowing was $0.8 billion in the last quarter of 1972, down sharply from the comparable 1971 period. Yields on long-term Treasury bonds traced a declining pattern during the first half of the fourth quarter but rose thereafter.

Lower bond yields, higher profits, completion of the national elections, and an improving outlook for a Vietnam peace moved stock prices to record levels. As measured by the New York Stock Exchange composite stock index, prices climbed 6.4 percent during the fourth quarter to close on December 31 at a level of 64.48, an advance of 14.3 percent during 1972. The Federal Reserve increased the required downpayment on margin stock purchases from 55 percent to 65 percent effective on November 24. After the rapid advance of stock margin

Chart IV

LONG-TERM INTEREST RATES



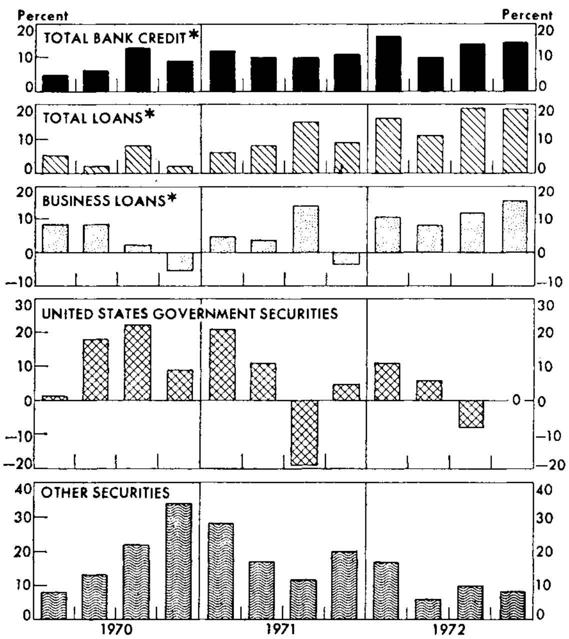
Note: Yields on the long-term Government bonds are monthly averages of daily figures. Yields on Aaa-rated utilities and twenty-year municipal bonds are monthly averages of weekly figures.

Sources: Board of Governors of the Federal Reserve System and The Bond Buyer.

Chart III

CHANGES IN BANK CREDIT AND ITS COMPONENTS

Seasonally adjusted annual rates



*Adjusted for loans sold to affiliates.

Source: Board of Governors of the Federal Reserve System.

credit during the first nine months of 1972, margin borrowing returned to more normal growth rates in the fourth quarter.

THRIFT INSTITUTIONS

The expansion of total thrift institution deposits slowed substantially during the fourth quarter, principally because of a significant moderation of deposit inflows to savings and loan associations (see Chart V). By comparison, deposit flows at mutual savings banks tapered only moderately from their rate of expansion in the July-September interval. These reductions notwithstanding, deposit inflows to the nation's thrift institutions continued at historically high rates. Together with the flow of deposits in the first nine months of the year, the growth during the fourth quarter brought the annual rate of thrift institution deposit growth to 16.7 percent, down only slightly from 17.5 percent in 1971.

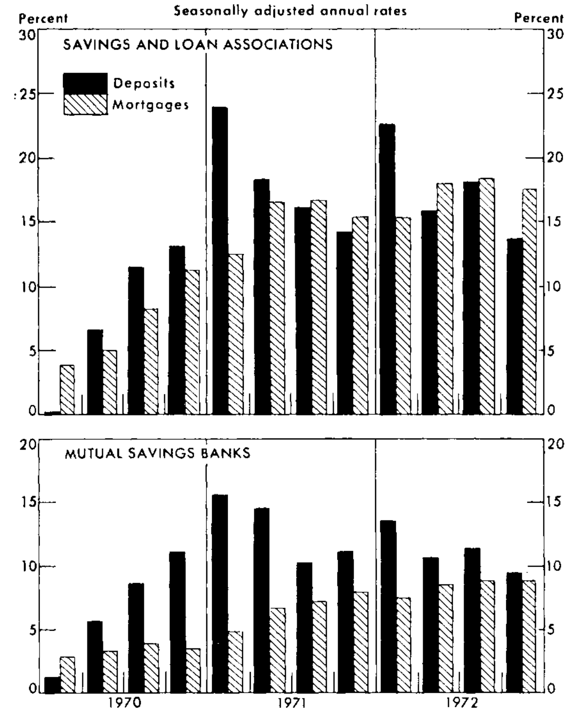
The strong deposit inflows to thrift institutions that began in 1970 reflected the greatly improved competitive position of these institutions. In turn, this improved competitive capability was based upon the aggressive marketing of the thrift institutions' higher yielding certificate-type accounts and the relatively lower yields prevailing on competing credit market instruments. More than 70 percent of deposit growth at savings and loan associations over the two-year period ended December 1972 was concentrated in these higher yielding accounts. The minimum maturity feature of the certificate-type accounts should alleviate some of the volatility traditionally associated with thrift institution deposits.

The strong flow of deposits to thrift institutions was the major factor contributing to the stability of the residential mortgage markets in the fourth quarter and throughout the year. In addition, the volume of residential mortgage lending by commercial banks has been unusually strong. Reflecting the stability of the mortgage market, the effective yields on new-home conventional mortgages ended the year at 7.66 percent, down 11 basis points from the level in December 1971. Moreover, secondary-market yields on Federal Housing Administration-insured mortgages closed 1972 down 3 basis points for the year at 7.56 percent. The ratio of the average size of loan made to the value of the home purchased rose slightly during the fourth quarter, closing the year at 77.9 percent compared with 74.5 percent at the end of 1971.

Chart V

THRIFT INSTITUTION DEPOSIT FLOWS AND HOME MORTGAGE LENDING

Seasonally adjusted annual rates



Note: Mutual savings bank mortgage statistics for the fourth quarter of 1972 are based on October and November data.

Sources: Federal Home Loan Bank Board and National Association of Mutual Savings Banks.

The Money and Bond Markets in January

Short-term interest rates rose considerably in January against the background of the strong economic advance and general apprehension over the future course of prices. The rapid recent growth of the monetary and credit aggregates added to this concern, with market participants expecting the monetary authorities to resist this growth. Indeed, the average effective Federal funds rate rose to 5.94 percent, 61 basis points higher than in December.

The exceptionally rapid increase in wholesale agricultural prices during December underlined the growing concern about inflationary pressures, and announcement of Phase Three in the Economic Stabilization Program engendered further caution stemming from uncertainty about its potential effects. On January 12, the Board of Governors of the Federal Reserve System approved a ½ percentage point increase in the discount rate to 5 percent at all twelve Reserve Banks. The Board explained that this adjustment was undertaken to bring the discount rate into better alignment with short-term market interest rates, which had risen earlier.

Banks experienced increased pressure on their reserve positions during January. Their efforts to cover reserve requirements enlarged by the rapid growth in deposits during December were reflected in higher rates for Federal funds and expanded member bank borrowings at the Federal Reserve discount window. As overnight money became more expensive, Government securities dealers sought to reduce their inventories, putting strong upward pressure on Treasury bill rates. Posted rates on private short-term instruments increased as well. The yields on Government coupon issues also rose appreciably, in part because of the approach of the Treasury's February financing.

Corporate bond yields rose while tax-exempt yields remained relatively steady during most of January. Dealers in corporate bonds met stiff investor resistance to aggressively priced issues. However, most new municipal securities were absorbed comfortably. Later in the month, bank selling of outstanding issues and lackluster investor interest led to a rise in tax-exempt yields.

BANK RESERVES AND THE MONEY MARKET

Money market conditions grew increasingly firmer during January. The average effective rate on Federal funds rose from 5.34 percent in the December 27, 1972 statement week to 6.35 percent in the January 31, 1973 statement week. Average required reserves rose $1.6 billion above December levels, as the large deposit expansion of late December was reflected in January's required reserves (see Table I). (Member banks calculate required reserves on deposit levels of two weeks earlier.) Consequently, reserves available to support private nonbank deposits (RPD) increased sharply in January, at a seasonally adjusted annual rate of 22 percent. Nonborrowed reserves, which are essentially managed by the monetary authorities, rose by only $1.3 billion. Thus, banks bid aggressively for Federal funds and expanded borrowings from Federal Reserve Banks by about $300 million.

With Federal funds trading at markedly higher interest rates, yields on other short-term instruments also rose (see Chart I). Dealers in prime commercial paper increased their rates by ¼ to ⅜ percentage point, and bankers' acceptance dealers adjusted their offering rates upward by ¾ percentage point. In the secondary market, rates on large negotiable certificates of deposit (CDs) rose about 50 basis points. The discount rate boost had been anticipated by most market participants and was not a disturbing influence.

The rapid growth of the narrow money supply (M_1) halted in January. Preliminary estimates indicate that M_1 —adjusted private demand deposits plus currency outside banks—was unchanged on a seasonally adjusted basis from December to January. The M_1 series has been revised to reflect benchmark adjustments for domestic nonmember banks and to incorporate additional international banking institutions, the impact of the revised Regulation J, and new seasonal factors. In spite of the leveling-off in January, M_1 increased at an annual rate of 6.2 percent

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1973

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

Factors	Changes in daily averages—week ended					Net changes
	Jan. 3	Jan. 10	Jan. 17	Jan. 24	Jan. 31	
"Market" factors						
Member bank required reserves	— 792	— 336	—1,319	+1,165	+ 420	— 862
Operating transactions (subtotal)	— 513	+1,094	+ 496	—1,449	—1,091	—1,463
Federal Reserve float	— 590	+ 511	— 811	— 879	—1,226	—2,995
Treasury operations*	— 22	+ 15	+ 32	— 638	— 368	— 981
Gold and foreign account	— 42	+ 35	— 4	— 15	+ 28	+ 2
Currency outside banks	+ 146	+ 469	+1,284	+ 177	+ 620	+2,696
Other Federal Reserve liabilities and capital	— 5	+ 64	— 5	— 93	— 145	— 184
Total "market" factors	—1,305	+ 758	— 823	— 284	— 671	—2,325
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+1,145	— 150	+ 341	+ 141	+ 884	+2,361
Outright holdings:						
Treasury securities	+ 483	+ 423	— 18	—	+ 788	+1,676
Bankers' acceptances	+ 1	+ 5	+ 2	+ 2	+ 1	+ 11
Federal agency obligations	+ 21	--	--	--	--	+ 21
Repurchase agreements:						
Treasury securities	+ 536	— 486	+ 324	+ 153	+ 44	+ 571
Bankers' acceptances	+ 53	— 47	+ 19	— 4	+ 18	+ 39
Federal agency obligations	+ 51	— 45	+ 14	— 10	+ 33	+ 43
Member bank borowings	+ 633	—1,063	+ 613	— 206	+ 216	+ 193
Other Federal Reserve assets†	+ 69	+ 21	+ 35	+ 72	— 9	+ 188
Total‡	+1,676	—1,192	+ 989	+ 7	+1,090	+2,570
Excess reserves‡	+ 371	— 434	+ 166	— 277	+ 419	+ 245

Member bank:	Daily average levels					Monthly averages
Total reserves, including vault cash‡	32,604	32,506	33,991	32,549	32,548	32,840§
Required reserves	32,044	32,380	33,699	32,534	32,114	32,554§
Excess reserves‡	560	126	292	15	434	285§
Borrowings	1,751	688	1,301	1,095	1,311	1,229§
Free, or net borrowed (—), reserves	—1,191	— 562	—1,009	—1,080	— 877	— 944§
Nonborrowed reserves	30,853	31,818	32,690	31,454	31,237	31,610§
Net carry-over, excess or deficit (—) ‖	59	248	105	140	27	116§

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

* Includes changes in Treasury currency and cash.

† Includes assets denominated in foreign currencies.

‡ Adjusted to include $279 million of certain reserve deficiencies on which penalties can be waived for a transition period in connection with bank adaptation to Regulation J as amended effective November 9, 1972. (The adjustment amounted to $450 million from November 9 through December 27, 1972.)

§ Average for five weeks ended January 31.

‖ Not reflected in data above.

over the three months ended in January (see Chart II).

Time deposits other than CDs accelerated slightly to a 14 percent annual growth rate. This component of the broad money supply (M_2) partially offset the deceleration in the M_1 component, resulting in expansion of M_2 at an annual rate of about 7 percent in January. For the three months ended in January, M_2 advanced at a 9 percent annual rate.

The growth of the adjusted bank credit proxy—which consists of daily average member bank deposits subject to reserve requirements and certain nondeposit liabilities—slowed to an annual rate of about 9 percent in January. The deceleration was particularly noticeable in CDs which nevertheless continued to grow rapidly, albeit at a slower pace than in December. For the three months ended in January the proxy posted an 11 percent annual rate of advance.

THE GOVERNMENT SECURITIES MARKET

Increased concern over the course of inflation and expectations of firmer monetary policy dominated sentiment in the Government securities market during January. The exceptionally large advance in gross national product during the fourth quarter of 1972 underscored the strength of the recovery in aggregate demands for goods and services. This suggested to many observers increasing upward pressure on interest rates as credit demands accelerate and on prices as the economy moves rapidly toward full-capacity output. Expectations of higher consumer prices in the months ahead were prompted by the announcement of the enormous increase in wholesale prices of agricultural goods in December.

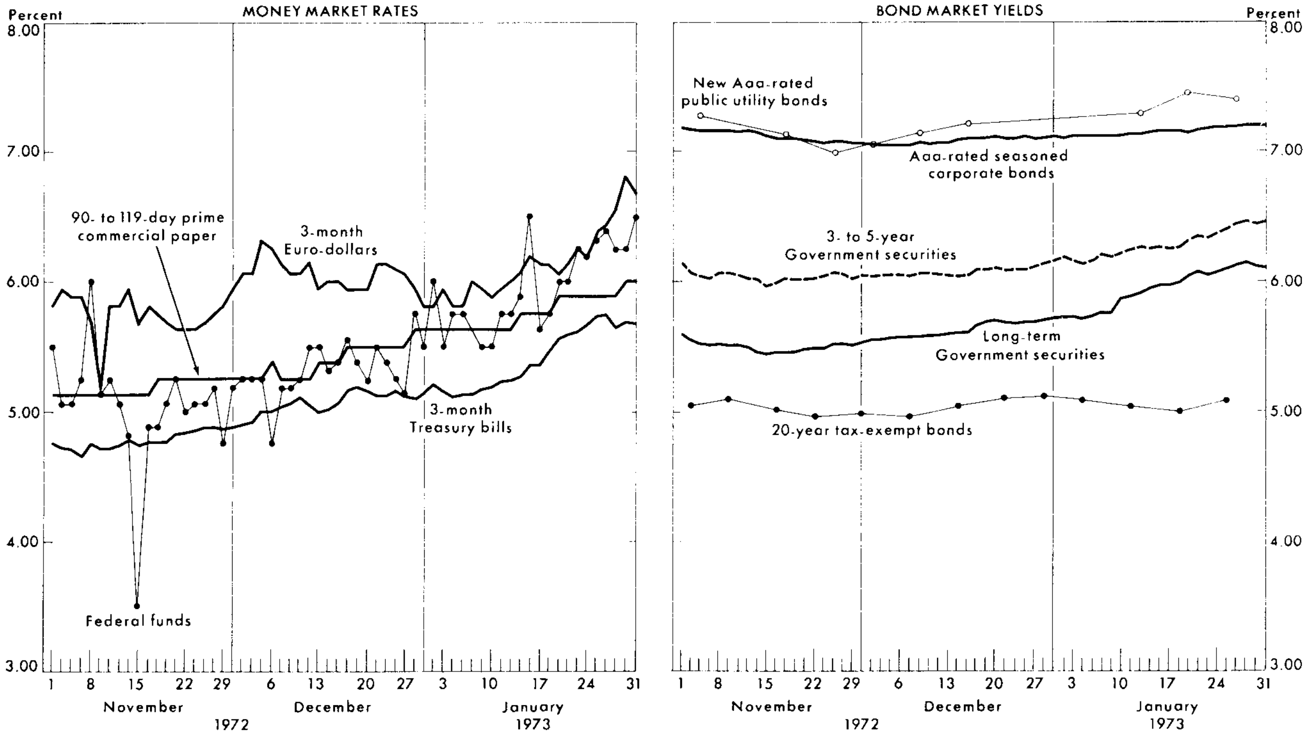
On January 11, the Administration disclosed the details of the Economic Stabilization Program's Phase Three. Some market participants interpreted the increased reliance upon voluntary compliance to wage and price guidelines to be a relaxation in the program's ability to control inflationary pressures. Expectations of a tighter monetary policy posture had been advanced following the rapid M_1 growth in December and the large wholesale price increase. The Phase Three announcement reinforced these sentiments, and the increase in the discount rate was taken as confirmation of the Federal Reserve's position.

The President's budget message, transmitted to the Congress on January 29, somewhat tempered the market's concern over inflation, however, by indicating the Administration's commitment to restraint on Federal spending. The new budget estimates fiscal 1973 outlays at $249.8 billion and receipts at $225 billion for a fiscal 1973 deficit of $24.8 billion on a unified budget basis. For fiscal 1974,

Chart I

SELECTED INTEREST RATES

November 1972 - January 1973



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; offering rates (quoted in terms of rate of discount) on 90- to 119-day prime commercial paper quoted by three of the 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 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.

outlays are projected at $268.7 billion and revenues at $256 billion for a deficit of $12.7 billion.

Expectations of firmer monetary policy combined with higher money market interest rates and a continued increase in the supply of Treasury bills to push bill rates upward. The average issuing rate for three-month bills rose 53 basis points from 5.16 percent at December's last auction to 5.69 percent at the January 29 auction (see Table II). The increased supply of bills came from enlarged Treasury issues and from sales by some foreign and international accounts. In each weekly bill auction through January 22 the Treasury sold an additional $200 million of bills, and in the monthly auction a net addition of $100 million of bills was placed. Although the Treasury discontinued sales of nine-month bills with the October auction, the amount of one-year bills auctioned exceeded the maturing nine-month and one-year bills by $100 million. On balance, foreign and international accounts continued to reduce the amount of marketable Government securities held in custody at the Federal Reserve. These accounts fell $0.6 billion over the four weeks ended January 31 to $30.2 billion. The increased supply of bills applied upward pressure on bill rates in the secondary market, and rates generally rose 30 to 70 basis points during January.

Yields on Treasury coupon securities increased rapidly in January. At the January 4 auction, the new twenty-year

Treasury bond was sold to yield about 6.79 percent. Approximately $472 million of the $627 million of accepted tenders was from the New York Federal Reserve District. This, in addition to the fact that only $81 million of noncompetitive tenders was received, suggested that the bond may have been positioned initially with short-term holders. As the security was distributed to permanent investors, the bond's price declined and the issue closed the month on a bid quotation at a 6.86 percent yield. The weak secondary-market performance of this long-term bond carried over to other coupon issues, and yields on intermediate- and long-term Treasury securities ended the month about 30 basis points above late-December levels.

On January 31 the Treasury announced the terms of its February financing. The Treasury offered a new 6½ percent note of 3½ years in exchange for $6.8 billion of securities maturing on February 15. The new notes due August 15, 1976 will yield about 6.60 percent at a price of 99.70. In addition, the Treasury auctioned on February 7 about $1 billion of 6⅝ percent notes due November 15, 1979.

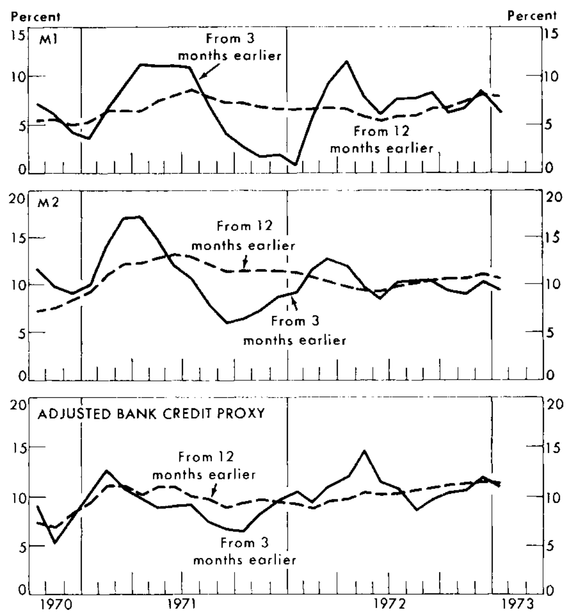
The upward rate movements in longer term issues extended into the Federal agency market. On January 16, $100 million of Tennessee Valley Authority (TVA) 25-year bonds was reoffered at a yield of 7.35 percent and met an enthusiastic reception at those terms. However, just eight days later, a much slower reception was accorded a Washington (D.C.) Metropolitan Area Transit Authority issue bearing an identical yield. The $220 million of bonds carried a Government guarantee and a ten-year call protection in contrast to the five-year protection for the TVA obligations, but bond market investors had increased their yield requirements since the TVA issue. On January 29, syndicate price restrictions were removed from the transit issue and the price initially dropped enough to raise the yield 10 basis points.

In other Federal agency activity, the Federal Land Banks offered, on January 5, $373 million of 6.25 percent bonds due in April 1976 and $300 million of 6.70 percent bonds maturing in January 1980. The issues replaced $407 million of maturing securities and raised $266 million of new money. The farm credit agencies sold $569 million of 5.95 percent six-month Banks for Cooperatives bonds and $544 million of 6 percent nine-month bonds of the Federal Intermediate Credit Banks on January 17. The new issues replaced $934 million of maturing debt and raised $178 million in new money.

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for January 1973 are preliminary.

M1 = Currency plus adjusted demand deposits held by the public.

M2 = M1 plus commercial bank savings and time deposits held by the public, less negotiable certificates of deposit issued in denominations of $100,000 or more.

Adjusted bank credit proxy = Total member bank deposits subject to reserve requirements plus nondeposit sources of funds, such as Euro-dollar borrowings and the proceeds of commercial paper issued by bank holding companies or other affiliates.

Sources: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York.

OTHER SECURITIES MARKETS

Corporate bond prices edged downward during January, as the traditional reinvestment demand from holders of year-end maturing securities failed to develop in the size expected. The market for tax-exempt securities, on the other hand, remained comparatively firm until late in the month. The municipal market was aided by recurring Congressional discussion of possible alternatives to full tax exemption for these securities and by the generally better financial position of these governments.

Investors responded very selectively to new utility issues in January, finding most unattractively priced. Two issues totaling $150 million were the first to test the market. The thirty-year bonds carried a split rating of Aa by Moody's and A by Standard and Poor's. Investors resisted the reoffering terms which specified about a 7.43 percent yield. Subsequently, both issues were released from syndicate and reduced sharply in price. The next major reoffering—$100 million of thirty-year Aa-rated bonds—was also considered to be aggressively priced at a yield of 7.47 percent, and the securities moved slowly. At a 7.50 percent yield, $100 million of 26-year Aa-rated bonds was distributed more easily. However, subsequent attempts to sell securities at lower yields met investor resistance. For example, another Aa-rated issue was poorly received when the $50 million of thirty-year bonds was priced to yield 7.44 percent.

The postponement of $125 million of Richmond, Virginia, expressway revenue bonds from the tax-exempt calendar aided the municipal market before midmonth. Pending litigation regarding environmental considerations was responsible for its removal. The State of Hawaii sold $55 million of A-rated debt priced to yield 3.70 percent in 1976 to 5.30 percent in 1993. On the same day, Wisconsin's $38 million of Aa-rated bonds was reoffered to return 3.10 percent in 1974 to 5.10 percent in 1992-93. Both issues moved well. New York State brought to market $130 million of Aa-rated obligations in the following week. Investors reacted favorably to terms providing a 3.00 percent yield in 1974 to a 5.40 percent yield in 1996-2003. The Blue List of advertised inventories of municipal bonds was reduced slightly to $905 million on January 31. The Bond Buyer index of twenty municipal bond yields rose by 5 basis points to 5.16 percent on February 1.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates — January 1973			
	Jan. 8	Jan. 15	Jan. 22	Jan. 29
Three months	5.155	5.277	5.633	5.689
Six months	5.412	5.540	5.760	5.871
	Monthly auction dates—November 1972-January 1973			
	Nov. 22	Dec. 26	Jan. 26	
Fifty-two weeks	5.226	5.337	5.986	

* 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.

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