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Banking Supervision and Monetary Policy

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An address before the seventy-second annual convention of the New Jersey Bankers Association in Bermuda on April 22, 1975

It is a real pleasure to join our Philadelphia colleagues in this traditional luncheon meeting with our many good friends of the New Jersey Bankers Association—and it is especially pleasant to do so in this lovely setting of Bermuda. As Mr. Eastburn has said, this is the last occasion I will have to address you in my capacity as President of the Federal Reserve Bank of New York. I have valued your friendship and your support in our many joint efforts looking toward better banking and better central banking over the years.

Since I saw you a year ago we have all been through a trying and difficult period, as the economy has experienced not only the deepest recession of the postwar years but also a period of virulent inflation coupled with peak interest rate levels. The worst of the inflation now seems to be behind us, and it is my hope and belief that business will be well on the road to recovery before many months have passed. But, while the severity of the recession and its financial ramifications are still very much on our minds, it may be well to reflect briefly on some of the lessons that have been pointed up more sharply than they had been in more stable and prosperous times. And I would like to dwell particularly on the relationships between the commercial banking system and the Federal Reserve in the latter's functions as the nation's monetary authority and as one of its principal bank supervision agencies.

At the outset, let me stress the mutuality of our interest in a healthy growing economy and a healthy growing banking system. As far as the Federal Reserve is concerned, our overall objectives are spelled out in broad terms in the Federal Reserve Act and in the Employment Act of 1946, and they are objectives to which I am confident all of you would subscribe—sustainable economic growth, full employment, stable purchasing power, provision of an elastic currency, provision of the functions of the lender of last resort, and maintenance of a sound banking system. By tradition and widespread agreement, the maintenance of reasonable balance-of-payments equilibrium has also been added to these objectives. Of course it is not always easy to serve all of these objectives at once. There must be a constant weighing of values—and all of us face serious dilemmas from time to time—but this is inevitable, and it underlines the vital importance of judgment, whether one is a commercial banker or a central banker. Judgment can never be satisfactorily replaced by easy automatic formulas, tempting though it may be to seek such simplistic guides.

As you well know, monetary policy operates through the banking and financial systems to ensure that the flow of money and credit is sufficient to foster sustainable growth of economic activity, but not so abundant as to foster excess demand and inflation; and of course the commercial banking system is affected most directly by our policies. It is essential that our banking and financial institutions remain strong and effective, since a weak and inefficient financial system would constrain or blunt the impact of monetary policy and would also impede the nation's economic progress. It follows that the Federal Reserve must take a keen interest in the soundness and efficiency of individual banking institutions and their ability not only to withstand the impact of adverse economic and financial developments but also to continue to meet the credit and deposit needs of the public.

Since ours is essentially a market economy, the channeling of money and credit rests primarily in the hands of bankers and other private lenders, who compete with one another as they determine the relative creditworthiness of

various borrowing needs. Whatever influence the Federal Reserve exercises is focused on overall monetary and credit conditions rather than on the channeling or allocation of funds. In my view, it is hard enough for the central bank to determine and achieve desirable total flows of money and credit without becoming involved in credit allocation. Not only would such allocation complicate enormously an already very demanding assignment, but it would also place the Federal Reserve in a position of deciding social priorities that are better left to political bodies such as the Congress. It also seems to me that credit-allocation devices are seldom effective for very long, in part because the credit markets are so highly interdependent. Attempts to increase the supply of credit for any one sector set in motion market forces, such as interest rate changes, and a search for new financing instruments and techniques, which over time tend to negate allocative efforts. I recognize that voices have been raised in various circles favoring an activist role for the Federal Reserve in this area, but I remain decidedly unconvinced.

Since this credit-channeling function is now performed primarily by private financial markets, you bankers have a heavy responsibility to see that your portion of these credit flows contributes to a vigorous and healthy economy. And now that business recovery is so essential, you have every reason to assist in this recovery by meeting the legitimate credit needs of business firms and other borrowers. In this connection, some of my banker friends have recently indicated some uncertainty as to the relationship between an accommodative overall monetary policy, such as the Federal Reserve has been pursuing for some months, and the earlier admonitions from the central bank urging greater attention to liquidity, asset condition, and capital adequacy. Actually I see no real conflict between these forces. The banking system must play a major part in financing recovery, but there will inevitably be differences in the ability of individual banks to do so in the light of their own financial condition.

Bankers have an obligation to appraise the impact of their credit operations and liability management practices on the financial strength of their organizations and on their ability to withstand the temporary, but often severe, adjustments that can occur in a changing economic environment. Certainly the current recession has carried further, and financial strains have been greater, than most observers would have predicted a year or so ago. But the wiser bankers had provided themselves with a comfortable margin of safety to tide them over the economic and financial strains of the past year.

It is also true, however, that in attempting to satisfy the inflated credit demands of the early seventies some banks allowed their liabilities and assets to expand much more rapidy than their capital. In too many of these banks, I fear that this reflected overemphasis on a "go-go" philosophy, which placed too much emphasis on the "bottom line" and not enough on building basic strength as a bulwark to withstand a deteriorating economic environment. Adequate capitalization is essential to banks in the performance of their function as the nation's principal suppliers of money and credit. And, if capital deficiencies show up, action to remedy them is called for.

I realize that the very conditions that have caused awareness of capital deficiencies have also made it difficult for banks and bank holding companies to acquire new capital. I am also aware that the disclosure requirements of the Securities and Exchange Commission (SEC), as now applied to banking organizations, are making it quite difficult for them to raise funds in the capital markets. While no one questions the need for sufficient disclosure to provide adequate protection for investors in the securities of banking organizations, it also seems clear that the same standards cannot be applied indiscriminately to banking organizations and industrial companies. The banking system has the unique function of creating deposits and money—a function which has long been recognized as so essential to the country's well-being as to require special legislative and regulatory treatment. The principal goal of banking legislation and regulation has been to insure the integrity of the nation's money supply and financial system, with special emphasis in this regard on depositor protection. Thus, I think there is a need for greater cooperation between bank supervisors and the SEC in an effort to develop standards pertaining to the securities issues of banking organizations that are realistic and equitable to all concerned.

I believe that these problems can and will be resolved and that banks and bank holding companies will find opportunities for raising new capital through the sale of debt and equity instruments in periods in which pressures in the nation's capital markets have eased. At the same time, banks should take a hard look at their dividend policies from the point of determining the best balance between internal and external sources of funds to meet their needs. For example, as bank profits have improved, a number of banks have been able to pare payout ratios without reducing dividends. In addition, banking organizations should not be deterred from raising equity capital merely because current market prices are below book values. Perhaps bankers should take a cue from those public utilities which have recently raised new equity capital through successful common stock offerings. Some

dilution of the existing equity interest may be a price well worth paying, for a strong equity base deserves a high priority in the thinking of banks' senior management and is surely in the long-run interest of the shareholders.

The dilution of equity can of course be avoided if banks build equity capital out of earnings. Banks should intensify their efforts toward increasing earnings by trimming operating expenses and curtailing marginally profitable activities, but more especially by pricing their products realistically. I have in mind the fact that banks have for many years been liberal in establishing lines of credit without fees and have charged too little in fees for loan commitments. The banks, like the proverbial grasshopper, found to their regret that fees paid for commitments contracted in the "summer" conditions of 1971 and 1972 represented bargain prices for access to credit in the "winter" conditions of 1973 and 1974. I was pleased to see the trend toward higher commitment fees which began last year. I might also add that there are many in the System—and I include myself among them—who would, over time, favor some easing of the reserve requirement burden borne by Federal Reserve member banks as an aid to improving their capital positions.

Needless to say, a bank's capital needs as viewed by the regulators are importantly affected by the quality of the bank's assets and the nature of its liabilities. Both bankers and regulators share a common interest in seeing that the quality of bank assets is maintained at high levels. Of course there are certain factors bearing on asset quality that are not under the immediate control of individual banking organizations. The percentage of loans involving delinquency by the borrowers typically rises in periods of economic strain and recession, and the present episode is no exception. To the extent that banks' asset quality has suffered as a result of the general softening of the economy, there should be a marked overall improvement once the national economy begins to recover. Meanwhile, bank regulators must "call the shots as they see them" and cannot lower their standards because the recession has spread a certain degree of loan weakness fairly widely throughout the banking community.

I should emphasize that, despite these loan troubles, I believe the nation's banking system is sound and in a good position to meet the changing economic and financial needs of the country. In this regard, the recent substantial increase in deposit insurance has helped to assure the public of the continued strength of the banking system. While some problems still remain, I think the worst is behind us. For example, the latest report of the Federal Deposit Insurance Corporation indicated that 183 banks required "close supervision" at year-end 1974, but these banks represented only 1.3 percent of all insured banks and about 1 percent of total deposits. We expect that the problems of these banks will not result in disruption of banking services to the public, or have any adverse impact on the overall strength of our banking system.

We have all been impressed with the international nature of some banking problems, and banking authorities in other countries are also interested in ensuring the strength of their own banking systems. Since the foreign exchange losses experienced last year, banks all over the world have taken a more cautious view of foreign exchange operations. In this country, authorities are strengthening examination techniques relating to foreign exchange operations, and are monitoring positions for indications of any tendencies toward undue exposure. The Federal Reserve System is also cooperating with other central banks in an attempt to develop an early warning system for banking problems that might have significant international effects. The Federal Reserve Bank of New York's action last summer in purchasing the foreign exchange book of the Franklin National Bank was motivated in part by a desire to prevent the international difficulties that might have stemmed from the Franklin National Bank's inability to deliver the foreign exchange for which it held forward contracts.

Let me say a word about the Federal Reserve's role as "lender of last resort". The System has demonstrated in a number of recent instances, notably in the case of the Franklin National Bank, its ability to cope effectively with severe liquidity problems in troubled banks, and the System's very effectiveness in such efforts has tended to cause a number of nonfinancial corporations and political entities to look to the System for help when they have found themselves in difficulties. However, the Federal Reserve is by its very nature better equipped to handle the problems of financial institutions than those of nonfinancial firms or political bodies. Moreover, it is worth pointing out that Federal Reserve credit is not available on a long-term basis to any institution, financial or nonfinancial. Rather, it serves to provide needed liquidity to creditworthy borrowers in temporary emergencies until more permanent financing can be arranged, and only if the failure of the borrower would have broad financial consequences. There are strict statutory limitations on the Federal Reserve's power to make emergency credit available, not least because Federal Reserve credit serves as the base for the creation of money and bank credit.

The financial difficulties encountered by various organizations in the past few years have led to a good deal of thinking about the possible need for a new Government agency, modeled perhaps along the lines of the Recon-

struction Finance Corporation, to provide intermediate- or long-term credit to important elements of our national economy having financial difficulties and finding themselves unable to obtain needed credit from existing private or public sources. There has been wide disagreement, however, as to the desirability of such an agency, with the opponents citing the danger of political abuse of such credit facilities and possible squandering of public funds on enterprises that might better be left to sink or swim on the basis of their degree of access to normal market funds. I recognize the risk of abuse, but on balance I find that the advantages of having such an emergency lender in the wings probably outweigh the disadvantages. I would emphasize, however, that I am expressing a purely personal view.

One question that has been receiving a great deal of attention recently is whether some change would be appropriate in the structure of the Federal bank regulatory framework in the interest of greater efficiency. Certainly a good case can be made for less dispersion of authority, but it is certainly not easy to find a solution that will meet all needs. The suggestion that the Federal regulatory and supervisory authority be centered in the Federal Reserve has encountered much opposition on the ground that combining all Federal supervisory authority with the responsibility of conducting monetary policy would constitute too great a concentration of power. On the other hand, I have been impressed, especially in the last few years, by the very close relationship between bank regulation and the exercise of monetary policy. The central bank has a direct interest in seeing that supervision is such as to provide a sound and efficient financial environment in which monetary policy can operate effectively. Moreover, the close familiarity with banking problems acquired through our bank supervision certainly permits a more intelligent implementation of monetary policy than would be possible if we were operating in more of an "ivory tower" atmosphere. No matter what solution is found, the Federal Reserve should have a major part to play in any more unified Federal supervisory structure.

As for the general economic outlook, I can see real grounds for optimism. The recession would appear to be following a customary cyclical pattern, with some constructive forces already at work in the form of diminished inflation, some strengthening of consumer buying, progress in achievement of a better inventory balance, and easier credit conditions that should bring gains in many economic sectors, including housing. On the other hand, now that the Congress has passed and the President has signed a bill to provide fiscal stimulus, there remains a serious risk that the Federal deficit may ultimately grow so large as to interfere with the financing of private credit demands and to rekindle inflationary fears. Obviously, this situation calls for a high degree of caution in keeping Federal spending under control.

On the international front, I am heartened by what I take to be an increasing awareness that the dollar's position in exchange markets deserves the close and solicitous attention of United States financial authorities. While the sudden emergence of huge current-account surpluses in oil-producing countries and huge deficits in oil-importing countries is still causing very real economic and financial difficulties for many countries, at least the magnitude of the problem is less than was feared only a few months ago, primarily because the world has learned to economize considerably in its use of petroleum and the oil-producing countries have been able to step up their imports and investments much more rapidly than most observers thought possible. Furthermore, the oil-producing nations have shown a willingness to grant sizable amounts of aid to less developed countries.

I might add that many people have been unduly pessimistic regarding the United States balance-of-payments position. I believe that the weakness of the dollar has been exaggerated in recent months, and the foreign exchange markets have tended to overlook a major improvement in the United States trade balance, reflecting a greater competitiveness of United States exports. In part, the dollar's weakness during the winter months was attributable to a temporary cyclical widening of the spread between interest rates here and abroad, which has tended to mask the underlying improvement in our payments position. I have been confident that a more realistic assessment of the United States balance of payments would soon come to the fore, and I have been gratified by the buoyant trend of the dollar rate in recent weeks.

We still face some danger that disruptive financial events here at home or abroad might interrupt the prospective improvement of the economy. The coming months will call for a prudent balance between policies of expansion and policies of consolidation, and nowhere will this need for balance be more marked than in the banking business. All of us—bankers and central bankers alike—have been through a profoundly sobering experience in the past few years. I trust that we shall make the most of that experience in coping with the economic developments that lie ahead. Indeed, the years ahead will not be easy ones. Taming the inflation which has plagued us for the past decade will require a long period of disciplined and sustained effort. I am confident, however, that my colleagues at the Bank, in the System, and in the banking community will measure up to tomorrow's problems and challenges.

The Business Situation

Economic activity has continued to decline, extending the duration of this most severe of the postwar recessions. In recent months the contraction has been primarily the result of a massive turnaround from inventory building to inventory liquidation, as firms have attempted to bring stocks into line with sales. The inventory correction currently under way is an essential element in setting the stage for future recovery. While the timing of the recession's end remains uncertain, a few encouraging signs have begun to appear in the economy. Consumption spending in recent months has shown tentative signs of renewed strength. While post-rebate car sales have been disappointing, the freewheeling fall in automotive sales appears to have bottomed out. Moreover, consumers have actually stepped up their purchases of other goods and services. No doubt further impetus to consumption spending will come from the recently passed tax reductions, which will add about $20 billion to disposable income. In addition, the substantial recovery in the stock market, amounting to more than 40 percent since early December, will probably also contribute to some pickup in consumer spending.

In the first quarter, real gross national product (GNP) dropped at a 10.4 percent annual rate, the steepest quarterly decline on record, to a level 7.5 percent below the peak attained at the end of 1973. While reductions in business fixed investment and residential construction contributed to the first-quarter fall, substantial inventory disinvestment was the major factor. Although inventory liquidation will probably persist for some time, it is unlikely to exert such a large drag on overall activity again. Conditions in the labor market deteriorated somewhat further in April as the unemployment rate rose from 8.7 percent to 8.9 percent. However, total employment increased for the first time in seven months.

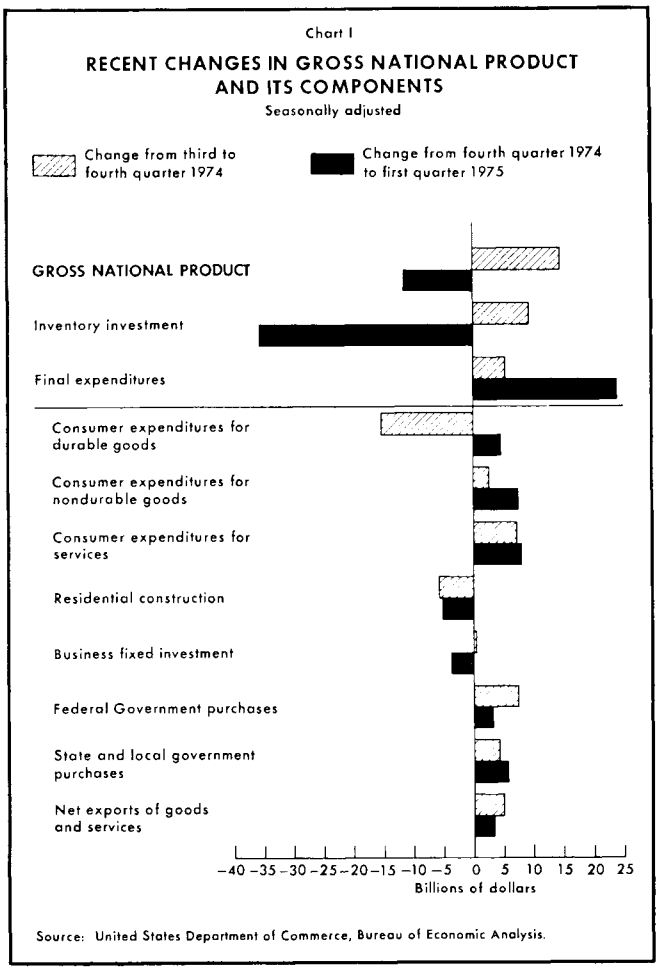
In recent months, there has been noticeable improvement in the price situation. The implicit price deflator for GNP rose at an 8 percent annual rate in the first quarter, the slowest advance since the second quarter of 1973. Much of this deceleration reflected the sharp plunge in farm prices. The implicit price deflator for the private nonfarm business sector increased at an 11.8 percent annual rate in the first three months of the year, down only modestly from the 13.2 percent rate of inflation recorded in the last quarter of 1974. Wholesale prices of industrial commodities have lately shown significant improvement, however. During the first quarter, these prices increased at a 5 percent annual rate, on average, well below the 7.9 percent advance of the previous quarter. In contrast, the slowdown in the rise of retail prices was much less pronounced. In all likelihood, however, the full impact of the moderation in nonfood wholesale prices has not yet been registered at the consumer level.

GROSS NATIONAL PRODUCT AND RELATED DEVELOPMENTS

According to preliminary data released by the Department of Commerce, the market value of the nation's output of goods and services declined by $11.7 billion during the first quarter to a seasonally adjusted annual rate of $1,419.2 billion. This amounted to a 3.2 percent annual-rate decline and was the first drop in nominal GNP in over fourteen years. Moreover, after correcting for changes in the price level, real GNP fell at a 10.4 percent annual rate, the fifth consecutive quarterly decline in real output and the sharpest quarterly reduction on record. (Quarterly GNP data extend back to 1946.) Thus far, real output has fallen 7.5 percent below the peak attained at the end of 1973.

The sizable liquidation of inventories was the most important factor affecting GNP in the first quarter (see Chart I). According to preliminary estimates based on partial data, total business inventories were pared at an $18 billion annual rate, creating a huge $35.8 billion swing from the rate of investment in the previous quarter. In contrast, current-dollar final expenditures—GNP excluding inventory investment—actually rose by $24 billion in the first quarter, compared with an increase of only $5.5 billion in the fourth quarter of 1974.

The liquidation of excess stocks was spread across all



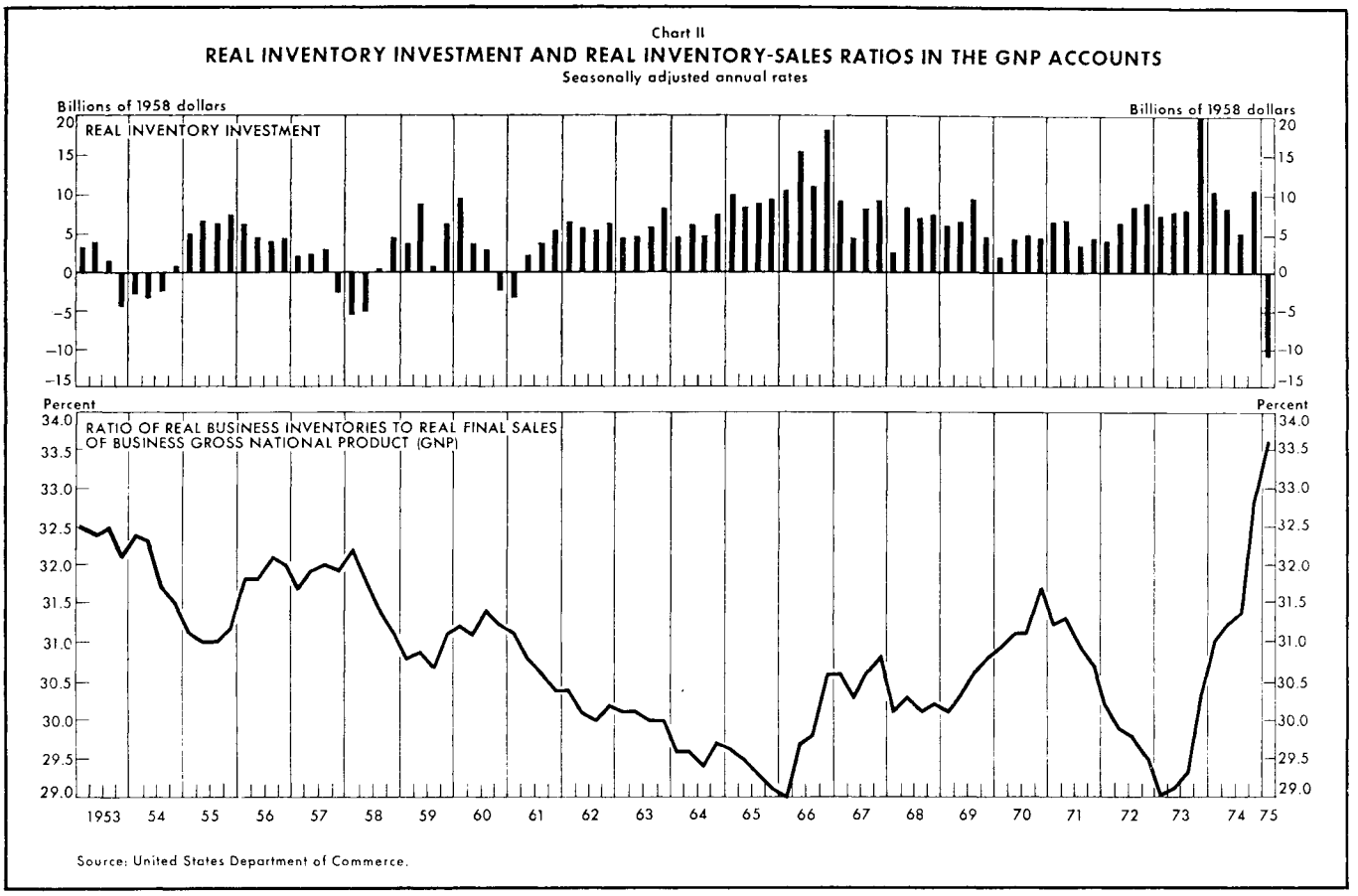
the major sectors. Stocks of durable and nondurable manufactured goods were reduced $11.2 billion and $6.8 billion, respectively, while farm inventories fell $1.6 billion at an annual rate. All the rundown in durables stocks occurred in the automotive sector. Last November, faced with a sales slump and a record 102 days' supply of automobiles, domestic manufacturers drastically cut production. However, little dent was made in the overhang of unsold automobiles until the price rebates on new cars were instituted in January. Sales then perked up in response to the lower effective prices, and car inventories were gradually drawn down, easing to 68 days of sales by the end of March. Despite this correction, the stock of nonfarm inventories, including unsold automobiles, still appears to be on the high side, and some further paring will undoubtedly take place in coming months. In the first quarter, based on GNP data, the real inventory-sales ratio for the nonfarm sector climbed to the highest level since 1952 (see Chart II). Moreover, according to the March survey of the National Association of Purchasing Management, about 50 percent of the respondents reported that they expected to continue working off excess stocks in coming months. While this suggests that further inventory liquidation is in prospect, there is a basis for believing that the worst has passed and that inventory investment will be a less severe drag on the economy in the months ahead. Indeed, disinvestment in the first quarter was so large that inventories would have to be reduced at three times the $18 billion annual rate of the first quarter to exert an equal drag on GNP.

Personal consumption spending exhibited renewed growth in the first quarter, rising by $20.5 billion. While in real terms the increase amounted to a modest $4.1 billion, this was still a vast improvement over the huge $19 billion plunge that occurred in the previous quarter. To a large extent, this pattern reflected the movements in consumers' purchases of durable goods, particularly automotive goods. However, even excluding autos, consumer durables spending managed to post a modest advance in the first quarter. The anticipation of the income tax rebates, as well as the publicity given to widespread price rebate programs, was probably influential in boosting consumption. Moreover, these factors may also have contributed to some recent improvement in consumer attitudes. For instance, The Conference Board survey conducted during January and February pointed to a rise in consumer sentiment of 11 percentage points. In coming months, consumption spending should receive additional impetus from the recently passed tax reductions. In all, about $20 billion will be added to disposable income in 1975, of which $8 billion will be derived from the income tax rebates. While consumers initially may choose to save this increment or use it to repay debt, it may eventually be used to purchase goods and services that they might not otherwise have purchased. Consumption spending will no doubt be a key element determining both the timing and vigor of the prospective economic recovery.

Residential construction spending declined by $5.2 billion in the first quarter, leaving expenditures on new housing about 40 percent below the peak reached in the second quarter of 1973. Much of the decline, however, is attributable to the sharp slide in housing starts that occurred throughout the second half of 1974. New housing starts leveled off during the first quarter at an average annual rate of 988,000 units. This is well above the depressed December figure of 880,000 units and suggests that the bottom of the current housing slide may have been reached. With a sizable volume of funds flowing

into thrift institutions, housing should receive some stimulus in coming months. In the first quarter the nation's thrift institutions are estimated to have gained deposits at a rate more than double that averaged over the last half of 1974. Despite these inflows, an outright advance in new home construction has not yet developed. Before the long-awaited recovery can begin, thrift institutions will have to rebuild their liquidity positions and the large backlog of unsold new homes will have to be reduced. Building permits continued to fall during the January-March period, declining to the lowest level on record.

Business fixed investment fell by $3.8 billion in the January-March period, the first outright decline since a strike in the automobile industry depressed business investment in the last quarter of 1970. In real terms, the drop was even greater, as constant-dollar expenditures on structures fell by $0.8 billion, while spending on equipment declined by $4.3 billion. Businesses have apparently reduced their capital spending plans as well. According to the most recent Commerce Department survey, taken during January and February, spending on new plant and equipment is expected to rise 3.3 percent in 1975. Not only is this less than the 4.6 percent rise projected in the preceding Commerce survey but, after allowing for expected increases in capital goods prices, it also represents an 8.5 percent decline in real business outlays. The latest McGraw-Hill survey also projects that real capital spending will fall in 1975 but only by 5 percent. In current dollars, business spending reportedly will rise by 5 percent over the 1974 level with more than half the total amount allocated toward modernization and replacement of plant and equipment rather than expansion. This reluctance to add to capacity is not surprising since a great deal of idle capacity currently exists. In the first quarter, manufacturers were producing at only 68.3 per-

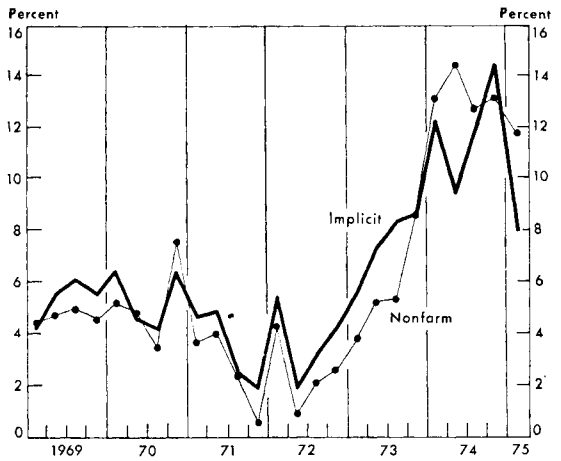


cent of capacity and, in the sensitive major materials industries, plant utilization fell to 70.7 percent, the lowest level since the second quarter of 1958. In any event, the rise in the investment tax credit included in the tax-cut legislation might provide some stimulus to investment later in the year.

Government purchases of goods and services rose by $9 billion in the first quarter, compared with $11.5 billion in the previous quarter. Federal outlays advanced by $3.2 billion, or less than half the increase posted in the fourth quarter, while state and local outlays rose by $5.8 billion. In real terms, outlays at each level advanced by $1 billion.

Finally, net exports rose by $3.5 billion in the January-March period despite the fact that both exports and imports declined. A $4 billion reduction in exports was due entirely to a drop in exports of services. Agricultural exports increased sharply during the first quarter, while exports of other goods remained strong. Meanwhile, imports fell by $7.6 billion, the second consecutive quarter in which imports have declined. With the exception of capital goods, imports of all goods and services were weaker. Petroleum imports, which fell by 12 percent during the January-March period, registered the sharpest drop. If anything, the overall improvement in net exports suggests that the recession has been more severe in the United States than it has been abroad.

Chart III
THE IMPLICIT AND PRIVATE NONFARM GNP DEFLATORS
Changes from previous quarter at seasonally adjusted annual rates



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

PRICE DEVELOPMENTS

Inflationary pressure showed further signs of easing in the first quarter. As measured by the implicit GNP deflator, prices of goods and services rose at an 8 percent seasonally adjusted annual rate. Although this remains intolerably high, it was sharply below the 14.4 percent advance of the previous quarter and was the slowest rate of advance since the second quarter of 1973. However, this improvement was distorted somewhat by the dramatic fall in farm prices. Thus, the implicit price deflator for the private nonfarm economy rose at an 11.8 percent annual rate in the January-March period, a mild improvement over the 13.2 percent increase recorded in the final quarter of 1974 (see Chart III). The fixed-weight GNP price index, which is unaffected by changes in the composition of output, rose at a 7.1 percent seasonally adjusted annual rate, compared with a 12.4 percent gain in the previous quarter.

Consumer prices rose at a 6.4 percent seasonally adjusted annual rate in the first quarter, down substantially from the 9.8 percent advance recorded in the previous quarter. The slowdown was mainly attributable to a mild 3.7 percent annual-rate rise in consumer prices during March, the smallest monthly advance since July 1973 when a partial price freeze was in effect. Responding to earlier declines at the wholesale level, retail food prices fell at a 6.3 percent annual rate in March. In addition, nonfood commodity prices rose at a 7.4 percent annual rate during the month, well below the 11.3 percent advance recorded in the last half of 1974. Finally, prices of consumer services increased at a 4.4 percent annual rate in March, compared with the 9.4 percent advance posted over the last six months. The moderation was due largely to a decline in mortgage interest rates.

Wholesale prices fell at a 6.8 percent seasonally adjusted annual rate in the first quarter, in sharp contrast to the 12.7 percent advance posted in the previous quarter. While the decline was centered in agricultural prices, which fell at a 33 percent annual rate during the January-March period, there was also a noticeable moderation in price increases for industrial commodities. During the first quarter, wholesale industrial prices rose at a 5 percent annual rate, well below the 7.9 percent advance that occurred in the fourth quarter of 1974. With prices of crude materials excluding food and feed declining at a 7.7 percent annual rate in the first quarter, further moderation in industrial prices appears likely. Moreover, the fact that wholesale prices of consumer finished goods rose at only a 4.9 percent annual rate in the first quarter suggests that there will be further relief at the retail level as well.

PRODUCTIVITY, WAGES, AND EMPLOYMENT

Despite the economic slump, cost pressures apparently mounted during the first quarter, as compensation per hour worked in the private economy rose at a 10.4 percent seasonally adjusted annual rate. This sizable increase, when adjusted for the slowdown in consumer prices, enabled real hourly compensation to rise modestly after two consecutive quarterly declines. Output per hour worked, which typically begins rising during the latter stages of economic contractions, edged up at a 0.6 percent annual rate in the January-March period. However, this was due to a sharp increase in farm productivity, which more than offset a further decline in productivity in the nonfarm sector. As a consequence of these changes in compensation and output per hour worked, unit labor costs rose at a 9.7 percent annual rate in the first quarter.

According to a separate survey of collective bargaining agreements covering 5,000 or more workers, agreements reached in the first quarter provided for a 13 percent annual rise in wages and benefits in the first year of the contract and a 7.5 percent gain over the life of the contract. Evidently, unions are still striving to make up for previous losses in real earnings as a result of inflation. For wages alone, first-year increases amounted to 12.5 percent while life-of-contract settlements provided for a 7.7 percent annual increase. The most lucrative settlements were negotiated in nonmanufacturing, but contract settlements in manufacturing, where unemployment has been especially severe, also were quite liberal. Settlements in the construction industry were modest, partly because of the small number of contracts that were signed during the period. Effective wages—which include gains arising from current settlements, deferred increases negotiated in earlier years, and additional gains resulting from escalator clauses—increased at a 6.1 percent annual rate during the first quarter, after rising 9.4 percent in all of 1974. Only 2 percent of the first quarter's advance was attributable to current decisions as opposed to 4.8 percent in 1974. Previous settlements accounted for another 2.4 percent, while only 1.6 percent resulted from escalator provisions.

Labor market conditions deteriorated somewhat further in April, although there was a gain in total employment. According to the household survey, the civilian labor force rose sharply by 433,000 persons in April after growing very little over the previous six months. Apparently, many workers had either dropped out of the labor force or delayed their entry because of the dismal job situation. Meanwhile, the number of persons employed rose by 237,000 in April, the first such increase since last September. This rise was less than the growth in the labor force, however, so that the seasonally adjusted unemployment rate rose by 0.2 percentage point to 8.9 percent in April. All labor force groups shared in this rise in joblessness. At 5.6 percent, the jobless rate for married men was the highest since August 1958. The nonwhite unemployment rate climbed to 14.6 percent in April, while the white jobless rate rose 0.1 percentage point to 8.1 percent.

According to the payroll survey of establishments, seasonally adjusted nonfarm payroll employment dropped slightly in April. Of course, the household and payroll surveys often diverge in a particular month because of sampling and coverage differences; however, over longer periods they tend to show comparable changes. Manufacturing employment fell by 96,000 workers in April, but the decline was much smaller than it had been in previous months. The stepped-up pace of automobile production in April led to some reduction in layoffs in this industry. Employment fell slightly in the construction and public utilities industries in April, while jobs in government, trade, and services increased.

Monetary and Financial Developments in the First Quarter

Private demands for short-term credit remained sluggish in the first quarter of 1975, while credit availability became more plentiful. As a result, short-term interest rates fell sharply through most of the quarter, although the declines moderated as the period drew to a close. In addition, the monetary authority's restrictions on the banking system eased considerably, and the average effective rate on Federal funds dropped from 8.53 percent in December to 5.54 percent in March, the lowest monthly level since December 1972. Similar declines were registered in rates on commercial paper, bankers' acceptances, large-denomination certificates of deposit (CDs), and on most other money market instruments as well. On three separate occasions during the quarter, the Board of Governors of the Federal Reserve System approved reductions of ½ percentage point in the discount rates charged at the twelve Federal Reserve Banks, and by mid-March the discount rate had reached 6¼ percent. During the quarter the Board also reduced reserve requirements on net demand deposits at member banks by between ½ and 1 percentage point.

In the long-term debt markets, yields fell initially but turned around in late February and by the end of the period were at levels approximately equal to those in early January. Long-term yields were strongly affected by both huge Treasury borrowing during the quarter and the prospects of even heavier borrowing over the remainder of the year. This development encouraged many corporations to advance their financing plans so as to fulfill their foreseeable needs for funds at prevailing interest rate levels. The result was a record quarterly volume of corporate borrowing on top of an unusually heavy Treasury schedule. In the municipal sector, the volume of new borrowing was moderate, but developments in other long-term debt markets put upward pressure on yields over the second half of the quarter. In addition, yields on some tax-exempt securities were affected by the financial difficulties of the New York State Urban Development Corporation and by concern over the financial position of New York City.

The overall growth of the narrowly defined money stock (M_1) remained about as sluggish in the first quarter as it had been in the final quarter of 1974. However, in the last two months of the period, M_1 rose at a relatively rapid pace after declining sharply in January. The further drop in short-term-market interest rates induced substantial increases in consumer-type time deposits at commercial banks during the quarter. Consequently, the more broadly defined money stock (M_2) continued to expand at a faster pace than M_1. Lower market interest rates also resulted in a dramatic increase in deposit flows into thrift institutions during the first quarter. These, however, failed to be reflected fully in mortgage lending, as the growth in both mortgage holdings and commitments outstanding remained modest.

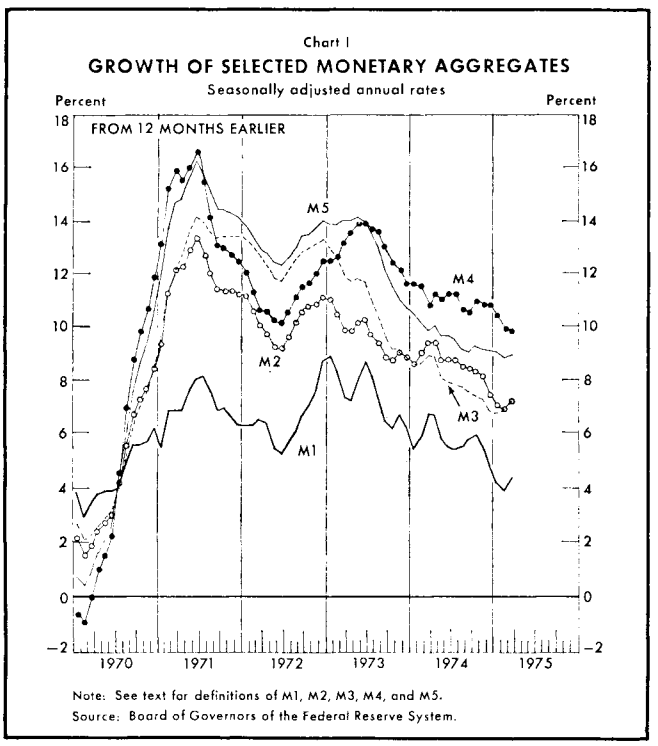
THE MONETARY AGGREGATES

Over the first quarter as a whole, M_1—private demand deposits adjusted plus currency outside commercial banks—advanced at a seasonally adjusted annual rate of 3.5 percent, down slightly from the 4.6 percent gain registered during the preceding three-month period. Growth in M_1 was erratic over the quarter, as it often is over brief periods. In January, M_1 fell at a seasonally adjusted annual rate of 8.9 percent. This was followed by rates of expansion of 6.8 percent in February and 12.7 percent in March. The erratic behavior of M_1 during the quarter mainly reflected sharp changes in the growth of its demand deposit component. The monthly fluctuations in the public's currency holdings followed a pattern similar to that of demand deposits, although the changes were less pronounced.

The growth in consumer-type time deposits at commercial banks accelerated further in the first quarter, as interest rates on competing market instruments continued to decline. Time deposits less large negotiable CDs rose at a seasonally adjusted annual rate of 12.7 percent, up from the 9 percent gain registered in the final quarter of 1974. As a result, the growth in M_2—which includes these deposits plus M_1—also accelerated over the period and remained considerably above the rate of expansion in M_1.

During the quarter, the Board of Governors modified slightly its M_3 measure of money and also added two new money stock concepts to its list of regularly published monetary statistics. The M_3 measure—previously defined as M_2 plus deposits at mutual savings banks and shares at savings and loan associations—now also includes credit union shares. These, however, constitute only a small fraction of the M_3 measure, so that its growth pattern was only slightly affected by the change. For example, in January 1974, the public held credit union shares of $27.9 billion, or 2.8 percent of M_3. The Board also began computing two additional money concepts which include large negotiable CDs. M_2 plus CDs now constitute the Board's M_4 measure of money, while M_3 plus CDs now comprise M_5.

Abstracting from differences in their long-term trends, movements in the Board's five money stock measures in the past several years have been generally similar (see Chart I). All five measures, for example, advanced at a relatively rapid pace in 1972, but subsequently grew more modestly in both 1973 and 1974. The decline in the rate of expansion of M_1 over these last two years, however, was proportionately greater than that of the broader monetary aggregates.



The adjusted bank credit proxy increased relatively slowly in the first quarter of 1975, continuing its performance of the previous three months. This measure, which includes total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds, rose at an annual rate of 3 percent in the January-March interval, following a gain of only 4.2 percent in the preceding three-month period. By way of contrast, during the first nine months of 1974, the proxy rose at an annual rate of more than 10 percent.

A contributing factor to the slow rate of expansion in the credit proxy during the first quarter was the sharp deceleration in the growth of large negotiable CDs. From a seasonally adjusted annual rate of growth of 25.9 percent in the fourth quarter of last year, the volume of CDs outstanding actually declined at a rate of 2.2 percent in the first quarter of 1975. During much of 1974, heavy loan demands on the banking system encouraged banks to bid aggressively for deposit funds and the outstanding volume of CDs rose sharply. With sluggish loan demand in the first quarter of this year, however, banks chose to allow some runoff in CDs by offering relatively low rates on such deposits. Member banks also repayed a considerable amount of borrowing from the Federal Reserve System during the quarter. Such borrowings dropped from $801 million in December to an average of $113 million in March.

BANK CREDIT, INTEREST RATES, AND THE CAPITAL MARKETS

Seasonally adjusted total bank credit, including loans sold to affiliates, resumed positive growth in the first quarter after declining in the fourth quarter of last year (see Chart II). The increase, 5.8 percent at an annual rate, was almost entirely attributable to a dramatic increase in investments and to a rise in securities loans. Banks were particularly heavy purchasers of United States Treasury obligations during the first quarter, as they found reserve positions becoming more comfortable and overall loan demand diminishing.

Almost every loan category decreased in the January-March period, and overall loan demand was weak for the second quarter in a row. Business loans at all commercial banks, for instance, fell at a rate of 3.7 percent in the first quarter, in comparison with a decline of 0.7 percent in the fourth quarter of last year. This accelerating decline in business loan volume coincided with the deepening economic slump. Indeed, the only loan category to register a substantial gain was securities loans. As the volume of Treasury borrowing picked up during the quarter and as

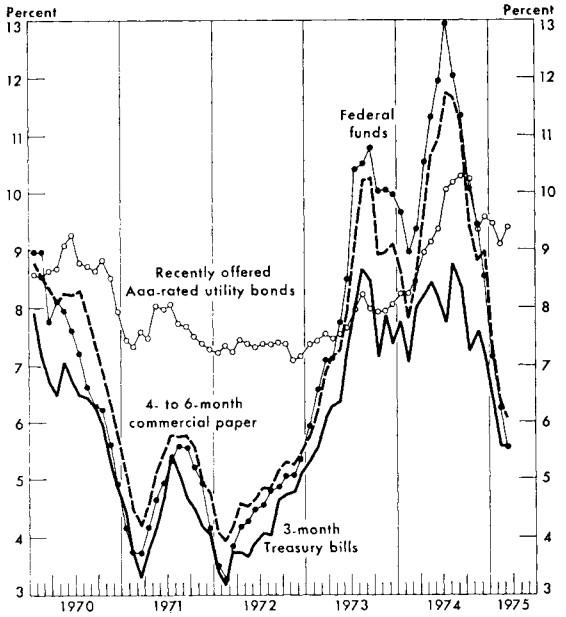
business loan demand fell off, securities dealers found banks more willing to accommodate their increased credit needs.

With few exceptions, short-term interest rates fell steeply through almost the entire first quarter before leveling off at the end (see Chart III). The rate on 90-day CDs, for example, fell about 3 percentage points over the quarter to close at 6.1 percent. Similar decreases were recorded on many other instruments. However, some rates began to back up around the middle of the quarter, partly as a result of heavy Treasury borrowing. Such a pattern was evident in Treasury bill rates. After falling 136 basis points from the end of December to mid-February, the rate on one-year bills subsequently proceeded to rise by 51 basis points to close the quarter at 5.89 percent. A similar but less pronounced end-of-quarter rise was exhibited by shorter term bill rates.

Reductions in commercial bank prime lending rates during the first quarter followed the decline in other money market rates with a substantial lag. As a result, unusually large spreads developed between the prime rates and other short-term rates. By the end of January, for example, the prime rates being quoted by most of the major banks exceeded the rates on commercial paper by almost 3 percentage points, very high by historical standards. This gap, which narrowed somewhat to around 1⅜ percentage points by the end of the quarter, induced a considerable degree of switching of corporate borrowing from banks to the commercial paper market. By the end of the quarter, most major banks were quoting prime rates of between 7¼ percent and 7¾ percent, down from the range of 10¼ to 10½ percent at the close of 1974. By way of comparison, the rate on 90- to 119-day commercial paper fell steadily from 9⅜ percent at the end of December to 6⅛ percent at the end of March.

Chart III

SELECTED INTEREST RATES



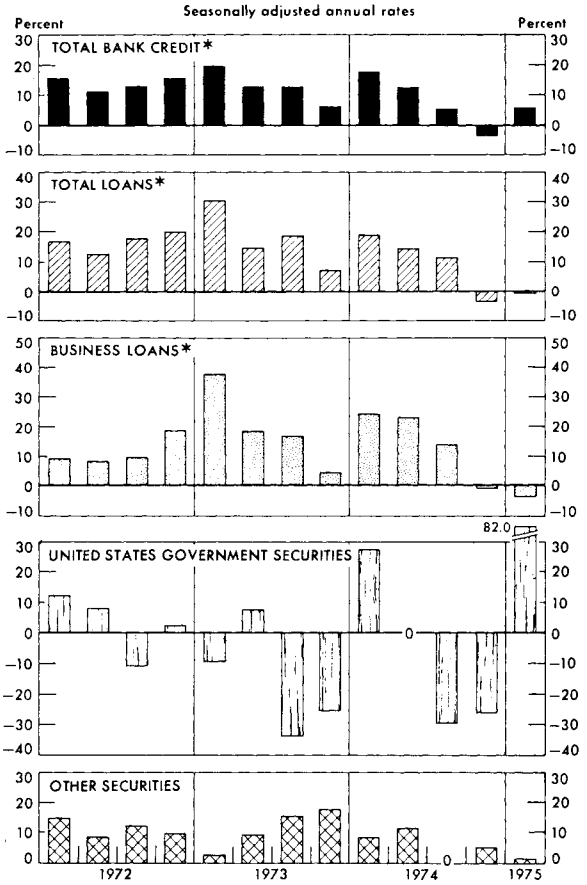
Note: Rates for Federal funds (effective rate) and three-month Treasury bills (market yield) are monthly averages of daily figures. Yields on recently offered Aaa-rated utility bonds and four- to six-month commercial paper are monthly averages of weekly figures.

Source: Board of Governors of the Federal Reserve System.

Chart II

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.

Intermediate- and long-term interest rates fell during the first half of the quarter before moving upward sharply in March. A contributing factor to this reversal was new Treasury borrowing during the quarter of $11.2 billion in coupon issues. In addition, the continued reevaluation during the quarter of Treasury borrowing needs over the course of the year was a source of concern. Investor apprehension about the size of these needs coupled with a heavy corporate calendar, as firms rushed to float new debt issues at attractive yields, contributed to the rise in long-term interest rates. The index of yields on three- to five-year Treasury securities, for example, fell about 60 basis points from the end of December to late February and then rose 57 basis points, closing the quarter at 7.25 percent. A similar pattern was evident in yields on longer term obligations as well. In the corporate market the estimated total of public and private placements, seasonally adjusted, was around $14 billion in the first quarter, a new record. New corporate bond issues in January amounted to the highest monthly total in almost four years. Volume records were set despite a significant number of postponements late in the quarter resulting from the rapid rise in long-term yields. The volume of Federal agency offerings declined somewhat over the first quarter, reflecting the improved financial position of thrift institutions. The $3.6 billion of new Federal agency issues was well below the quarterly average volume of $6.2 billion in 1974.

The market for municipals was buffeted by two significant developments during the quarter. In February the New York State Urban Development Corporation (UDC) was unable to redeem $104.5 million in maturing short-term notes. The failure to carry out its financial responsibilities with regard to these issues generated substantial doubt in the market concerning the status of "moral obligation" bonds. Moral obligation bonds are basically revenue bonds that carry a tacit assurance by a political subdivision that the issuing authority's obligations to the bondholders will be met. This event precipitated an increase in yields on outstanding moral obligation issues as investors became somewhat more wary of such issues. New flotations of moral obligation bonds were made more difficult by the increased investor apprehension. In addition, the continuing budget problems of New York City were another source of concern in the municipal market. The UDC difficulties could not help but focus renewed investor attention on the city's problems as the city continued to approach the market with sizable short-term offerings. By March the city was forced to pay a rate of 8.69 percent for $537 million of bond anticipation notes, the highest rate ever paid by the city for such borrowing. Later in the quarter, however, the city announced a reduced short-term borrowing schedule, which in turn contributed to a more constructive market atmosphere.

The volume of tax-exempt bond offerings in the first quarter rose to $6.5 billion, up from the quarterly average volume of $5.7 billion in 1974. Yields in this market behaved much like those in the other long-term markets, as The Bond Buyer index fell 81 basis points in the first half of the quarter before rising 68 basis points to end the quarter at 6.95 percent.

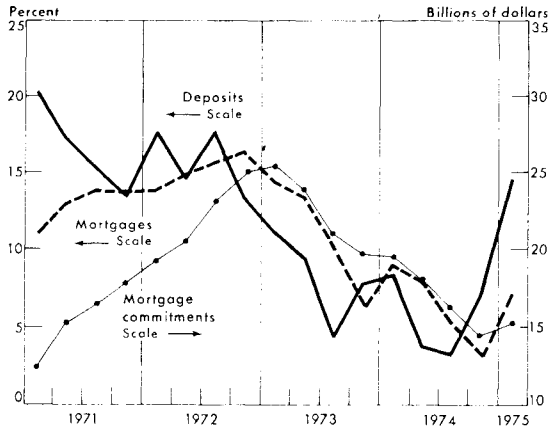
THRIFT INSTITUTIONS AND THE MORTGAGE MARKET

Deposit flows into thrift institutions increased sharply in the first quarter (see Chart IV). Combined deposits at savings and loan associations and at mutual savings banks advanced at a seasonally adjusted annual rate of 14.9 percent, more than double the fourth-quarter growth and the most rapid expansion since November 1972. The increased thrift deposit inflows at least partially reflected the increased attractiveness of such deposits, as rates on competing short-term instruments declined sharply over the quarter. Thrift institutions, on the other hand, actively encouraged deposit inflows by maintaining the rates paid on their deposits at the highest levels permitted by law.

The sharply increased inflow of deposits to thrift insti-

Chart IV

DEPOSITS AND MORTGAGES AT THRIFT INSTITUTIONS AND OUTSTANDING MORTGAGE COMMITMENTS



Note: Thrift institution deposit and mortgage loan growths are expressed at seasonally adjusted annual rates. Mortgage commitments are the sum of the seasonally adjusted levels of mortgage commitments at all savings and loan associations and at all mutual savings banks in New York State. Mortgages for the first quarter are based on data available through February.

Sources: Federal Home Loan Bank Board, National Association of Mutual Savings Banks, and Savings Bank Association of New York State.

tutions did not result in a similar increase in mortgage holdings in the first quarter. Over the two-month period ended in February, mortgage holdings grew at a 7 percent rate, somewhat above the 3.3 percent rate of growth of the previous three months but only slightly above the 6.5 percent expansion over all of 1974, a year of slow mortgage growth. Similarly, commitments for new home mortgages failed to reflect fully the improved thrift deposit situation. Although the seasonally adjusted volume of outstanding mortgage commitments did rise over the first quarter by $800 million, it still remained more than $10 billion below the peak level recorded in early 1973.

The general easing in interest rates was reflected in mortgage yields as well. In the secondary mortgage market, the average yield set at the last Federal National Mortgage Association auction in March was 8.85 percent, 62 basis points below the average yield at the last auction in December. Most of this decline took place early in the quarter, when yields in both the short- and long-term markets were declining. In the primary market, a similar situation existed, with the Federal Home Loan Bank (FHLB) Board series on effective rates on new-home mortgages falling 29 basis points over the quarter to 9.08 percent. Since deposits were more plentiful, thrift institutions reduced their level of borrowing. The volume of outstanding FHLB advances to member savings and loan associations fell by $3.6 billion over the first quarter to $17.9 billion.

The Money and Bond Markets in April

The money market in April was dominated by heavy Treasury borrowing. While most short-term interest rates changed little, rates on some longer term Treasury bills rose over the month. Overall, the Treasury raised about $9 billion in new cash in April, the bulk of it through the sale of new notes and additions to the weekly bill auctions. In the face of this substantial borrowing, investors revealed a preference for short-term maturities, and the yield curve for Treasury bills grew increasingly steep. An initial difference of roughly 40 basis points between three- and twelve-month Treasury bill rates widened to about 80 basis points by the month end.

Yields rose, in some cases substantially, in the long-term markets. The expectation that heavy Treasury borrowing would continue through fiscal year 1976 and the attempts to distribute the large issues of Treasury coupon securities auctioned recently placed great pressure on the market for United States Government securities despite a brief respite from Treasury financing after mid-month. Some of these pressures were reflected in the corporate bond market where rates generally increased, although cancellations and postponements of issues helped reduce the calendar to more manageable proportions. Investors' preferences for intermediate-term maturities continued to provide borrowers with the incentive to include intermediate-term issues in their debt financing. Despite a manageable calendar in the municipal bond market, rates moved up there as well, as the lack of sizable demand from banks continued to be a stumbling block. On May 1, the Treasury lowered the projections of its new cash needs over the May-June period and the bond market rallied strongly the next day, with the prices of some long-term Treasury bonds rising as much as 1⅜ points.

According to preliminary data, the growth of M_1—private demand deposits adjusted plus currency outside commercial banks—moderated in April from the very rapid pace experienced in March. Time deposits other than large certificates of deposit (CDs) continued to rise sharply, and thus the slowing in the growth of M_2—which combines M_1 with these time deposits—was less pronounced. With business loans remaining sluggish and consumer time deposits growing rapidly, large commercial banks were less aggressive in selling CDs and the amount outstanding declined.

Long-term monetary growth rate targets were disclosed by Federal Reserve Board Chairman Arthur F. Burns on May 1. The target rate of growth for M_1 from March 1975 to March 1976 is a range from 5 to 7½ percent. In comparison, M_1 grew at a seasonally adjusted rate of 4.7 percent in 1974 and at a 3.5 percent annual rate in the first quarter of 1975.

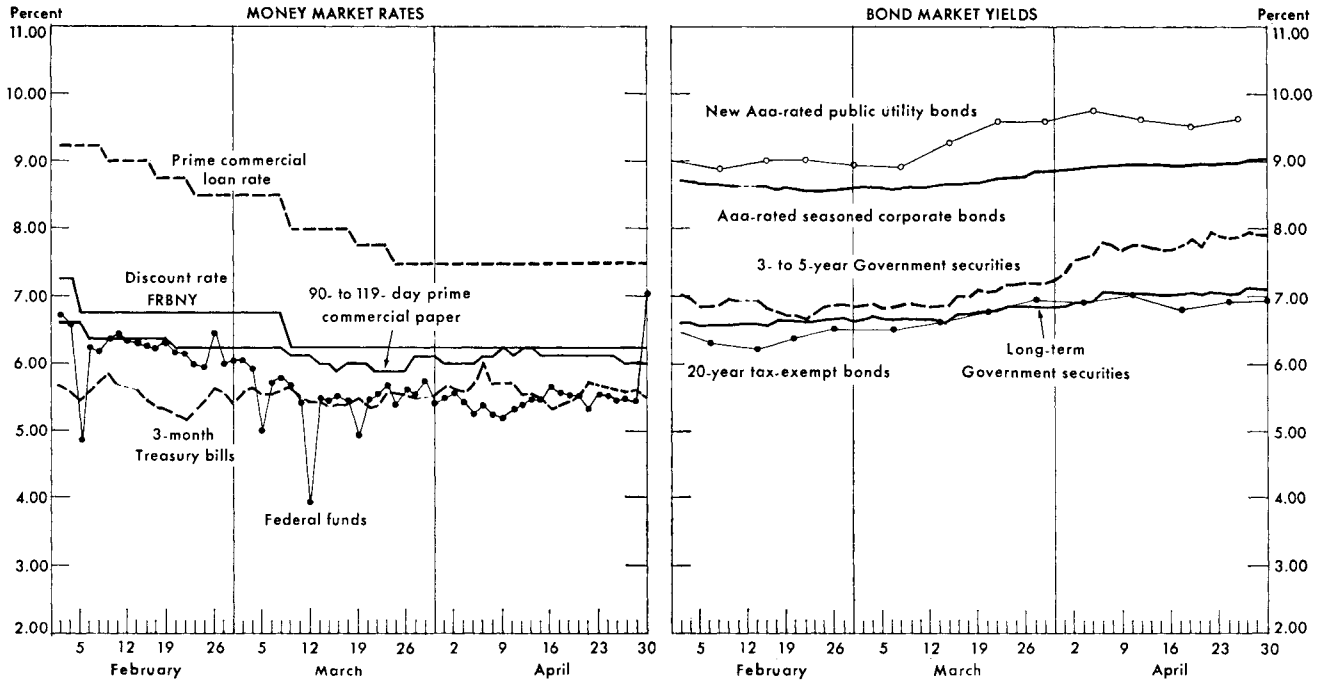
THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

Money market rates leveled off in April (see Chart I), bringing to a halt—at least temporarily—the rather steady decline of the previous seven months. Most rates moved up early in the month, then declined somewhat in response to a rally in the Treasury bill market, and finished the period about unchanged. For the month as a whole, the Federal funds rate averaged 5.49 percent, down only 5 basis points from the March average. The rate on 90- to 119-day dealer-placed prime commercial paper remained at 6⅛ percent for most of April and closed the period at 6 percent. Similarly, rates on CDs in the secondary market and rates on bankers' acceptances fluctuated in a narrow range and finished the month relatively unchanged. Meanwhile, most major commercial banks kept their prime lending rate at 7½ percent for the month, although one major bank was quoting 7¼ percent.

Weakness was still quite evident in business demand for short-term credit. Commercial and industrial loans at large commercial banks declined by $529 million in the first four statement weeks of April, and the amount of nonfinancial commercial paper outstanding was basically unchanged. The combined total of these two series generally increases sharply in April, owing in part to business borrowing over the April tax date.

Preliminary data indicate that M_1 grew in April at

Chart I
SELECTED INTEREST RATES
February - April 1975



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Prime commercial loan rate at most major banks; offering rates (quoted in terms of rate of discount) on 90- to 119-day prime commercial paper quoted by three of the five dealers that report their rates, or the midpoint of the range quoted if no consensus is available; the effective rate on Federal funds (the rate most representative of the transactions executed); closing bid rates (quoted in terms of rate of discount) on newest outstanding three-month Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new Aaa-rated public utility bonds are based on prices asked by underwriting syndicates, adjusted to make them equivalent to a standard Aaa-rated bond of at least twenty years' maturity; daily averages of yields on seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields on twenty seasoned twenty-year tax-exempt bonds (carrying Moody's ratings of Aaa, Aa, A, and Baa).

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, Inc., and The Bond Buyer.

less than half its March rate. M_1 increased at a 5.4 percent seasonally adjusted annual rate in the four-week period ended April 23 from its average level of the four weeks ended March 26. Three months of fairly rapid expansion in M_1 have brought its growth in the first four statement weeks of April from its average level in the corresponding period thirteen weeks earlier to a 7.2 percent rate (see Chart II). M_2 grew at an 8.1 percent annual rate from the four weeks ended March 26 to the four weeks ended April 23, as other time deposits rose at an 11.1 percent rate. The adjusted bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—grew at roughly a 6 percent rate in the same period even though outstanding CDs declined. There was little pressure on member bank reserves in April, and member bank borrowings from the discount window averaged $102 million for the five statement weeks ended April 30 (see Table I).

On April 9, the Board of Governors of the Federal Reserve System announced that it had lowered the reserve requirement on Euro-dollar borrowings from 8 percent to 4 percent. The reduction will initially affect reserves that must be maintained against Euro-dollar borrowings in the four-week period beginning May 22. The actual reserves held during that period will be based on the level of borrowings in the period April 10 through May 7. The move will reduce required reserves of member banks by approximately $65 million and will also release about $15

million of reserves maintained voluntarily by foreign-owned banking institutions. In commenting on its action, the Board noted that the move will bring reserve requirements against Euro-dollar borrowings into better alignment with reserve requirements against time deposits and that it may strengthen the position of the dollar in foreign exchange markets. During the first week in which the new, lower reserve requirements were in effect, New York City banks began substituting Euro-dollar borrowings for purchases of Federal funds, and their liabilities to foreign branches increased by about $450 million in the statement week ended April 16.

THE GOVERNMENT SECURITIES MARKET

Yields on most Treasury securities rose in April, as the market for Treasury obligations was buffeted by the Treasury's heavy borrowing requirements. The scope of the Treasury's near-term needs became clearer when the tax-reduction bill was enacted at the end of March. The Treasury announced on March 31 that it expected to borrow an additional $17.5 billion in the April-June period, raising total borrowing for the first half of 1975 to $41 billion. In comparison, early in the year, private forecasts had estimated that the Treasury's new cash needs in the first half of 1975 would be close to $20 billion, while at the end of February the Treasury said it expected to raise $28 billion to $38 billion in the first half. For the month of April the Treasury concentrated its borrowing in the short maturity area, raising approximately $6 billion in new cash through the bill market and another $3 billion with twenty-month and two-year notes. The market for Treasury securities improved after May 1, in the wake of the Treasury's announcement that its net financing in the first half of 1975 had been reduced to $36 billion.

Treasury bill rates rose sharply in the first few days of April in response to heavy new supplies. The Treasury raised $800 million of new cash at the regular weekly bill auction on March 31, $400 million at the regular monthly auction on April 2, $800 million at the weekly auction on April 7, and $1.5 billion at a special auction on April 8. At April's first regular weekly auction, the three-month bill was sold in cautious bidding at an average rate of 6.02 percent, 46 basis points above the rate at the previous auction, while the rate on the six-month bill was 57 basis points higher at 6.35 percent (see Table II). By the next day, however, it appeared that rates had moved up sufficiently to encourage investor demand and the special auction of 292-day bills drew good interest, with the average issuing rate set at 6.56 percent. Investor de-

Table I

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

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

Factors	Changes in daily averages—week ended					Net changes
	April 2	April 9	April 16	April 23	April 30	
"Market" factors						
Member bank required reserves	— 137	+ 261	— 521	— 81	— 146	— 624
Operating transactions (subtotal)	+ 983	+1,566	— 108	—2,629	—3,891	—4,079
Federal Reserve float	+ 657	+ 124	— 634	+ 209	— 266	+ 90
Treasury operations*	+ 604	+ 914	+ 951	—2,539	—4,460	—4,530
Gold and foreign account	— 100	+ 118	+ 91	— 22	+ 10	+ 97
Currency outside banks	+ 90	— 192	— 379	— 159	+ 887	+ 247
Other Federal Reserve liabilities and capital	— 268	+ 602	— 137	— 119	— 62	+ 16
Total "market" factors	+ 846	+1,827	— 629	—2,710	—4,037	—4,703
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	— 493	—2,016	+ 619	+2,383	+4,096	+4,589
Outright holdings:						
Treasury securities	+ 455	—2,009	+ 197	+1,977	+1,785	+2,405
Bankers' acceptances	+ 15	— 6	— 16	+ 4	+ 23	+ 20
Federal agency obligations	+ 209	— 1	—	—	—	+ 208
Repurchase agreements:						
Treasury securities	— 838	—	+ 345	+ 328	+1,936	+1,771
Bankers' acceptances	— 159	—	+ 34	+ 28	+ 127	+ 25
Federal agency obligations	— 175	—	+ 59	+ 51	+ 225	+ 160
Member bank borrowings	— 104	— 19	— 11	+ 144	+ 76	+ 86
Seasonal borrowings†	—	—	— 2	+ 1	—	— 1
Other Federal Reserve assets‡	— 114	+ 2	+ 89	+ 190	— 37	+ 80
Total	— 711	—2,033	+ 647	+2,717	+4,134	+4,754
Excess reserves‡	+ 135	— 206	+ 18	+ 7	+ 97	+ 51

	Daily average levels					Monthly averages§
Member bank:						
Total reserves, including vault cash‡	35,096	34,674	35,213	35,301	35,544	35,166
Required reserves	34,817	34,556	35,077	35,158	35,304	34,982
Excess reserves	279	118	136	143	240	183
Total borrowings	51	32	21	165	241	102
Seasonal borrowings†	7	7	5	6	6	6
Nonborrowed reserves	35,045	34,642	35,192	35,136	35,303	35,064
Net carry-over, excess or deficit (—)‖	49	129	55	95	46	75

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 April 30, 1975.
‖ Not reflected in data above.

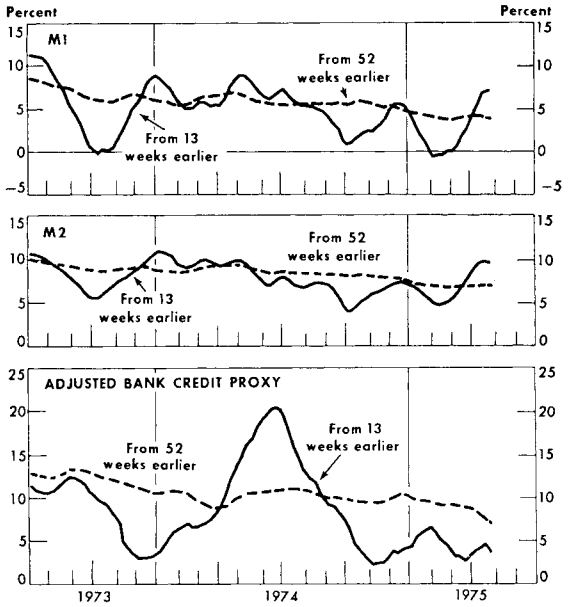
mand remained strong and bill rates retraced their early April increases, spurred by Federal Reserve purchases for foreign customer accounts. While interest in the second weekly auction was routine at prevailing rate levels, sizable declines had already occurred and the average issuing rates were about 50 basis points lower. Bill rates fluctuated within a narrow range for the rest of the month, and the average issuing rates at the auctions moved up slightly. For the month as a whole, bill rates were generally 12 basis points lower to 52 basis points higher.

The market for Treasury coupon securities labored under the effort of distributing the Treasury's notes and bonds marketed in March (about $7 billion) and early April (another $3 billion). The price declines which had occurred at the end of March meant that underwriters and investors had sustained losses on recently issued Treasury securities. As a result, they became more defensive in their bidding at the first auction of coupon securities in April. The auction on April 1 of $1.5 billion of twenty-month notes attracted $3.8 billion in tenders, but at yields well above those prevailing on similar outstanding maturities. The average issuing yield was 7.15 percent, and a 7⅛ percent coupon was placed on the issue. Yields continued to rise, but by mid-April rates had leveled off, partly in response to the improvement in the bill market, and most participants felt that the market had established a sustainable trading range. The auction on April 15 of $1.5 billion of two-year notes attracted broad demand near the prevailing yield levels. A sizable $4.1 billion in tenders was received; the average issuing yield was 7.43 percent, and the coupon was established at 7⅜ percent. The market's confidence proved fragile, however, and toward the end of the month rates moved up in advance of the May refunding announcement. For the month as a whole, the index of yields on three- to five-year Treasury coupon securities rose 64 basis points to 7.89 percent, while the index for long-term Government securities rose by 26 basis points to 7.10 percent.

On May 1, the Treasury announced its plans to refinance $3.8 billion of publicly held debt maturing on May 15 and to raise $1.2 billion in new cash. The $5 billion of securities will be sold in three separate auctions: $2.75 billion of 3¼-year notes on Tuesday, May 6; $1.5 billion of seven-year notes on May 7; and $750 million of thirty-year bonds on May 8. The coupon rates will be determined after the tenders are allotted. The 3¼-year notes will be sold in minimum denominations of $5,000, while the other two issues will have minimum denominations of $1,000.

New offerings of Federal agency securities were well received in April at interest rates that were generally higher than those paid on recent issues. In the first week the Federal Land Banks raised $550.1 million in new money through the sale of two issues: $750.1 million of 21-month notes priced to yield 7.45 percent and $300 million of seven-year bonds priced to yield 8.15 percent. In January the Federal Land Banks had sold seven-year bonds priced to yield 7.80 percent. On April 15 the Government National Mortgage Association auctioned $245.9 million of mortgage-backed securities which were reoffered to yield 8.60 percent. The next day the Farm Credit Administration sold two issues totaling $1,231.5 million: $322.5 million of Banks for Cooperatives (BC) six-month bonds priced to yield 6.15 percent and $909 million of Federal Intermediate Credit Banks (FICB) nine-month notes priced to yield 6.60 percent. In March, comparable BC bonds were priced to yield 5.85 percent and FICB bonds were priced to yield 6.05 percent.

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 April 23, 1975.

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

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

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

Source: Board of Governors of the Federal Reserve System.

THE OTHER SECURITIES MARKETS

The pressures encountered in the corporate and municipal bond markets at the end of March continued into April. In the face of rising yields early in the month, many offerings were postponed (among them a $300 million Aaa-rated corporate issue) and many underwriters scheduled a large amount of new issues on a day-to-day basis rather than set a firm sale date. Dealers reduced their inventories by releasing several recent offerings from syndicate restrictions and the prices of these issues declined, some dramatically. At midmonth, the long-term markets were bolstered by the reductions in the supply of new issues and dealers' inventories as well as by the respite from the Treasury's borrowing in the latter half of April. At the month end, however, yields were again rising in response to weakness in the Government sector.

Investors remained cautious and continued to prefer shorter maturities. Borrowers responded by presenting offerings containing intermediate- as well as long-term components. In the second week of the month, the Aaa-rated issues of $75 million of ten-year notes and $75 million of 25-year debentures of Warner-Lambert Company were reoffered to yield 8.30 percent and 8.925 percent, respectively. This yield differential of about 63 basis points was comparable to the spreads of roughly 65 basis points which occurred on several large industrial offerings in March. During the next week, a spread of 85 basis points occurred on an A-rated $200 million offering by United Aircraft Corporation. The company's ten-year notes in the amount of $100 million were reoffered to yield 9.10 percent, and its 25-year debentures were reoffered to yield 9.95 percent. In an Aaa-rated issue during the same week, South Central Bell Telephone Company sold $100 million of eight-year notes, which were priced to yield 8.20 percent, and $200 million of 35-year debentures, which were priced to yield 9.20 percent. This differential was only slightly smaller than the 106 basis point spread on a comparable Bell issue in March.

Yields on new issues of tax-exempt securities continued their upward trend, begun in February, into early April. As a consequence of the escalation in costs and statutory limitations on interest payments, several local authorities postponed borrowing. Pressure on the market was eased somewhat at the end of the first week when New York City, which had been meeting investor resistance, received an advance payment of funds from New York State and was thus able to cancel a planned $450 million note offering slated for the middle of April. New York State, in turn, sold $400 million of 4¼ percent two-month tax anticipation notes, roughly half the rate paid by New York City on a short-term issue in March.

In the longer term municipal market, several issues met resistance in the uncertain atmosphere prevailing in the first week of the month. A $75 million offering of State of California Aaa-rated bonds sold slowly when priced to yield from 5.10 percent in 1982 to 6.50 percent in 2000, and price concessions were eventually made to move them out of inventory. The market improved somewhat during the second week, and a New Jersey offering of $75 million of Aaa-rated bonds sold out when priced to yield from 4.75 percent in 1979 to 6.30 percent in 1995—yields that were 5 to 20 basis points above those on comparable maturities of the California issue. Late in the month the Commonwealth of Massachusetts successfully brought to market April's largest municipal offering, a $150 million issue of bonds rated Aa by Moody's and AAA by Standard & Poor's. The bonds were priced to yield from 4.25 percent in 1976 to 6.70 percent in 1996-2005, between 40 and 65 basis points higher than a similar issue sold in February.

A high yield premium paid by a New York State agency illustrated, in part, the continuing impact on the municipal bond market of the problems surrounding the New York State Urban Development Corporation (UDC). Late in the month the New York State Medical Care Facilities Finance Agency sold $62 million of A-1-rated moral obligation bonds. The bonds sold out when priced to yield from 7.00 percent in 1977 to as high as 9.59 percent in 2006. These yields were roughly 1½ percentage points higher than yields on comparably rated issues sold at

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—April 1975			
	April 7	April 14	April 21	April 28
Three-month	6.021	5.538	5.653	5.716
Six-month	6.351	5.843	6.067	6.158
	Monthly auction dates—February-April 1975			
	February 5	March 5	April 2	April 30
Fifty-two weeks	5.313	5.637	6.475	6.400

* 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.

about the same time. During the same week, Boston sold $40 million of A-rated bonds priced to yield between 5 percent in 1976 to 7.70 percent in 1993-1995, while one week earlier the Salt River Project Agricultural Improvement and Power District had sold A-1-rated bonds priced to yield between 5.80 percent in 1983 to 7.60 percent in 2015. Both issues sold slowly, however, and the Salt River bonds were released to the resale market at price concessions.

On May 1 The Bond Buyer index of twenty municipal bond yields was 6.95 percent, unchanged from the end of March. The Blue List of dealers' advertised inventories finished the month at $463 million. It declined by $76 million for the month.