

# FEDERAL RESERVE BANK OF NEW YORK



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## Testing Time for Monetary Policy

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*An address before the forty-seventh annual midwinter meeting of the  
New York State Bankers Association in New York City on January 20, 1975*

I would like to talk to you today about the unusually difficult problem faced by monetary policy in the present setting of national and international economic conditions. There are always conflicting factors for the central bank to consider and weigh, but at most times during my years with the Fed it has been easier to resolve these conflicts than it is now. For one thing, there has usually been a clearer indication as to the relative risks of policies of expansion and restraint. At present the risks on both sides are very substantial. Also, while cyclical problems are always complicated by various long-term and structural factors, this complication is underlined today by the frightening magnitude of the energy crisis, with its wide-ranging influence on incomes, financial flows, and institutional arrangements. Thus it is more important than ever, in my judgment, that monetary policy, while maintaining its advantageous characteristic of flexibility, should move with the greatest caution in the months ahead.

Let me touch briefly on some of the key elements requiring our close attention. First of all, inflation continues at a rapid pace, not only in the United States but in almost all other major industrial countries. Despite the pressure of wage demands, as labor tries to make up for recent losses of real income, I can see real hope of a substantial reduction in the inflation rate during 1975, as most forecasters seem to agree. Sluggish business has already had a salutary impact on raw commodity prices, and this tendency should continue and spread through the economy as the business slack continues. This process could be helped along if more firms would respond to emerging excess capacity and increasing inventories with price reductions. Nevertheless, the really troublesome

prospect is that the rate of inflation will still be unacceptably rapid when the economy starts on its next upward phase, with the possibility that it may then accelerate and reach new peaks in the next boom.

Meanwhile, we obviously must feel concerned with the deepening and pervasive recession that has developed in the last few months—with little hope of a pickup for at least another six months or so. We cannot be blind to the accompanying rise in unemployment, which seems likely to persist even for a considerable period after business begins to recover. Our concern must be heightened by the unfortunate distribution of unemployment by age, race, and geographical area. At the same time we should bear in mind that 7 percent unemployment does not mean 7 percent of the members of the labor force are permanently out of work. A large part of even today's sizable unemployment is frictional and of relatively short duration. The incidence of unemployment is constantly shifting as workers move into and out of jobs. Many of the unemployed, moreover, are secondary workers rather than primary breadwinners for their households. And the burden of temporary joblessness for many, though by no means all, unemployed workers is partially eased by unemployment compensation and in some cases by supplements provided under wage contracts.

I do not mean to suggest that unemployment never entails costs beyond minor inconveniences. On the contrary, it certainly imposes major hardships on some. In my view, however, these hardships should be mitigated by special relief measures—as is being done with extended unemployment benefits and temporary public jobs programs—rather than by excessive monetary stimulation,

which can only make the goal of price stability even more remote. For the longer run, we should seek to reduce structural unemployment and to improve productivity by more effective vocational training programs, by the establishment of computer banks of information that might better direct available workers to available jobs, and perhaps by waivers of minimum wage requirements for young workers. Such reforms are needed not only to achieve a permanent reduction in the level of unemployment consistent with price stability, but also to ameliorate the social problems that arise from a lack of employment opportunities, especially among the young in our inner cities.

The central bank must be troubled, too, by the extent to which pessimistic sentiment has come to prevail among both businessmen and consumers. In my view, the pessimism is grossly exaggerated when warnings are voiced that we may be on the verge of a 1930's-type depression. Nevertheless, the current gloom is affecting the business outlook substantially, and it is mingled with a rather broad loss of faith in the ability of public authorities to cope with economic as well as political problems. The pessimistic talk frequently heard about the worthlessness of currencies in general is one symptom of this erosion of confidence, as is the sometimes rather desperate search for commodities or collectors' items that might serve as a store of value.

Another area demanding our attention is the financial stress we find today in our markets and institutions. Fortunately, some of the most acute market fears have faded as interest rates have fallen from their peaks of mid-1974. On the other hand, we cannot view with equanimity the evidence in many sectors of the economy that credit has been expanded too rapidly or unwisely. A long-declining stock market makes external equity financing difficult or impossible just when a strengthening of equity positions is needed most to offset the debt accumulation of recent years.

The most usual indicators of monetary policy are of course the money and credit aggregates, as well as interest rates. For the past year the narrowly defined money supply has grown at a moderate pace, considerably below that of 1973 and substantially below the too rapid rate of 1972. Growth was very slow in the third quarter of last year and, while it recovered somewhat in the fourth quarter, the growth rate had not then reached the level of the first half. As we have emphasized so often, growth rates of money over short periods are not only very difficult to influence but are of relatively little economic significance. It is also well to bear in mind that the statistical measurement of the money supply is far from an exact science, and is subject to frequent revisions besides conceptual

difficulties as to what types of bank deposits should be included. For example, as more and more savings deposits are made withdrawable by check or draft, the line between  $M_1$  and  $M_2$  becomes more and more blurred. The System has always paid attention to both measures, but it may be that  $M_2$  will deserve growing attention in the future. It is also worth stressing that velocity of money, as well as the supply of money, is a variable having important effects on the economy.

The role of interest rates in connection with monetary policy is a multiple one. Since the level of short-term interest rates has a strong influence on the speed of money growth, some short-term rates—and especially the Federal funds rate—play a major part in the day-to-day execution of policy. At the same time, movements of both short and long rates may have pronounced economic effects as, for example, on the health of the housing industry, the burden of financing inventories, the level of stock prices, and even the viability of the various markets for debt instruments. Thus the central bank can never afford to neglect the interest rate repercussions of its decisions, even though it would be rare indeed for the authorities to have any precise objective in terms of the level of interest rates. Last summer there was no rejoicing in the System when short-term rates reached record-high levels, but credit demands were then so heavy that any effort to reduce interest rates would have carried an acute risk of too rapid credit and money growth. Indeed, by exciting further inflationary expectations already clearly embedded in the high levels of rates, any attempt to hold down rates by massive injections of money and credit could well have been counterproductive. More recently we have welcomed the easing of interest rates from the abnormal levels of last summer in view of the slowing of credit demands, at least in short-term markets; and, with the easing of credit demands, monetary policy has been able to contribute to the rate declines by some deliberate easing without recourse to unduly rapid monetary and credit expansion.

In deciding how monetary policy might best be used in the current setting, it is important to distinguish between cyclical factors and longer term economic tendencies. Also it goes without saying that monetary policy cannot do the whole job, that it must take cognizance of—and adjust itself to—other official policies and especially fiscal policy. On the first point, most elements in the current domestic scene point to the likelihood of a cyclical recovery—though perhaps a rather gradual one—beginning some time after the middle of this year. With recession deepening until then, and unemployment rising, it would seem logical to apply a relatively stimulative policy to insure against the recovery's being aborted. But, while the

rate of inflation will probably decline as a result of the recession, I can see no real hope that it will drop this year to a level that would have been considered satisfactory only a few years ago, for the present inflation is much more than a purely cyclical phenomenon. An overly rapid recovery of business from the prospective cyclical trough might very well lead to even higher inflation rates in the next boom than we have seen in this cycle, with all that that might imply for even deeper recession and even higher unemployment in the following cyclical period of business weakness.

Rising consumer expectations in almost all countries have undoubtedly been an important longer term cause of inflation, and now this factor is reinforced by the energy crisis. In a sense the rising expectations and high energy costs are on a collision course, for the much higher oil price means a large transfer of wealth from the industrialized oil-importing countries to the oil-producing countries, and thus a slowing or even cessation of the rising trend in living standards in the oil-importing areas until such time as productivity gains can recover enough to permit a resumption of gains in living standards. Unless this truth is recognized in political circles, there will be continuing pressure to try to restore living standards by providing larger supplies of money, even if the effort is doomed to failure and will merely add to the forces of inflation. Just to narrow the focus for a minute to the more immediate setting, there is an understandable desire now on the part of the American workers to make up for losses of real income in the past year or two. Yet overall productivity is still stagnant or declining, so that wage increases are almost sure to be translated promptly into higher prices. To be sure, this process could be prevented through a cut in corporate profits. It must be recognized, however, that corporate profits as a share of national income are at a historically low level already, and would be even lower if they were restated to reflect a more realistic evaluation of inflation's impact on inventories, depreciation, and other elements in corporate accounts.

It follows from what I have said that inflation must remain at least as important a consideration in central bank policy decisions as recession, with all that that requires in the way of avoiding any flooding of the economy with excessive monetary ease. But unfortunately this country's economic and political traditions are such that pressures for excessive easing in the present recessionary setting may become very strong indeed.

As I have already suggested, higher productivity is one major area that offers hope of some escape from the dilemma I have outlined. And higher productivity depends in considerable measure on continuing large capital ex-

penditures. It is at least encouraging to reflect that the oil payment flows can be turned to good account in one respect if the accumulation of capital in the hands of oil-producing countries is effectively channeled into productive investment in the United States and other industrialized countries. Efforts in this direction would clearly be worthwhile.

I have spoken earlier of the financial strains that have been commanding our attention and that will continue to do so for some months to come. The Federal Reserve's role as "lender of last resort" has been rightly emphasized in many pronouncements over the past year or so, and highlighted by the successful handling of the Franklin National Bank's problems. In this connection, I might note that it was encouraging to me to see over the weekend that the commercial banking system has resources within itself to resolve a problem bank situation without the need of financial assistance from the Federal Government other than limited use of the discount window. Nevertheless, it seems to me well to note that by its nature the central bank is a short-term lender rather than a provider of longer term capital. Moreover, our ties are very direct with the banking system, somewhat less direct with other financial institutions, and even less direct with industry and commerce in general. For these reasons I can see real merit in an examination of the need for some new form of public institution designed primarily to provide capital to corporations suffering unusual financial stress or corporations engaged in programs of great importance to the solution of major national problems, such as energy and transportation, when adequate capital is not obtainable from private sources.

I spoke earlier of the need to mesh monetary policy appropriately with fiscal policy. I have recently, and somewhat reluctantly, come to the conclusion that we will have to have some easing of fiscal policy this year, preferably in the form of a tax cut. I say reluctantly, because I believe that fiscal policy has generally been too expansionary over much of the past decade. Coupled with the pressures it has put on monetary policy to be too expansionary at times, it has been a significant source of our underlying inflationary problem. Nevertheless, I believe that in today's world the sort of economic weakness we face this year does call for some positive action on the fiscal front.

The program proposed by President Ford in the State of the Union message is intended to provide such action. Since most parts of the program require Congressional approval, the Congress will doubtless make at least some changes in the program before it is enacted. Therefore, rather than comment in detail on the President's proposals,



or upon any alternatives that might be brewing in the Congress, I shall merely mention a few general principles that appeal to me with respect to fiscal action. First, any net tax cut (that is, net of any increase in energy taxes) should be clearly understood to be readily reversible, so that we do not lock ourselves permanently into an overly stimulative and inflationary fiscal policy. Second, I believe at least part of the tax cut should be simple in structure so that it can be put in place promptly to cope with the recession now when stimulus is urgently needed. Third, I believe the cut should be directed at both individual and business incomes—the latter because the need to stimulate investment is clear. Fourth, I think the net size of the tax reduction should be held to moderate proportions, yet large enough to have a significant impact on consumer and business sentiment. Finally, I think we have to be careful that the Federal Reserve does not find itself inadvertently financing the enlarged Federal deficit by an undue increase in the rate of reserve expansion. Obviously, monetary policy should not offset the effects of additional fiscal stimulus by becoming less expansionary than would otherwise have been appropriate. On the other hand, it should not be deflected for any protracted period from progress toward the long-run goal of moderate monetary and credit expansion consistent with reasonable price stability. Within these guidelines, I think a new move to fiscal stimulus can serve a useful purpose at this time in cushioning economic weakness without threatening progress on the price front.

There are ample reasons from almost all points of view for this country and the oil-importing world generally to pursue a vigorous energy policy, with special emphasis on conservation of energy, designed to reduce gross oil payments and net oil deficits. It is gratifying that the Administration has been willing to propose a comprehensive program to this end. It would be beyond my competence to comment on the specifics of the energy program, but it does seem important to weigh the implications of steep boosts in fuel taxes for the general price level. In any case, the need for a thoroughgoing energy policy is

compelling even though it could have some adverse initial effects on certain sectors of the economy. I am optimistic that the American people are coming to appreciate the vital need to get on with such a program, even though it may—and probably must—involve some considerable sacrifices.

Finally, let me stress the ever-growing interdependence of our world, and hence the ever-present need to take international factors into account in determining monetary policy. For example, we cannot overlook the significance of exchange rate developments in the setting for policy, and especially the inflationary effects in the United States of a sharply depreciating dollar. We must share with monetary authorities abroad a mutual concern for financial mishaps that could reverberate beyond national borders; the solvency of the Euro-banking system is one such matter of mutual concern. More generally, granted that domestic needs must always have first priority, the time is long past when we or other nations could pursue domestic goals without thinking of the effects policies might have in terms of international money flows and international economic relations in general. Progress toward a better alignment of monetary policies among leading countries, therefore, should have a high priority, even though such progress may be halting and fragmentary for some years to come. We will need to keep this objective in mind, as we cope with the exceedingly complex problem of adjusting national monetary policies to the needs of a radically changing world.

I have, I am afraid, pointed to a host of problems and pressures that now confront us: inflation, recession, unemployment, and energy, as well as strains in our domestic and international financial markets. But a full recognition of these problems is necessary before we can try to find reasonable and sound solutions for them. The recent and prospective international meetings to discuss the economic and financial response to the high cost of fuel, and the Administration and Congressional proposals to deal with our domestic economy, show that we are ready to begin the process. Each of us has a part to play in arriving at the best solutions and in applying them.

## The Business Situation

Economic activity in the nation contracted sharply in the fourth quarter of 1974, and the decline apparently continued in the opening weeks of the new year. Real gross national product (GNP) declined at a 9.1 percent annual rate, falling to a level about 5 percent below the peak recorded during the last quarter of 1973. At the same time, industrial production, which had earlier been holding up, dropped at a 12.1 percent annual rate in the fourth quarter. While much of the decline in industrial production is attributable to the large reductions in automotive output, the decrease in manufacturing activity was widespread and extended beyond the automotive sector. The deterioration in economic activity was reflected in a marked worsening in labor market conditions. The unemployment rate has registered a steep rise in recent months reaching 8.2 percent in January, with all major labor-force groups showing increases.

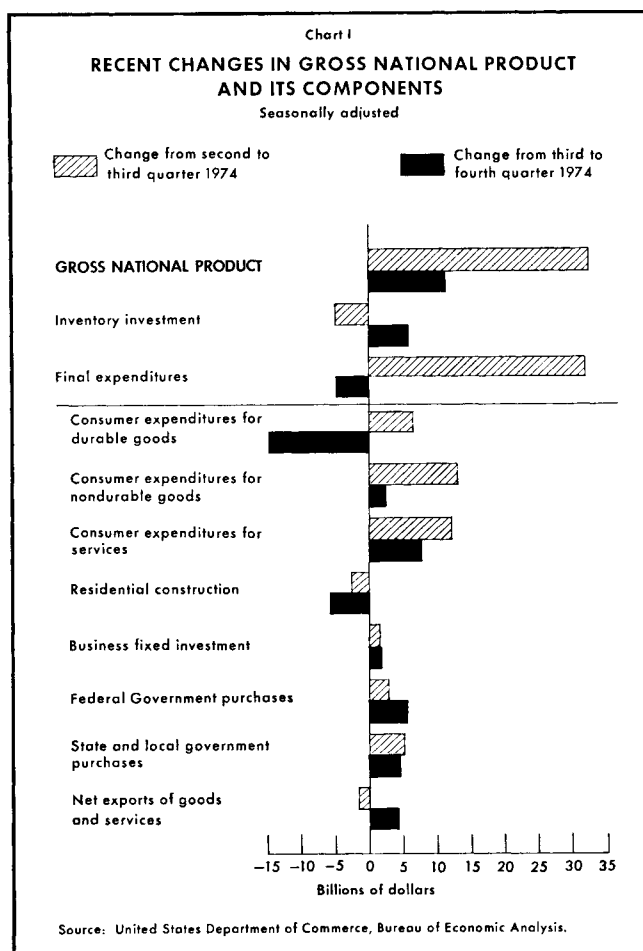
As outlined in his recent State of the Union message to the Congress, President Ford's proposed fiscal policy measures are aimed both at stimulating the economy and at increasing the nation's self-sufficiency in energy sources. On the one hand, to stimulate the economy, the President proposed a partial rebate of 1974 personal tax payments and a one-year increase in the investment tax credit. If adopted, these two measures would return about \$16 billion to the private economy. On the other hand, higher taxes on petroleum and natural gas products were proposed as part of a program to reduce energy consumption as well as to boost domestic production. Toward these ends, the President proposed import duties on crude oil and refined petroleum products, an excise tax of \$2 per barrel on domestic crude oil and an equivalent tax on natural gas, the decontrol of domestic oil prices, and a windfall profits tax on oil producers. However, to prevent the measures from being deflationary, the proceeds from these taxes are to be returned to the economy through several channels: changes in the personal income tax schedule, a cut in the corporate profits tax rate to 42 percent, cash payments to low-income persons to compensate them for higher energy costs, and revenue-sharing payments to state and local governments.

Inflation has slowed markedly at the wholesale level in recent months. In the fourth quarter, increases in wholesale industrial prices slowed to a 7.9 percent annual rate, a substantial decline from the 26 percent recorded in the previous quarter. Prices at the retail level have shown only a modest deceleration in recent months. Thus, the consumer price index increased at an annual rate of 9.8 percent during the fourth quarter, bringing its total climb for the year to 12.2 percent. In December, however, reflecting special pre-Christmas sales at many stores, the consumer price index rose at only a 7.9 percent rate, the slowest advance in many months.

### GROSS NATIONAL PRODUCT AND RELATED DEVELOPMENTS

According to preliminary Department of Commerce figures, the market value of the nation's output of goods and services increased by \$11.7 billion during the fourth quarter of 1974 (see Chart I) to a seasonally adjusted annual rate of \$1,428 billion. However, the observed expansion was attributable entirely to price inflation and, after correction for price change, real GNP in 1958 prices declined sharply at an annual rate of 9.1 percent (see Chart II). As a result, the real value of the nation's output at the end of 1974 was 5 percent below the peak attained at the end of 1973. The hardest hit sectors have been residential construction down 32 percent, consumer spending on durable goods off 12.6 percent, and business fixed investment down 7 percent. Other components have shown varying degrees of weakness.

Industrial production fell at a 12.1 percent annual rate during the fourth quarter (see Chart II). During the two previous quarters, it had recovered somewhat following its sharp decline during the oil embargo and, by September, industrial production was only 1.5 percent below its high of November 1973. However, starting in September, output was severely reduced in several sectors of the economy. Automobiles and related industries were hit the hardest, with the output of automobiles and parts falling back by 10.6 percent and iron and steel down by 3.3 per-



cent. However, the production of nondurable goods also fell by 3.4 percent and, reflecting some influence of the coal strike, output in mining and utilities was off by 1.7 percent. Hence, businesses used their capacity much less intensively than they had in the recent past. The index of industrial capacity utilization fell to 80.6 percent during the fourth quarter, compared with 88.5 percent during the third quarter and 92.3 percent at the end of 1973.

Although production was cut back substantially, the real value of business sales plunged at an even faster rate. As a consequence, businesses accumulated inventories—no doubt against their wishes, in light of sales experience—at a noticeably faster rate during the fourth quarter than they had earlier in the year. The real value of inventory investment was \$9.1 billion, compared with an average of \$7.9 billion over the first three quarters. Automobile inventories alone accounted for \$4.5 billion of the advance,

and at the end of 1974 automobile dealers held inventories equal to 94.8 days of sales, compared with only 68.5 days at the end of 1973. This change in auto stocks also accounts, in part, for the fact that the average level of all business inventories measured in constant dollars rose to 32.8 percent of real business sales measured at an annual rate, up from 30.3 percent at the end of 1973 (see Chart III).

Faced with substantial idle capacity, businesses have evidently begun to pare their expenditures on new capital goods. Business fixed investment measured at current market prices increased by only \$1.8 billion during the fourth quarter (see Chart I), compared with an average increase of \$3 billion during the first three quarters of the year. All of the increase was in structures where investment expanded by \$3.3 billion. Investment in equipment actually declined by \$1.5 billion even before adjustment for price changes. Correcting for inflation, business fixed investment fell 5.1 percent to \$89.3 billion in 1958 prices, with outlays for structures rising \$0.8 billion and expenditures on equipment declining by \$5.6 billion. Moreover, the general weakening of economic conditions appears to be having a negative impact on the investment plans of business. The most recent Commerce Department survey of planned investment spending for 1975 indicates that businesses plan to spend only about 4.6 percent more on plant and equipment in 1975 than they did in 1974. These results are substantially lower than those of a September survey by McGraw-Hill, which projected a 12 percent jump in fixed investment expenditures. The McGraw-Hill survey also found that businessmen anticipated that capital goods prices would rise by approximately 12 percent during 1975. Therefore, as of September, planned real investment for 1975 was about the same as for 1974. However, if the price expectations reported by McGraw-Hill in September were still held in December, the findings of the recent Commerce survey would indicate that firms now plan a sizable net reduction in real investment during 1975.

Consumers' real disposable income continued to deteriorate during the fourth quarter, falling by 4.4 percent at an annual rate to \$596.2 billion. The declining purchasing power was at least partly responsible for the sharp falloff in the volume of household consumption expenditures in real terms, which declined at an 11.9 percent seasonally adjusted annual rate—the largest quarterly drop in the postwar period. Most of the decline was concentrated in purchases of durable goods, which decreased 42.9 percent on an annual-rate basis. The typically more stable nondurables component declined at a 7.1 percent annual rate, while expenditures on services rose by 1.9

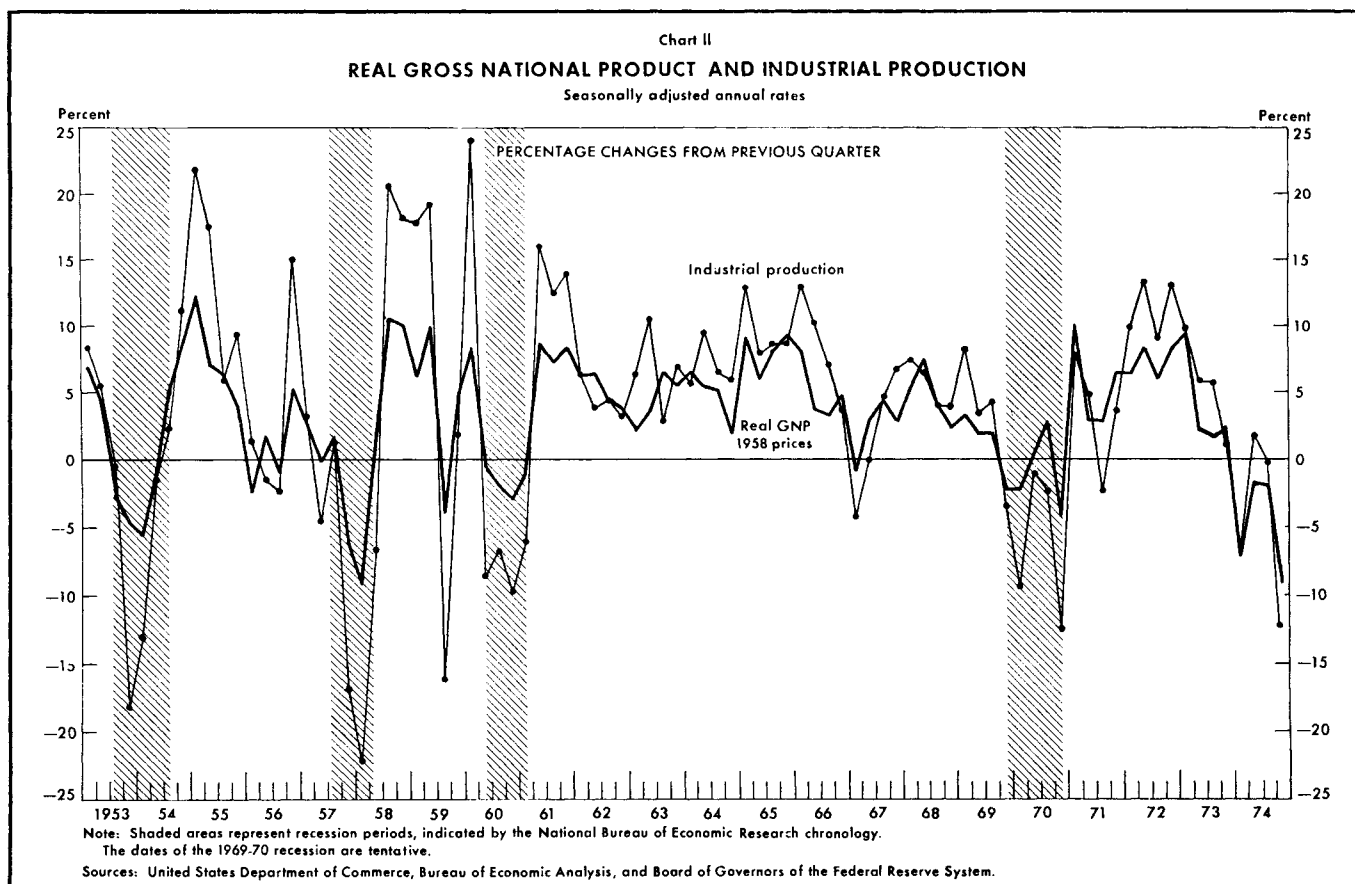
percent. In addition, recent surveys indicate that consumer confidence has receded to extremely low levels. The University of Michigan survey, based on interviews conducted during October and November, showed consumer confidence had fallen to its lowest level since the inception of the survey in the late 1940's. The Conference Board consumer confidence index is also at a record low of 39.9 percent, down 9 points from the September-October period. Both surveys indicated that intentions to buy houses, cars, and appliances were at new lows.

The combination of high interest rates and a pessimistic outlook among potential buyers led to another substantial decline in residential construction during the fourth quarter. The real value of building activity was down by 14 percent during the fourth quarter, after having already fallen 21 percent during the first three quarters of the year. New housing starts during the quarter were recorded at a 990,000 annual rate. This is only the second full

quarter in which starts have averaged less than 1 million at an annual rate since 1946. While the recent decline in interest rates may stimulate this finance-sensitive industry, the data on new housing permits do not foreshadow an immediate recovery. Permits during the fourth quarter were at their lowest level since the series began in 1959.

Higher prices accounted for the substantial boost in Government expenditures on goods and services during the fourth quarter. The Federal Government increased its spending by over \$5.5 billion to an annual rate of \$122.8 billion. Most of the advance was in defense spending, which rose by \$5 billion. State and local governments increased their expenditures by \$4.5 billion. In real terms, however, total government spending has remained virtually constant since the second quarter of 1974.

In contrast to the other major components of GNP, net exports increased by \$1.6 billion in real terms in the fourth quarter, after having declined in two previous quarters.





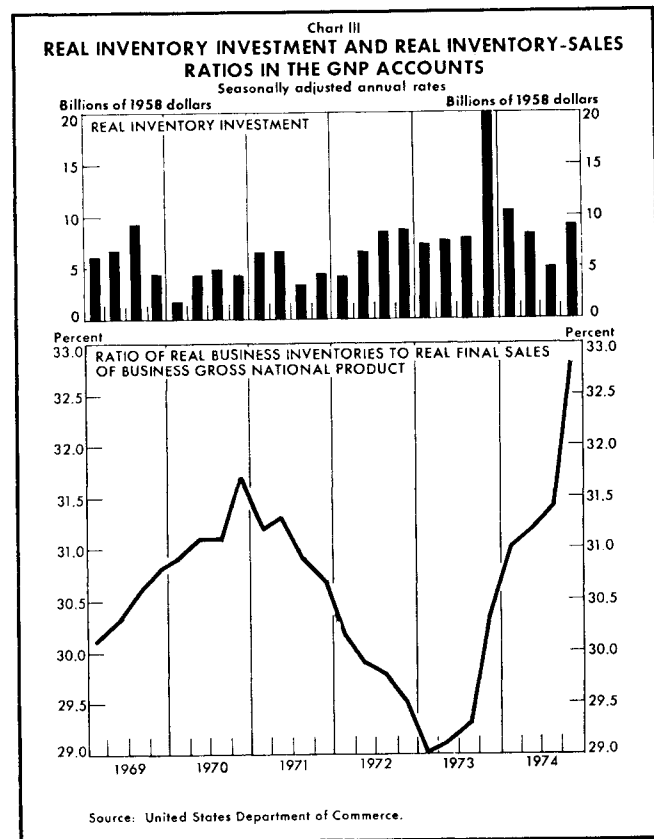
### PRICE DEVELOPMENTS

Despite signs of an improving price outlook, prices of final goods and services as measured by the implicit GNP price deflator rose at a 13.7 percent annual rate in the fourth quarter, up somewhat from the 11.9 percent growth rate recorded in the previous quarter. However, this measure appears to have overstated the extent of inflation to some degree. Thus, the fourth-quarter acceleration reflected both the Federal pay raise in October and the change in the composition of output brought about mainly by the drop in gross auto product. The fixed-weight deflator for private GNP increased at a 12 percent annual rate in the fourth quarter, down slightly from the 13.2 percent growth rate in the previous three-month period.

The consumer price index rose at a 9.8 percent annual rate in the final three months of 1974, its slowest quarterly rate of the year. This slowdown occurred despite an acceleration in the advance of retail food prices to a 13.8 percent rate, up from 11.7 percent during the third quarter. The prices of all commodity items except food rose at a 7.1 percent annual rate, well below the third quarter's 15.3 percent rate and less than half the average rate of increase during the first nine months of the year. Service prices in the fourth quarter rose at a 10.5 percent rate, just slightly less than the 11.3 percent average for the year as a whole.

At the wholesale level, however, there has been a substantial moderation in the rate of inflation. The wholesale price index advanced at a 12.7 percent annual rate in the final three months of the year, down from 31.3 percent during the third quarter and an average of 21.5 percent for the first nine months of the year. In December, wholesale prices actually declined at a 5.9 percent annual rate. For the quarter as a whole, the deceleration of prices was most noticeable among industrial commodities, which increased at a 7.9 percent annual rate, down from 25.7 percent in the third quarter. Moreover, this slowdown was quite broadly based, showing up in a large number of commodities including textiles, fuels, and paper products. The prices of farm products and processed foods and feeds rose at a 20.3 percent pace during the final quarter, well below the 49.3 percent rate of the third quarter. Viewed in combination with recent forecasts of larger harvests in the forthcoming season, this sharp fallback in the rate of inflation may signal a general weakening of farm price increases.

To some extent, the relief in industrial prices represents a working-forward of declines in raw materials prices, which have been under way for some months. The spot prices of raw industrial commodities declined 3.6 percent



during the third quarter and by an additional 17.6 percent in the fourth. During the same period, increases in the wholesale prices of intermediate materials, excluding food and feeds, dropped from an 8.5 percent rate in the third quarter to 3.3 percent during the fourth.

### WAGES, PRODUCTIVITY, AND EMPLOYMENT

The cost of production continued to rise rapidly during the fourth quarter of 1974, as the compensation paid to labor increased while labor's productivity declined. Compensation per hour worked in the private sector of the economy increased at a 9.3 percent seasonally adjusted annual rate. At the same time, output per hour worked declined at a 5.3 percent rate. This productivity decline, coupled with the higher compensation rates, caused unit labor costs to increase at a 14.7 percent annual rate.

The effective wage of labor covered by collective bargaining increased at a 6 percent annual rate during the fourth quarter, bringing the total increase for 1974

to 9.2 percent. By comparison, the wage gain of contract labor in 1973 was 7 percent. Of the 1974 increase, 4.6 percent resulted from contracts negotiated during the year, 2.6 percent came from previous settlements, and 1.9 percent is attributable to cost-of-living-escalator provisions. According to preliminary data from the Bureau of Labor Statistics, collective bargaining agreements—covering 5,000 or more workers—that were negotiated during the fourth quarter of 1974 called for first-year wage and fringe benefit increases of 14.8 percent. This is somewhat higher than the 11.9 percent written into contracts during the third quarter, and well above the 9.3 percent average during the first three quarters of the year. Over their entire lives, new contracts in the fourth quarter will provide average annual increments of 8.7 percent in wages

and benefits, compared with 7.1 percent during the preceding three quarters.

Reflecting the sharp decline in the production of goods and services, the seasonally adjusted civilian unemployment rate rose to a postwar record of 8.2 percent in January. The increase in unemployment, up from 7.2 percent in December, was felt by all age groups in the labor force. However, it was particularly pronounced among teenagers. The jobless rate among workers under twenty years of age increased to 20.8 percent in January, while unemployment among prime-age workers, twenty-five years and older, rose to 5.7 percent. Looking at the breakdown by job categories, the January unemployment rate for white-collar workers was 4.6 percent, while the blue-collar rate was 11 percent.

## Monetary and Financial Developments in the Fourth Quarter

Most short-term interest rates fell substantially during the fourth quarter of 1974, extending the downtrend that began toward the end of the summer. The average effective rate on Federal funds dropped from 11.34 percent in September to 8.53 percent in December, its lowest monthly average in a year and a half. Similarly, sharp declines were registered over the quarter as a whole in rates on commercial paper, bankers' acceptances, and large certificates of deposit (CDs), although some rates experienced periods of upward pressure. In early December, the Board of Governors of the Federal Reserve System approved the first reduction in discount rates in three years. These rates were cut by  $\frac{1}{4}$  percentage point to  $7\frac{3}{4}$  percent, and shortly after the start of the new year an additional  $\frac{1}{2}$  point reduction was approved. The discount rates were lowered to  $6\frac{3}{4}$  percent in early February. In the early weeks of 1975, the Federal funds rate and other short-term rates continued to fall.

Yields on long-term debt instruments dropped over the quarter with the exception of municipal bond yields. In the Government coupon sector the declines were fairly sharp and steady. Corporate bond yields, on the other hand, rose as the year drew to a close, reversing part of the earlier declines. The unseasonably large volume of offerings plus a substantial buildup of the forward calendar for early 1975 weighed heavily on the market. The municipal bond market came under pressure and yields rose sharply. The weakness of bank demand for municipal securities and the financial difficulties of state and local governments placed upward pressures on yields of municipals. The Bond Buyer index rose over the quarter by 46 basis points.

In the fourth quarter, the growth of the money stock measures accelerated a bit from the sluggish pace of the third quarter. However, in the final month of the period the narrowly defined money stock ( $M_1$ ) rose very slowly, and preliminary data indicate that it fell in the early weeks of 1975. The sharp decline in market interest rates encouraged flows into commercial bank time and savings deposits. As a result, the more broadly defined money stock ( $M_2$ ) grew more rapidly in the fourth quarter and continued to rise early in 1975.

Lower market interest rates also encouraged flows into thrift institutions, and deposit growth accelerated significantly during the fourth quarter from its extremely slow pace over the previous six months. At the same time, however, the growth of mortgage loans outstanding continued to decelerate, reflecting in part previous declines in commitments. Outstanding commitments dropped again in the fourth quarter. With overall credit conditions easing, secondary mortgage market rates moved sharply lower. Primary rates, however, as measured by the Federal Home Loan Bank (FHLB) Board effective yields series, continued to advance as investors took down loans that had been committed in earlier periods when rates were still rising.

Reserve requirements on member bank time and demand deposits were amended and reduced twice in recent months. In November, the Board of Governors lowered reserve requirements on long-term time deposits and raised reserve requirements on short maturities. The requirements on net demand deposits in excess of \$400 million were lowered  $\frac{1}{2}$  percentage point. At the same time, the marginal reserve requirement on short-term CDs and related instruments instituted a year and a half earlier was removed. The requirements on net demand deposits were lowered  $\frac{1}{2}$  to 1 percentage point in January to facilitate moderate growth in the monetary aggregates. In addition, the Board permitted the establishment of "investment certificates", a new type of long-term consumer-type time deposits on which member banks are allowed to pay up to  $7\frac{1}{2}$  percent annual interest. The Federal Deposit Insurance Corporation (FDIC) and the FHLB Board took similar actions during December to allow their member institutions to issue these higher yielding time deposits.

### MONETARY AGGREGATES AND SHORT-TERM INTEREST RATES

After rising very slowly during the summer months,  $M_1$ —private demand deposits adjusted plus currency outside banks—advanced over the fourth quarter as a whole at a somewhat faster pace. The growth of  $M_1$  acceler-

ated to a 4.3 percent seasonally adjusted annual rate, up from the 1.6 percent rate of expansion experienced during the previous three-month period (see Chart I).  $M_1$  growth, however, was concentrated in the first two months of the quarter, when it rose at an annual rate of 5.3 percent. In December,  $M_1$  grew very slowly and, according to preliminary data, it declined in the early weeks of January.

For the year as a whole,  $M_1$  advanced by 4.5 percent, down substantially from the 6.1 percent increase experienced in 1973 and the rapid 8.7 percent gain registered in 1972. An unusually large part of the growth of  $M_1$  in 1974 was concentrated in the currency component. The public's holding of currency rose about 10 percent, more than triple the rate of expansion in the public's demand deposit balances. Increases in currency seem to be directly related, in part, to the dollar volume of ordinary household expenditures on nondurable goods and services, which are often paid for with cash. These expenditures rose sharply in 1974 in contrast to a marked slowdown in the rate of advance in many of the other components of GNP.

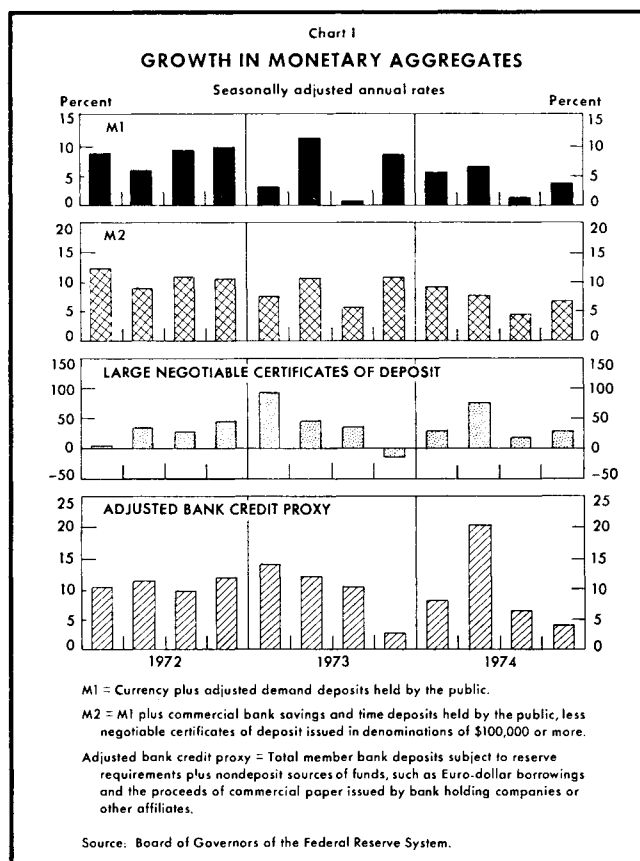
The expansion of  $M_2$ —which adds to  $M_1$  time deposits other than large CDs—also accelerated in the fourth quarter to an annual rate of 6.8 percent, compared with an increase of 4.6 percent in the preceding three-month period. The speedup in  $M_2$  growth during the quarter reflected the more rapid advance in  $M_1$  as well as a greater increase in  $M_2$ 's time deposit component. Growth in the latter was probably boosted, in part, by the decline in interest rates on most competing market instruments. Over the year as a whole,  $M_2$  rose 7.3 percent. This also represented a substantial slowdown from the rates of expansion experienced over the previous two years.

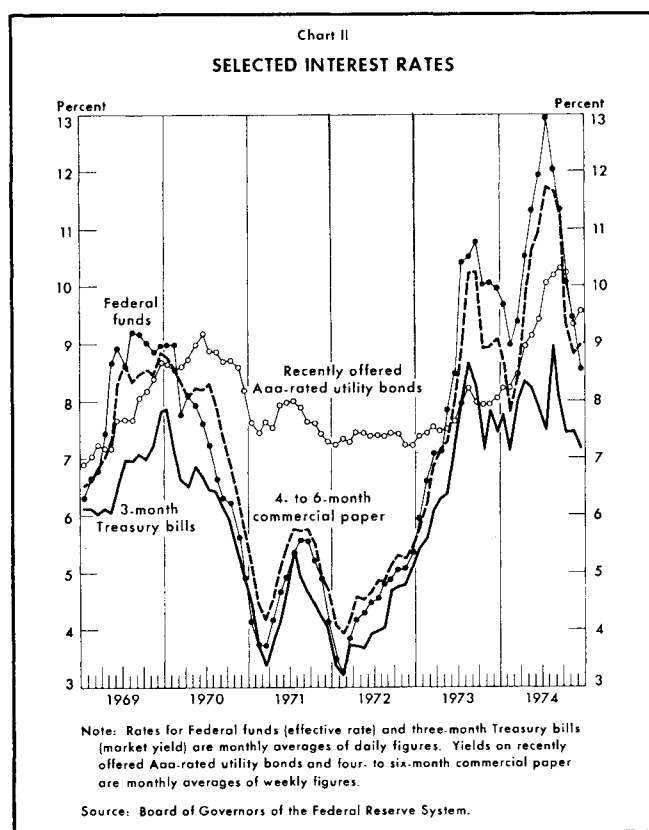
In contrast to the money stock measures, the bank credit proxy—member bank demand deposits subject to reserve requirements plus certain nondeposit liabilities—grew at a slower pace in the fourth quarter than in the preceding three-month period. The disparity between the growth of the proxy and that of the monetary aggregates arose mainly because banks did not completely offset a sharp decline in Government deposits by issuing CDs. Major New York City banks did market these instruments more aggressively toward the end of the year, in part to finance a temporary buildup of loans at that time. At banks outside New York City, credit demands were not strong and loan growth was weak over the quarter.

Member bank borrowings from the Federal Reserve dropped \$2.6 billion in the fourth quarter to an average of \$0.7 billion in December, the lowest level since November 1972. About \$1.75 billion of the decline represented the assumption by the FDIC of advances by the Federal Reserve Bank of New York to Franklin National Bank,

while the remainder reflected the increased availability of nonborrowed reserves relative to requirements.

Over the fourth quarter, most short-term interest rates fell substantially, although this general trend was interrupted at times (see Chart II). In many cases, the largest declines occurred at the start of the quarter; indeed, some rates retraced part of their downward movement as the year drew to a close. The rate on four- to six-month commercial paper, for example, fell about  $1\frac{3}{4}$  percentage points from the end of September to the end of October and then rose about  $\frac{1}{4}$  percentage point by the close of the quarter. A similar pattern was exhibited by the rate on 90-day CDs in the primary and secondary markets. The backup in these rates was caused, in part, by reevaluations by some market participants who had expected the Federal funds rate to fall much farther rather than to remain about constant during November and, in part, by enlarged demands for funds which reached the markets in the closing months of the year. In December the Federal funds rate resumed its downward trend, and it continued to





took place at a 7.7 percent seasonally adjusted annual rate in the fourth quarter, significantly above the 2.5 percent rate of advance experienced in the third quarter (see Chart III). Despite this improvement, deposit growth for the year as a whole was at a slow 5.8 percent pace, down from 8.4 percent in the preceding year. The sluggishness of thrift institution deposit growth in 1974 stemmed largely from the adverse impact of relatively high interest rates that were available on competing money and credit market instruments during a considerable part of the year. Mutual savings bank deposit growth slowed to 3 percent in 1974, while savings and loan association deposit growth decelerated to 7 percent. The respective growth rates for the deposits of these institutions in the preceding year were 5.2 percent and 9.8 percent.

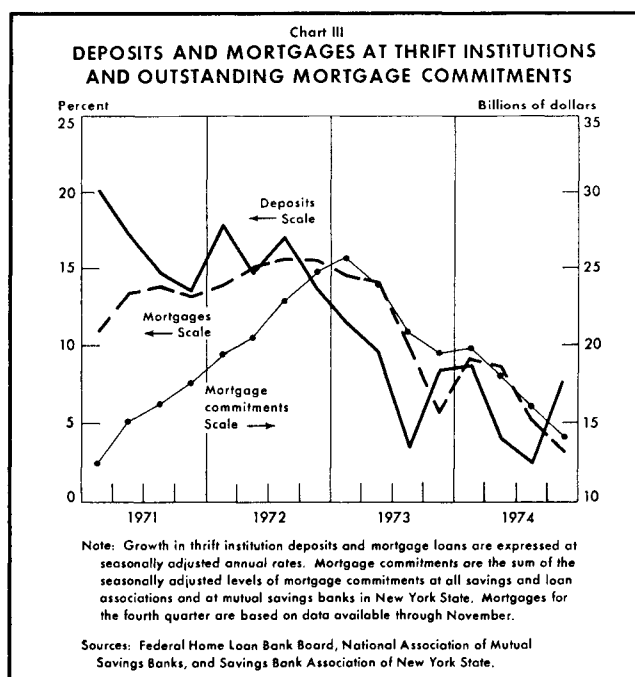
Although deposit growth accelerated in the fourth quarter, the rate of advance of mortgage holdings continued to decelerate. This deceleration reflected the sharp decline in mortgage commitments that began in mid-1973 and continued in 1974. For the year through November, the latest month for which data are available, mortgage holdings grew at a seasonally adjusted annual rate of 7 percent, after having grown about 11½ percent in 1973. Commitments for new home mortgages declined again during the fourth quarter, as thrift institutions continued to

fall early in January along with other short-term interest rates.

During the quarter, commercial banks cut their prime lending rates in several steps from the record high of 12 percent which prevailed over the July-September period. However, these reductions lagged the fall in other short-term market rates, generating unusually wide spreads and leading borrowers to shift their financing activity away from banks. By the year-end, major banks were about evenly divided between those posting a 10¼ percent prime rate and a 10½ percent rate. Subsequently, most major banks further reduced their prime rates in January.

#### THRIFT INSTITUTIONS AND THE MORTGAGE MARKET

Thrift institution deposit growth accelerated during the fourth quarter, responding in part to the decline in short-term market interest rates that began toward the close of the preceding three-month interval. Total deposit growth



manage their portfolios cautiously.

Secondary market mortgage yields fell sharply during the quarter. The easing of money market conditions reduced the pressure on mortgage originators to dispose of mortgages in their portfolios. Reflecting this development, the average yield on four-month commitments on insured mortgages at the last Federal National Mortgage Association auction in December was 9.47 percent, 109 basis points lower than the average yield at the final auction in September. These yields continued to decline in January. In the primary market the FHLB Board series on effective rates on new-home conventional mortgages rose 12 basis points over the quarter to 9.31 percent, as borrowers took down mortgages for which they had obtained commitments when credit market conditions were still firming. The volume of FHLB advances outstanding rose by about \$1 billion during the quarter. Some of this borrowing from the FHLBs was offset by a reduction in thrift institution borrowing from other sources.

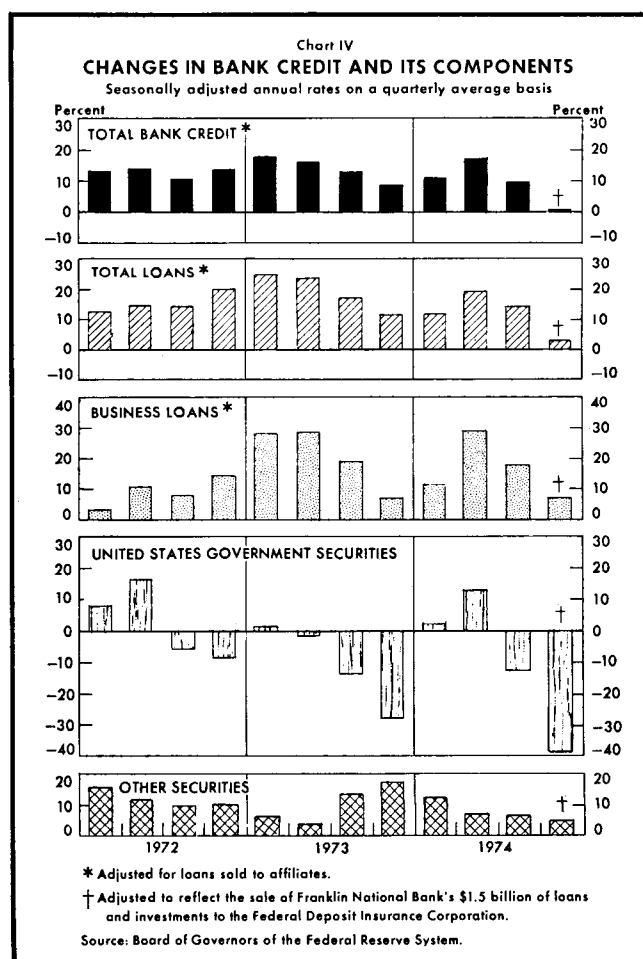
#### BANK CREDIT AND THE CAPITAL MARKETS

Seasonally adjusted total bank credit, including loans sold to affiliates, changed little in the fourth quarter from its average level over the previous three months (see Chart IV). In general, total bank credit has been exceptionally weak since August. The volume of total loans, for example, which dropped sharply in December, was virtually flat from August to November after advancing at an annual rate of about 18 percent during the first eight months of the year. Similarly, total investments declined almost consistently over the August-December period following sizable advances earlier in the year.

Business loans at all commercial banks grew at a 7½ percent rate in the fourth quarter, down substantially from the 20 percent average growth rate in the first three quarters of the year. Most of the recent slowdown occurred in December when business loans dropped off sharply. A slackening in the demand for business loans is not surprising in view of the sharp contraction in economic activity. Also, there seem to be indications that some of the regional banks may have been reluctant to make additional loans because of concern over bank liquidity and adequacy of capital. In contrast, major New York City banks experienced heavy loan demand as the year drew to a close, though declines in the early weeks of 1975 were much larger than seasonal. The different loan pattern exhibited at New York City banks relative to the rest of the country was due partly to heavy borrowing at major banks by some utility firms that were encountering problems in borrowing in the long-term debt

markets. Moreover, New York City banks apparently attracted, particularly in December, borrowings from some firms which were experiencing difficulties in issuing commercial paper.

In the capital markets, yields fell on balance over the fourth quarter in both the Government securities and corporate sectors. The declines were generally less than those experienced in short-term rates, as new issue activity in the long-term debt markets over the period was exceptionally heavy and long-run inflationary expectations remained firmly embedded in yields. In the Government securities sector, rates on coupon-bearing issues dropped almost steadily throughout the quarter though concern about the potential size of the Treasury cash needs was evident. On three- to five-year issues, for example, rates fell about 1 percentage point from the end of September to





the end of December. Over the same period, yields on long-term Government securities dropped about  $\frac{1}{2}$  percentage point. Corporate bond yields declined considerably through mid-November and then retraced part of their downward movement for the remainder of the quarter. Yields experienced upward pressure, as the forward calendar of new offerings for January built up to near-record levels while new issue activity in December remained unseasonably heavy. Investors continued to show concern for the quality of many public utility offerings over the quarter, and the spread between yields on these and yields on other corporate securities remained unusually wide.

In contrast to most other interest rates, yields on municipal bonds moved upward over much of the fourth quarter. As measured by The Bond Buyer's twenty-bond index, yields reached a record high of 7.15 percent in mid-December before receding to 7.08 percent at the year-end, a net gain of 46 basis points over the quarter. The rise in yields on municipal bonds seemed to reflect the absence of demand from commercial banks and fire and casualty insurance companies, which are traditionally heavy purchasers of these securities. A major contributing factor, however, was the budget difficulties affecting state and local governments.

## **The Money and Bond Markets in January**

A further reduction in short-term credit demands by businesses and an increased availability of nonborrowed reserves resulted in sharp declines in short-term interest rates during January. Recent actions by the Board of Governors of the Federal Reserve System also fostered rate declines. In early January, the Board approved a reduction in the discount rate from  $7\frac{3}{4}$  percent to  $7\frac{1}{4}$  percent at six Federal Reserve Banks and the others followed suit as the month progressed. Effective February 5 the discount rate was again reduced at nine banks, including New York, to  $6\frac{3}{4}$  percent. In addition, the Board announced a lowering of reserve requirements against net demand deposits on January 20. This action will provide over \$1 billion of reserves to the banking system. (Details of the change are discussed on page 33.) The Board noted that the change should facilitate moderate growth in the monetary aggregates.

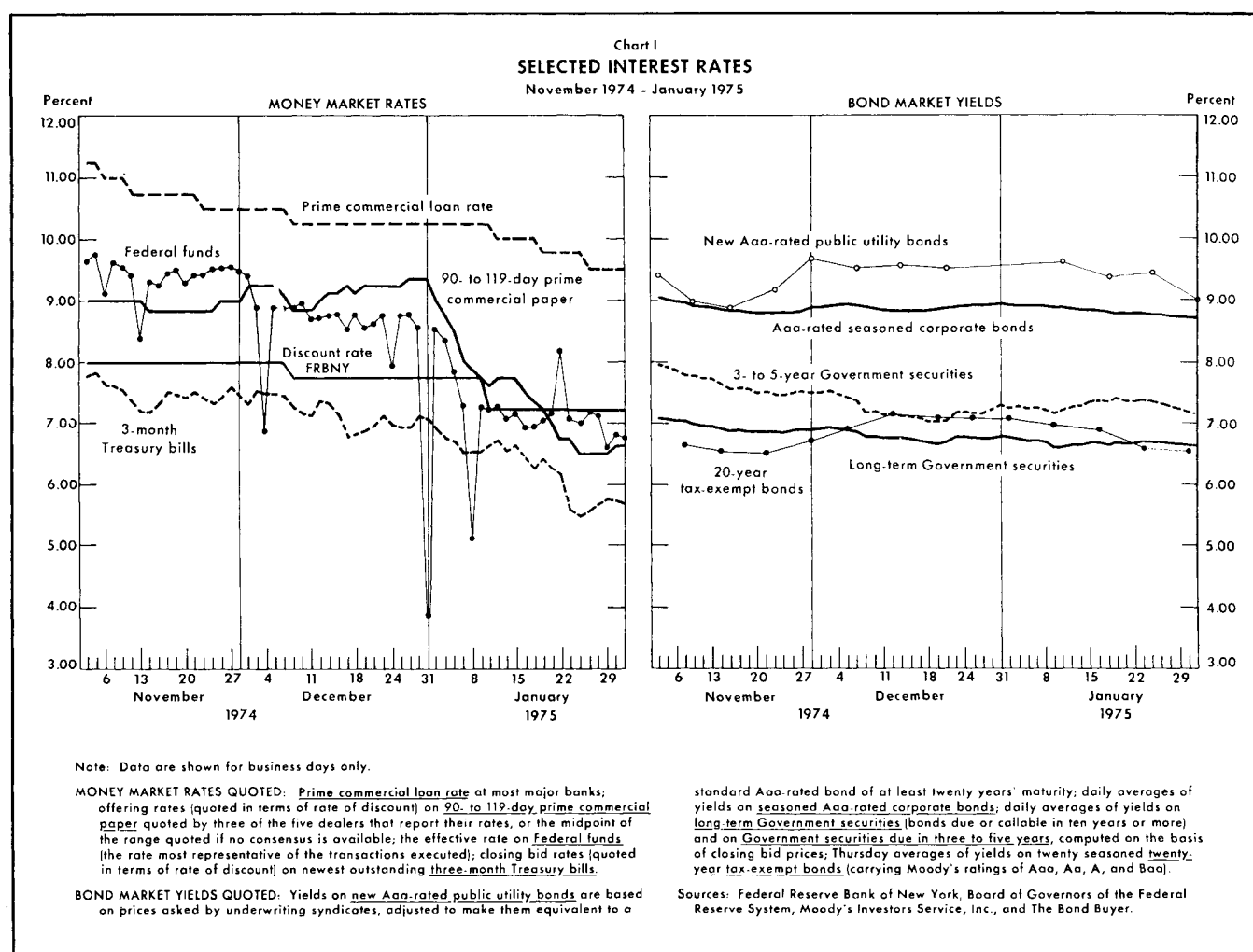
Treasury bill rates moved down sharply in concert with other money market rates. Yields in the intermediate-term Government sector, however, fell only slightly over the course of the month as market participants showed concern about the potential for sizable Treasury cash borrowing in the months ahead and prepared for the quarterly refunding operation. Yields on long-term Government bonds were initially under some upward pressure but turned down later in the month and ended generally lower.

Business continued its drive to bolster liquidity, and borrowing demands in the corporate bond market were consequently very heavy. Still, the decline in short-term rates prompted investors to lengthen maturities in their portfolios, and demand for new issues proved strong enough to raise prices in this sector over the course of the month. Interest in tax-exempt securities remained sluggish, but the financing calendar was light and some price gains occurred in this sector as well.

Preliminary data indicate that the narrowly defined money stock ( $M_1$ ) contracted substantially during the first several weeks of January following a rather small increase in the previous month. Declines in market rates of interest fostered strong inflows of consumer time and savings deposits to commercial banks, however, so that the more broadly defined money stock ( $M_2$ ) and the adjusted bank credit proxy did rise in January though apparently at rather slow rates reflecting the weak growth in demand deposits.

### **THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES**

Money market rates moved downward sharply in January (see Chart I), as banks found nonborrowed reserves in more ample supply and loan demand slackened. Dur-



ing January the effective rate on Federal funds averaged 7.13 percent, 140 basis points below its average over the preceding month and at its lowest level since April 1973. Most banks reduced their prime rates by  $\frac{1}{2}$  point to  $\frac{3}{4}$  point during the month, and the range in the industry at the close was 9 to  $9\frac{1}{2}$  percent. This rate remained well above rates on other sources of funds to businesses, so that commercial and industrial loans at the weekly reporting New York City banks displayed a somewhat larger than seasonal decline of about \$2 billion over the four-week period ended January 29. Banks withdrew from active bidding to issue certificates of deposit (CDs) and even sustained some runoff during January. The rate on three-month CDs in the secondary market fell over the course

of the month by more than  $2\frac{1}{2}$  percentage points to 6.78 percent. The volume of CDs outstanding at New York City weekly reporting banks dropped by \$1,130 million over the four weeks ended January 29. Member banks reduced their borrowings from the Federal Reserve Banks over the five weeks ended January 29 by \$519 million (see Table I).

The easing in money market conditions was also reflected by a fall in the rates on commercial paper, with the rate on 90- to 119-day dealer paper declining by  $2\frac{3}{4}$  percent to a level of  $6\frac{5}{8}$  percent by the end of the month. The wide spread between the prime rate and the commercial paper rates induced businesses to shift some of their borrowing toward the commercial paper market, and the volume of nonfinancial commercial paper rose over the

five weeks ended January 29 by \$2.1 billion.

According to preliminary estimates  $M_1$ —which includes private demand deposits adjusted plus currency outside banks—declined at an annual rate of 9.6 percent in the four-week period ended January 29 over the average of the four weeks ended January 1. The unusually large decrease was entirely attributable to a fall in demand deposits, whereas currency continued to increase. But short-term movements in money stock growth are often quite volatile and may not reflect underlying trends. In January 1974 the money stock also declined but then went on to rise significantly the following month. As market interest rates fell this January, time deposits other than large CDs grew rapidly over the same period. This offset the demand deposit decline, and  $M_2$ —which consists of  $M_1$  plus these other time deposits—expanded at a 3 percent annual rate. The adjusted bank credit proxy—which includes demand deposits of member banks subject to reserve requirements plus certain nondeposit liabilities—increased by 3.4 percent over the same period, slow by previous standards. The growth rates from a longer perspective are shown in Chart II.

The reduction in reserve requirements announced by the Board of Governors on January 20 incorporated the following changes. Reserve requirements for the first \$400 million of net demand deposits held by a member bank were reduced by  $\frac{1}{2}$  percentage point and for demand deposits in excess of \$400 million by 1 percentage point. Specifically, the requirements were reduced to 7.5 percent on the first \$2 million of demand deposits, to 10 percent on deposits above \$2 million but below \$10 million, to 12 percent on deposits above \$10 million but below \$100 million, to 13 percent on deposits above \$100 million but below \$400 million, and to 16.5 percent on deposits above \$400 million. Reserve requirements on time and savings deposits were unaffected by the change.

#### THE GOVERNMENT SECURITIES MARKET

Treasury bill rates declined substantially while yields on coupon securities moved only slightly lower during January. Expectations that fiscal policy would become more stimulative to counteract the current economic slowdown made market participants increasingly aware of the possibilities that Treasury financing needs could become quite large in the months ahead. In addition, the approach of the quarterly refunding operation prompted dealers to lighten their inventories. As a result, prices of intermediate maturity issues moved downward over most of the month but rose toward the close.

In the market for Treasury bills, demand generally

**Table I**  
**FACTORS TENDING TO INCREASE OR DECREASE**  
**MEMBER BANK RESERVES, JANUARY 1975**

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

Factors	Changes in daily averages— week ended					Net changes
	Jan. 1	Jan. 8	Jan. 15	Jan. 22	Jan. 29	
<b>"Market" factors</b>						
Member bank required reserves..	— 584	— 156	— 1,091	+ 183	+ 901	— 747
Operating transactions						
(subtotal) .....	+ 977	+ 1,761	+ 1,454	— 685	— 880	+ 2,627
Federal Reserve float .....	+ 1,062	+ 108	— 824	— 501	— 144	— 299
Treasury operations* .....	— 119	+ 762	+ 517	— 262	— 1,380	— 482
Gold and foreign account .....	+ 12	+ 9	— 122	+ 167	— 10	+ 56
Currency outside banks .....	+ 94	+ 704	+ 1,919	+ 11	+ 652	+ 3,380
Other Federal Reserve						
Liabilities and capital .....	— 72	+ 178	— 36	— 100	+ 2	— 28
Total "market" factors .....	+ 393	+ 1,605	+ 363	— 502	+ 21	+ 1,880
<b>Direct Federal Reserve credit transactions</b>						
Open market operations						
(subtotal) .....	— 102	— 1,918	— 864	+ 665	+ 315	— 1,906
Outright holdings:						
Treasury securities .....	— 15	— 145	— 206	— 190	+ 257	— 299
Bankers' acceptances .....	+ 50	+ 21	+ 18	+ 24	+ 32	+ 145
Federal agency obligations .....	—	— 14	—	—	—	— 14
Repurchase agreements:						
Treasury securities .....	— 396	— 862	— 380	+ 673	+ 28	— 927
Bankers' acceptances .....	+ 187	— 353	— 85	+ 56	+ 47	— 148
Federal agency obligations .....	+ 72	— 565	— 211	+ 102	— 49	— 651
Member bank borrowings .....	— 101	— 249	+ 296	— 14	— 451	— 519
Seasonal borrowings† .....	— 7	— 3	— 6	— 1	— 2	— 19
Other Federal Reserve assets‡ .....	+ 63	+ 86	+ 18	+ 134	+ 48	+ 349
Total .....	— 140	— 2,081	— 550	+ 785	— 91	— 2,077
Excess reserves‡ .....	+ 253	— 476	— 187	+ 283	— 70	— 197
	Daily average levels					Monthly averages§
Member bank:						
Total reserves, including						
vault cash‡ .....	37,661	37,341	38,245	38,345	37,374	37,793
Required reserves .....	37,011	37,167	38,258	38,075	37,174	37,537
Excess reserves .....	650	174	— 13	270	200	256
Total borrowings .....	561	312	608	594	143	444
Seasonal borrowings† .....	22	19	13	12	10	15
Nonborrowed reserves .....	37,100	37,029	37,637	37,751	37,231	37,350
Net carry-over, excess or deficit (—)   .....	243	204	150	— 15	88	134

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

\* Includes changes in Treasury currency and cash.

† Included in total member bank borrowings.

‡ Includes assets denominated in foreign currencies.

§ Average for five weeks ended January 29, 1975.

|| Not reflected in data above.

avored shorter maturities and, over the month as a whole, Treasury bill rates in the secondary market fell by 84 to 149 basis points. Rates set at Treasury bill auctions moved successively lower over the four weeks of January (see Table II). At the final auction of the month, on January 27, the average issuing rate set on three-month bills was 5.61 percent while the average rate on six-month bills was set at 5.83 percent, for respective declines of 151 and 128 basis points from the final auction in December. At the regular monthly auction of 52-week bills, the average issuing rate was set at 6.38 percent, down from 6.63 percent set at the previous month's sale. On January 2, the Treasury held an auction of \$750 million in additional 8 percent notes due in March 1976 on which an average yield was set at 7.24 percent.

In mid-January, proposals for a tax rebate to stimulate the economy caused estimates of the Treasury's cash needs to be revised upward. The Treasury announced plans for raising an additional \$19 billion by June 30 to cover the currently estimated deficit. According to these plans, part of this amount will be raised after January by increasing the regular weekly bill offerings, by offering \$100 million more at the next 52-week-bill auction, and by offering in February two note issues totaling \$3 billion. Finally, the Treasury said that it might sell two-year notes each month, rather than just at the end of each quarter. These statements were viewed by the market as indicating that intermediate-term issues would be in greater supply. Yields on intermediate Government maturities rose in the wake of these announcements but, after further drops in short-term rates, strong interest in these issues emerged.

The first stage of these plans involved holding three auctions in late January to refinance \$3.6 billion in issues maturing on February 15 and to raise \$1.95 billion in new cash. All issues were available in minimum denominations of \$1,000. Specifically, \$3 billion of 3¼-year notes was auctioned on January 28 at an average yield of 7.21 percent, \$1.75 billion of six-year notes was auctioned on January 29 at an average yield of 7.49 percent, and finally on January 30 \$750 million in 25-year bonds was auctioned at an average yield of 7.95 percent. For the month as a whole, the yields on intermediate-term coupon issues declined 3 to 21 basis points, while long-term bond yields dropped 7 to 25 basis points.

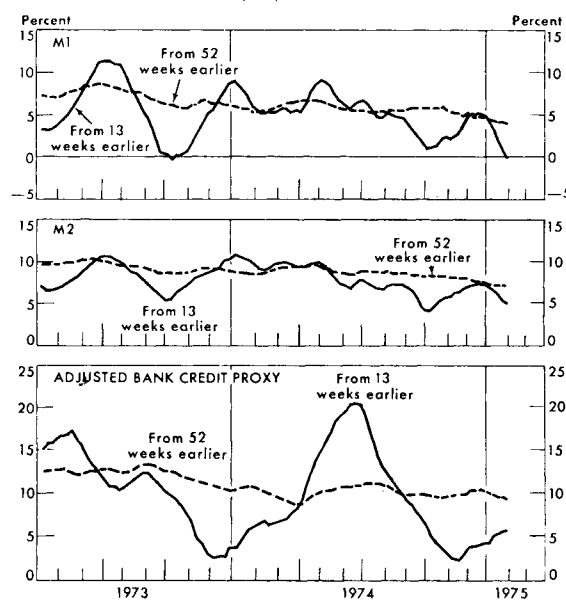
The market for agency securities turned in a relatively strong performance in January. Investor sentiment reflected the prospects that lower market rates would continue to improve the position of thrift institutions and therefore reduce borrowing by the housing-related agencies. In the first week of the month, the Federal Land Banks raised \$593.4 million in new cash by selling \$713.4

million in bonds due April 1978 at a yield of 7.6 percent and \$400 million in seven-year bonds at a yield of 7.8 percent. At midmonth the Banks for Cooperatives (COOP) and the Federal Intermediate Credit Banks (FICBs) offered \$1,228 million in a coordinated sale. Both the \$474 million in the six-month COOP bonds, which were used to help retire \$580.5 million in maturing obligations, and the \$754 million in the nine-month FICB bonds, which raised \$65 million in new money, were sold at a yield of 7.05 percent. In December a similar FICB sale was made at a 7.35 percent yield.

### THE OTHER SECURITIES MARKETS

Yields moved down in the corporate sector despite a near record calendar of offerings. Some investor hesitancy was shown toward the middle of the month, as concern

Chart II  
CHANGES IN MONETARY AND CREDIT AGGREGATES  
Seasonally adjusted annual rates



Note: Growth rates are computed on the basis of four-week averages of daily figures for periods ended in the statement week plotted, 13 weeks earlier and 52 weeks earlier. The latest statement week plotted is January 29, 1975.

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

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

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

Source: Board of Governors of the Federal Reserve System.

over the size of the Federal deficit developed. In view of the heavy supplies reaching the market, new offerings were priced to yield a bit more than usual, relative to issues in the secondary market, in order to spur quick distribution. Improvements in the long-term municipal market lagged those in other sectors, though yields on short-term tax-exempt securities fell substantially as traditional buyers began to show some interest.

Early in the month, an Aaa-rated Bell Telephone subsidiary experienced a sellout of its negotiated sale of \$150 million of forty-year debentures priced to yield 9.3 percent and \$100 million of seven-year notes yielding 8.2 percent. These yields were in marked contrast to the last sale of a similarly rated Bell subsidiary in October when forty-year debentures carried a yield of 10.03 percent. Investors continued in January to display a preference for quality industrial offerings over similarly rated utility obligations. At midmonth, an Aa-rated industrial concern sold \$300 million of thirty-year debentures at a yield of 8.5 percent, while at the same time a similarly rated utility offered a yield of 9 percent on its \$60 million in mortgage bonds of the same maturity. Both issues were well received. A somewhat tighter market situation existed at midmonth, especially for lower rated debt. For example, an A-rated industrial found it necessary to provide a yield of 8.83 percent on a midmonth offering of \$100 million of ten-year notes; this represented a concession to the market in that a similar offering made early in the month carried a yield of 8.45 percent. Prices rebounded later in the month when all sectors did better. On January 28, the American Telephone & Telegraph Company sold \$600 million divided evenly between seven-year notes priced to yield  $7\frac{3}{4}$  percent and debentures due in 2007 with a yield of  $8\frac{5}{8}$  percent. Both issues, which were rated Aaa, had been offered to the public in November but were withdrawn at that time. The yield on the shorter maturity was 42 basis points lower than on the original financing, and the other was down by only 4.5 basis points.

A lightened supply of new tax-exempt issues plus the impressive performance in the corporate sector contributed to some improvement in selling conditions in the

**Table II**  
**AVERAGE ISSUING RATES**  
**AT REGULAR TREASURY BILL AUCTIONS\***  
In percent

Maturity	Weekly auction dates—January 1975			
	Jan. 6	Jan. 13	Jan. 20	Jan. 27
Three-month .....	6.698	6.678	6.369	5.606
Six-month .....	6.682	6.646	6.373	5.825
	Monthly auction dates—November 1974-January 1975			
	Nov. 13	Dec. 11	Jan. 8	
Fifty-two weeks .....	7.362	6.625	6.378	

\* 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.

tax-exempt market as the month progressed. The state of Minnesota in an early-January offering was accorded a sellout of its \$33.8 million of Aaa-rated bonds maturing in 1976 to 1994 and yielding 4.2 percent to 6.5 percent, respectively. These rates were below the 4.7 percent to 7.25 percent yields that a similarly rated locality posted in December on maturities from 1976 to 1990. On January 31, The Bond Buyer index of twenty municipal bond yields stood at 6.54 percent, 54 basis points below its level at the end of December. The Blue List of dealers' advertised inventories declined over the month by \$159 million to a level of \$561 million on January 31.

Short-term financing by municipalities was large, but the rates in this area fell with those on other money market instruments. New York City offered a large volume of one-year revenue-anticipation notes on January 7. The \$620 million offering provided investors with a return of 9 percent but was yielding only  $7\frac{1}{2}$  percent at the end of the month.