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Treasury and Federal Reserve Foreign Exchange Operations February—July 1975

By Alan R. Holmes and Scott E. Pardee*

In late 1974-early 1975 the exchange markets were subject to an almost unremitting diet of bearish news for the dollar. Mounting evidence showed that the United States economy was slipping into severe recession. United States interest rates were falling more steeply than those in many other countries with no bottom in immediate prospect. United States economic policy was still under vigorous debate, and traders were concerned over the possibility of measures which could eventually exacerbate domestic inflation. In the gloomy atmosphere that developed, the market ignored any favorable news for the economy, such as the underlying improvement in the trade balance and the slackening in our rate of inflation. Consequently, the dollar lost its resiliency in the exchanges. Market forces drove dollar rates lower nearly every day as trading became more and more unsettled. Under these circumstances, the Federal Reserve and European central banks had intervened to moderate the decline in dollar rates. By the end of January, to finance its intervention the Federal Reserve had drawn a total of $412.5 million equivalent of German marks, Swiss francs, and Dutch guilders under the swap arrangements with the respective central banks. But, with the markets growing increasingly nervous, a more forceful approach was clearly needed to avoid the outbreak of disorderly conditions.

On February 1, senior officials of the Federal Reserve, the Bundesbank, and the Swiss National Bank met in London to conclude details of a more forceful intervention approach. On Monday, February 3, these central banks countered renewed selling pressure on the dollar with concerted intervention. Over that and the following day, the Federal Reserve sold a total of $139.4 million of German marks, Swiss francs, Dutch guilders, and Belgian francs. This operation, and its confirmation by Chairman Burns and officials of the Bundesbank and the Swiss National Bank, prompted a sharp rebound for the dollar.

Subsequent events, including the further decline in interest rates in the United States and release of sharply higher unemployment figures, nonetheless served to reinforce market pessimism toward the dollar, which soon came under renewed and occasionally heavy selling pressure. The Federal Reserve continued to intervene as necessary to avoid the outbreak of disorderly conditions without holding the rate at any particular level. Consequently, although dollar rates fell back to the late-January lows and beyond, the retreat was generally orderly. Outright speculative pressure resurfaced, however, on February 27, despite the release of clearly improved United States trade figures for January, and the Federal Reserve countered forcibly, selling some $104.2 million equivalent of German marks, Swiss francs, Dutch guilders, and Belgian francs. This operation helped steady the market, and immediate selling pressure against the dollar lifted.

Total Federal Reserve sales of currencies in February amounted to $620 million, of which $433.1 million was in German marks, $123.3 million in Swiss francs, $46.9 million in Dutch guilders, and $16.7 million in Belgian francs. These operations were all financed by drawings under the swap arrangements with the respective central banks, raising outstanding drawings from market operations since late 1974 to $1,032.5 million.

In March and April the market atmosphere gradually

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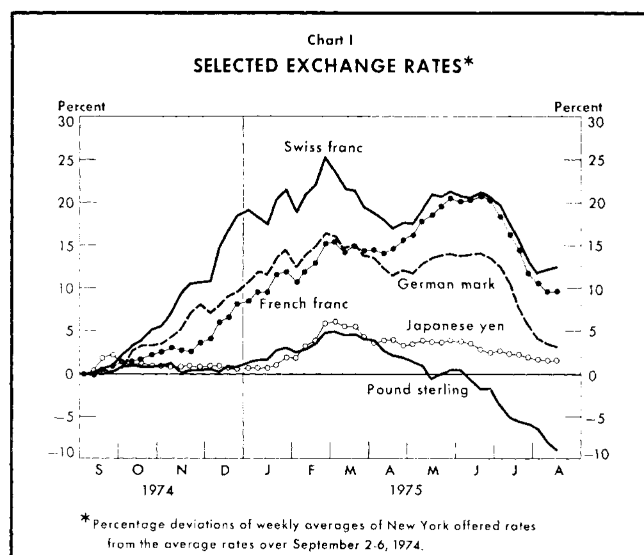

improved for the dollar. By that time the United States trade accounts were shifting into surplus, in response not only to the deeper recession here than elsewhere but also to our improved competitive position in world markets. Inflation was abating more rapidly here than in most other countries. In addition, some of the temporary factors which had depressed the dollar began to lose force. In particular, reports of disagreement within the Organization of Petroleum Exporting Countries (OPEC) eased some of the immediate concern in the market that the group was on the verge of collectively cutting production and of boosting prices further. Passage and signing of tax-relief measures to stimulate the United States economy also helped clear the air. Moreover, statements by United States officials, emphasizing the fundamental strength in this country's trade and payments position and pointing to the Federal Reserve's recent substantial intervention in the exchanges, reassured the markets that the United States was not pursuing a policy of "benign neglect" toward the dollar. Once immediate fears of additional dollar declines began to fade, traders began to respond to a further favorable shift in interest rate differentials as rates here firmed somewhat while those elsewhere continued to fall. Consequently, the dollar was gradually bid up from its lows, and by the end of April it had recovered by 4 to 6 percent against the German mark and Swiss franc and by similar amounts against most major European currencies.

The dollar's rise was highly tentative at first, and the Federal Reserve continued to intervene in German marks and Swiss francs to prevent a backsliding in rates that threatened to undermine a more solid recovery. But intervention tapered off as the dollar gained resiliency over the course of March and April. In those months the System sold a total of $161.6 million of marks, $9.5 million of Swiss francs, and $2.1 million of Dutch guilders. In late March, the System's outstanding indebtedness from market operations in late 1974-75 reached a peak of $1,066.2 million. Of this, $837.8 million was in marks, $159.4 million in Swiss francs, $52.2 million in Dutch guilders, and $16.7 million in Belgian francs. By that time, however, the Federal Reserve had begun to buy currencies in the market here and abroad and from correspondents to repay debt. In March the System repaid $25 million of mark drawings. As the dollar strengthened further in April, the System repaid all of the Swiss and Belgian franc drawings incurred in late 1974 and early 1975 and a further $244.6 million of the German mark drawings. On balance, therefore, the Federal Reserve reduced its outstanding swap debt incurred since late 1974 to $657 million by April 30.

The dollar's recovery was not sustained, however, as

Table I

FEDERAL RESERVE RECIPROCAL CURRENCY ARRANGEMENTS

In millions of dollars

Institution	Amount of facility July 31, 1975
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	2,000
Bank of Italy	3,000
Bank of Japan	2,000
Bank of Mexico	180
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	1,400
Bank for International Settlements:	
Swiss francs-dollars	600
Other authorized European currencies-dollars	1,250
Total	19,980

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Table II

FEDERAL RESERVE SYSTEM DRAWINGS AND REPAYMENTS UNDER RECIPROCAL CURRENCY ARRANGEMENTS

In millions of dollars equivalent

Transactions with	System swap commitments, January 1, 1975	Drawings (+) or repayments (−) 1975			System swap commitments, July 31, 1975
		I	II	July	
National Bank of Belgium	261.8	+ 16.7	+ 13.1 − 29.8		261.8
Bank of France	-0-		+ 45.6 − 5.1	− 40.5	-0-
German Federal Bank	218.7	+644.1 − 25.0	+ 63.4 −487.7	−413.5	-0-
Netherlands Bank	3.2	+ 49.0	+ 47.3 − 90.6	− 8.8	-0-
Swiss National Bank	378.5	+152.1	−159.4		371.2
Bank for International Settlements (Swiss francs)	600.0				600.0
Total	1,462.2	+861.9 − 25.0	+169.4 −772.7	−462.8	1,232.9

Note: Discrepancies in totals are due to rounding.

United States interest rates eased once again early in May. Renewed outflows of liquid funds from the United States and the diversion of foreign-held funds to other money markets left the dollar vulnerable to crosscurrents in other markets. Thus, occasional selling pressure against sterling and bursts of demand for French francs tended to generate demand for other continental European currencies as well, particularly the German mark and the Swiss franc. Adding to the dollar's softer undertone were market uncertainties over the implications of the collapse of non-Communist governments in Indochina and of renewed tensions in the Middle East.

Consequently, the dollar came on offer in periodically unsettled markets. The Federal Reserve resumed intervention on May 7, selling modest amounts of German marks and Dutch guilders. On May 12, news of the Cambodian seizure of a United States merchant ship triggered heavy speculative sales of dollars, and dollar rates fell by some 1 to 1½ percent over the next two days. To resist a cumulative erosion of dollar rates, the Federal Reserve intervened in German marks, Dutch guilders, and Belgian francs, selling a combined total of $69.1 million. Several European central banks stepped in and bought dollars in their own markets. The selling wave broke quickly, and dollar rates were already rising when the United States announced that the merchant ship had been freed.

The market nevertheless settled down only briefly as the continuing buildup of demand for French francs set off more generalized selling of dollars by May 21. As dollar rates declined sharply, the Federal Reserve again intervened in marks, guilders, and Belgian francs. Moreover, following the Bank of France's heavy dollar purchases in Paris, the Federal Reserve also intervened in French francs in New York. In all, during May 21-23, the Federal Reserve sold a total of $115.6 million of foreign currencies. This concerted intervention was favorably received in the market and the press and, as trading conditions improved, the dollar stabilized in late May.

Overall, during episodes of unsettled trading in May, the Federal Reserve sold a total of $212.5 million of currencies, of which $157.8 million was financed by swap drawings and $54.6 million by balances. Meanwhile, whenever market conditions permitted, the System continued to buy currencies and repaid $79.2 million of drawings in May. On balance, therefore, outstanding drawings rose to $735.6 million.

In June and July the balance of market forces tipped increasingly in favor of the dollar. By that time, the United States trade account had moved decisively into surplus. Growing signs of a United States economic

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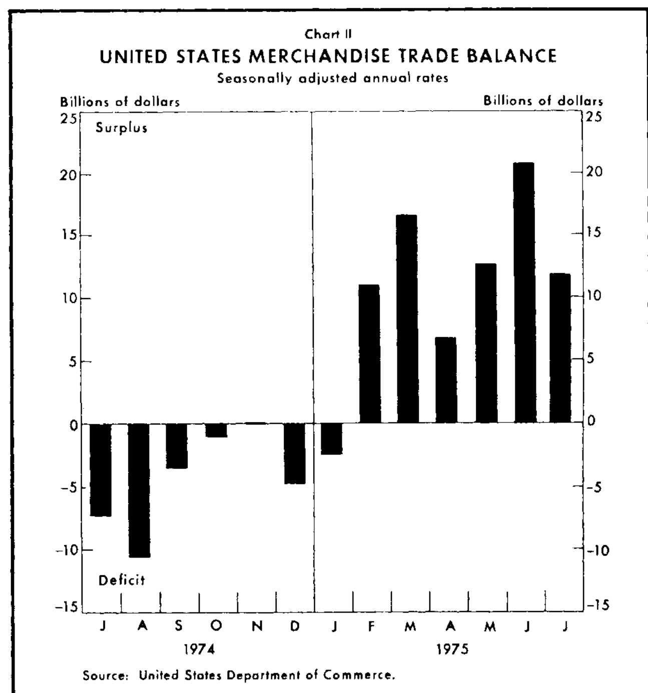
recovery also helped bolster confidence in the dollar by dispelling fears of an even more serious downturn and clearing away the market's expectation of further sharp declines in United States interest rates. Economic recovery abroad was still lagging, and the market had shifted to expect additional stimulative measures, including lower interest rates, in several foreign countries. At first, the favorable shift in market psychology led mainly to a firmer tone for the dollar, in which the dollar showed greater resiliency to potentially adverse news or events. But, following a jump in United States interest rates in late June, the dollar was bid up across the board. By early July, a ground swell of demand developed, as earlier speculative positions against the dollar were unwound, adverse leads and lags were reversed, and arbitrage and investment funds were drawn into New York and the Euro-dollar market.

Just as the decline of the dollar in late 1974-early 1975 had been mainly against major continental European currencies, its rise was particularly sharp against those currencies as well. Thus, by the end of July, the dollar had climbed against the German mark by some 9¾ percent from mid-May and by almost 11½ percent from the lows of late February. Dollar rates for other continental European currencies followed a similar pattern except for the French franc, against which the dollar had fallen by 8½ percent from February through early June before fully reversing that decline.



The Federal Reserve intervened on only four occasions in June and once in July to resist abrupt declines in dollar rates, selling a total of $39.4 million of marks out of balances. Otherwise, the System took the opportunity of a strengthening dollar to acquire currencies to repay debt. The 1974-75 drawings in Dutch guilders, French francs, and Belgian francs were fully repaid by early July. Purchases of marks continued through late July and, by the month end, all drawings in that currency had been liquidated as well.

In sum, in intervention during the six-month period February through July, the Federal Reserve sold a total of $1,045 million of foreign currencies, of which $848 million was financed by drawings on swap lines with the respective central banks and $197 million was from balances acquired in the market or from correspondents. All of these drawings, plus some $412.5 million carried over from late 1974-early 1975, were fully repaid by July 31. Operations were conducted in five currencies. In marks, the System sold $740.6 million, of which $543.6 million was drawn under the swap line with the Bundesbank and $197 million was from balances. In Swiss francs, sales amounted to $132.8 million, all financed by swap drawings on the Swiss National Bank. Aggregate sales of $96.3 million of Dutch guilders, $45.6 million of French francs, and $29.8 million of Belgian francs were also financed by swap drawings on the respective central banks. On July 31, the Federal Reserve had $971.2 million of Swiss franc drawings and $261.8 million of Belgian franc drawings, and the United States Treasury had $1,599.3 million equivalent of Swiss-franc-denominated obligations with the Swiss National Bank, all outstanding from August 1971.

Finally, as previously reported, last September the Federal Reserve Bank of New York acquired the $725 million equivalent of forward exchange commitments of the Franklin National Bank. The last of these commitments matured in August. The residual of funds provided by Franklin to cover the risks of these operations therefore reverted to the Federal Deposit Insurance Corporation as liquidator of the Franklin National Bank.

GERMAN MARK

Coming into 1975, expectations of an early upturn in the German economy and a still favorable outlook for Germany's trade provided a firm undertone for the mark in the exchanges. A much slower pace of inflation in Germany than in its major trading partners, together with

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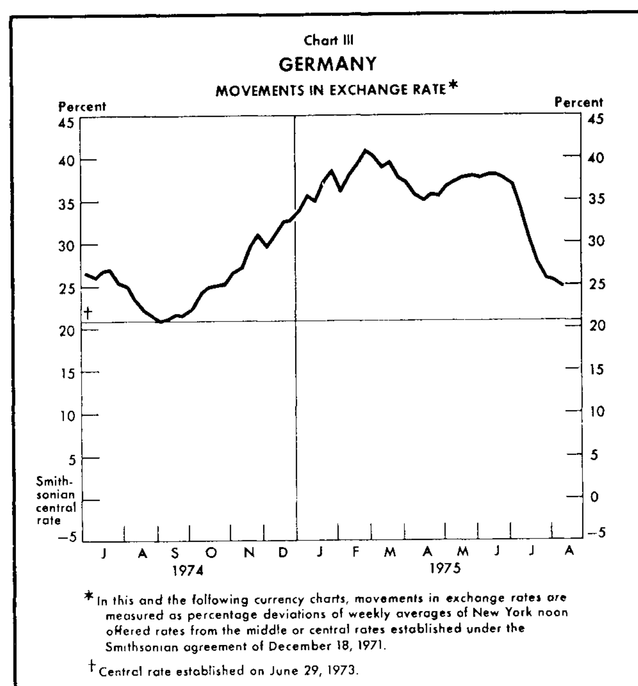
expanding orders from both Eastern Europe and the OPEC countries, was expected to ensure a continuing large trade surplus and thereby to cushion the German economy from the recession spreading elsewhere in the industrial world. At home, the government had responded to the persistent slowdown in domestic demand by implementing in December a fiscal package to boost capital investment. In addition, the Bundesbank had continued to relax its monetary policy, reducing its discount rate in two steps to 6 percent by December 20 and increasing the banks' rediscount quotas.

Against this background, highly publicized OPEC direct investments and a reversal of the bulk of last fall's short-term capital outflows reinforced the market's bullish sentiment toward the mark. Moreover, flare-ups of speculation in the Swiss franc, which pushed that currency up sharply in late 1974 and January 1975, also tended to pull the mark up against the dollar. By late January the mark had advanced some 16½ percent from its early-September 1974 lows to $0.4356. The Federal Reserve and the Bundesbank, having intervened in modest amounts on a day-to-day basis, then began to stiffen their resistance to further selling pressure against the dollar which threatened to disrupt the market. To finance its intervention, the Federal Reserve had accumulated by January 31 a net $382.7 million of drawings on the swap line with the Bundesbank.

Immediately after the London meeting of February 1, the German and Swiss central banks countered renewed selling pressure on the dollar through concerted dollar purchases. The Federal Reserve followed up in New York with large offerings of marks as well as other currencies. Over just two days, February 3-4, the Federal Reserve thus sold $74.4 million of marks financed by drawings on the Bundesbank. This joint operation, and its confirmation by officials of the three participating central banks, prompted a sharp turnaround in rates in which the mark dropped by some 4 percent in two days.

Subsequent events, however, served to reinforce the mark's buoyancy. A tapering-off in the rise of Germany's unemployment rate strengthened the view that the recession in Germany would be less severe and prolonged than in the United States. In addition, the market still expected the downtrend in German interest rates to continue to lag well behind that in the United States. Even after the Bundesbank cut its discount and Lombard rates another ½ percentage point early in February and the decline in United States money market rates began to slacken, successive reductions in prime rates here tended to confirm the market's expectations. Meanwhile, OPEC representatives were already speaking of their concern over the weakness of the dollar and of measures they might take to protect their oil revenues and international reserves from any further depreciation. With OPEC countries now diversifying a major portion of new dollar receipts into Continental currencies, a rush of newly issued mark-denominated Euro-bonds provided yet another outlet for investment in marks.



* In this and the following currency charts, movements in exchange rates are measured as percentage deviations of weekly averages of New York noon offered rates from the middle or central rates established under the Smithsonian agreement of December 18, 1971.

† Central rate established on June 29, 1973.

In this atmosphere, demand for marks pushed the spot rate back to and above its January peak, reaching $0.4395 in late February. To avoid an outbreak of disorderly conditions, the Federal Reserve intervened on ten of the fourteen business days from February 5 through February 26, selling a total of $278.2 million of marks drawn on the swap line with the Bundesbank. Even after the release on February 27 of clearly improved United States trade figures for January, the dollar failed to rise and the New York market was soon flooded with speculative selling out of Europe. The Federal Reserve sold a further $56.7 million of marks that day, financed by a swap drawing on the Bundesbank. This operation, followed up with sustaining intervention the next day of $23.7 million of marks drawn on the Bundesbank, helped set the stage for an improved market atmosphere beginning early in March.

By that time, United States money market rates had

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leveled off. In Germany, by contrast, short-term interest rates were easing more rapidly than before, and the already favorable arbitrage differentials for the dollar continued to widen even though both the Bundesbank and the Federal Reserve cut their respective discount rates by ½ percentage point early in March. Consequently, some of the immediate selling pressure on the dollar lifted and the mark rate began to ease. But the turnaround was highly tentative and, when activity thinned out in late New York trading, the mark rate was frequently bid up again. To avoid a resurgence of speculative demand for marks, the Federal Reserve intervened, selling in the first four days of March $63.3 million of marks from balances—part of the $102.3 million of marks acquired in early March from the Bank of Italy in connection with an Italian drawing on the International Monetary Fund (IMF). Thereafter, the market gradually settled down, and the Federal Reserve, though still prepared to respond to temporary unsettlements in the market, operated on only five of the twelve business days from March 7 through March 24. A total of $55.8 million of marks was sold, of which $47.1 million was financed by swap drawings and the rest by balances.

In all, to finance its intervention in February and March, the Federal Reserve drew a total of $480.2 million of marks under the swap line with the Bundesbank and, using part of the balances acquired from the Bank of Italy, repaid $25 million equivalent of drawings. Thus, by late March, outstanding swap drawings in marks had reached a peak of $837.8 million. Nevertheless, trading conditions had become generally more settled, and the mark had eased to around $0.4240, some 3½ percent below its February highs. The Federal Reserve had, therefore, begun to make modest daily purchases of marks in the market both here and abroad, accumulating balances for subsequent intervention if needed or for repayment of debt.

By April the outlook for the German economy was being clouded by the deeper than anticipated recession in Europe. The volume of Germany's export orders had dropped some 20 percent from the level of the year before, and the loss of export sales was keeping investment depressed. In addition, unemployment was again rising and, in response to the deteriorating economic climate, the savings rate shot up to its highest level in at least ten years. At the same time, German interest rates continued to ease while United States interest rates had firmed somewhat. Consequently, the mark edged downward against the dollar to $0.4180 just after midmonth. With German interest rates now among the lowest in Europe, funds also flowed out of marks into other European currencies. Indeed, for the first time since the third quarter of 1974, capital outflows from Germany exceeded the current-account surplus, and the mark declined to its lower limits of the European Community (EC) "snake" where it required occasional support.

Nevertheless, the market remained uneasy over the extent to which OPEC interests were still shifting into marks from dollars and sterling, especially as the pound came under heavy selling pressure late in the month. When these concerns surfaced, the mark was occasionally bid up sharply, and the Federal Reserve intervened four times in April to sell a total of $42.6 million equivalent of marks, of which $31 million was from balances and the remainder

Table III

DRAWINGS AND REPAYMENTS BY FOREIGN CENTRAL BANKS AND THE BANK FOR INTERNATIONAL SETTLEMENTS UNDER RECIPROCAL CURRENCY ARRANGEMENTS

In millions of dollars

Banks drawing on Federal Reserve System	Drawings on Federal Reserve System outstanding January 1, 1975	Drawings (+) or repayments (—) 1975			Drawings on Federal Reserve System outstanding July 31, 1975
		I	II	July	
Bank for International Settlements (against German marks)	-0-	{+45.0 {—45.0	{+1.0 {—1.0	{+67.0 {—67.0	-0-
Total	-0-	{+45.0 {—45.0	{+1.0 {—1.0	{+67.0 {—67.0	-0-

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drawn on the swap line with the Bundesbank. Otherwise, the System took advantage of the general weakening tendency of the mark to continue to buy marks in the market and from correspondents to repay debt. Thus, with repayments of $244.6 million, Federal Reserve swap drawings in marks had been reduced on balance by $233.1 million to $604.7 million by the end of April.

As the dollar's hesitant April recovery stalled early in May, the mark began to firm again. Amidst concern over a renewed fallback in United States interest rates, a sharp run-up in the French franc revived fears of a movement of foreign-held funds to the Continent. When particularly heavy bidding for French francs spilled over into the market for German marks and threatened to disrupt trading conditions generally on May 7, the Federal Reserve sold $17 million of marks, of which $6.9 million was drawn on the swap line and the rest from balances. Five days later, with renewed tensions in Southeast Asia and the Middle East already overhanging the exchanges, news of the Cambodian seizure of a United States merchant ship triggered another jump for the mark in somewhat confused trading. The Federal Reserve intervened in marks as well as other currencies on May 12-13 to steady the market and sold a total of $46.3 million equivalent of marks, of which $25.7 million was drawn on the swap line and the rest from balances. The Bundesbank simultaneously intervened, and this concerted operation helped reassure the market. The mark was again bid up late in May, in response to a renewed upsurge of the French franc, and firmed briefly in early June, in the backwash of a substantial switch of funds from sterling into marks. The Federal Reserve intervened during May 21-23 and, to a lesser extent, on three occasions in early June to sell a total of $77.5 million of marks. Of these, $19.3 million was drawn on the swap line with the Bundesbank and the rest was from balances. But, with the dollar gradually gaining greater buoyancy, the Federal Reserve continued its program of acquiring marks to repay debt whenever market conditions permitted. After repaying in May $62.7 million equivalent, the System reduced its mark swap indebtedness by another $129.5 million by the middle of June.

Toward the end of June, a sudden rise in United States interest rates triggered renewed bidding for dollars against all currencies. Moreover, the United States economy was showing signs of an upturn. By contrast, the recession in Germany persisted. The Bundesbank had acted decisively in late May to relax monetary policy further with additional cuts in its discount and Lombard rates to 4½ percent and 5½ percent, respectively, and with successive reductions in minimum reserve requirements. With short-term German money rates again easing, the shifting of interest arbitrage funds out of Germany and the Euro-mark market accelerated. In addition, earlier speculative positions were reversed, nonresidents' long-term investments were increasingly withdrawn, and commercial leads and lags shifted against the mark. The slide of the spot mark was therefore sustained through the end of July. By the month end the rate had dropped to as low as $0.3894, some 9½ percent below its June high and almost 11½ percent below its peak in February.

As the mark declined, the Federal Reserve acquired additional balances in the market and from correspondents to repay debt, stepping up its purchases on days when the mark was declining sharply. On the other hand, when the mark was suddenly bid up in a thin market on June 24 and July 25, the Federal Reserve offered marks, selling a total of $5.1 million out of balances. By end-July the Federal Reserve had acquired sufficient marks to repay fully the remaining $464.4 million of mark swap debt.

STERLING

By late 1974-early 1975 the United Kingdom had begun to slip into recession. Britain's already serious wage-price spiral was accelerating, in sharp contrast to slackening rates of inflation in other major countries. The United Kingdom had been financing its large trade deficit by means of public and private borrowings abroad. By early 1975, however, the government had drawn down most of its $2.5 billion Euro-dollar loan, and borrowings abroad by other public-sector entities were tapering off. At the same time, the market questioned whether the relatively high interest rates in London, which had exerted a pull on nonresident funds, could be long maintained in view of rising unemployment and the still worrisome strain on corporate profits and liquidity. Against this background, the market had become extremely sensitive to any signs of a significant decline in new OPEC investments in the United Kingdom or of stepped-up diversification of OPEC funds out of sterling and into other currencies. Sterling had therefore come under periodically heavy selling pressure around the turn of the year. But the Bank of England had provided forceful support and, after Middle East reassurances of continued investment in sterling assets, the immediate pressures had abated. The pound then began to join in the generalized advance of European currencies against the dollar, moving up to around $2.38 by end-January. At that level, its effective depreciation against Smithsonian central rates was around 21.7 percent.

By early February, the further declines in interest rates in the United States, in the Euro-dollar market, and on the European continent were providing scope for a modest

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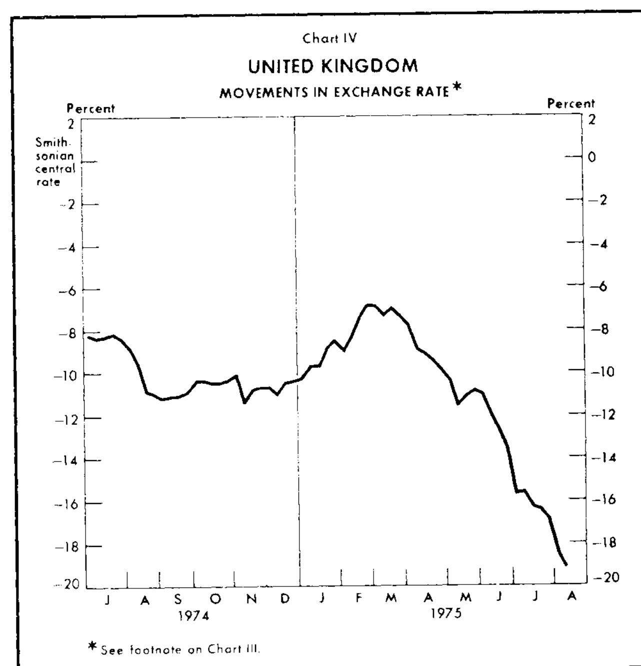
easing of United Kingdom interest rates, including a cut in the Bank of England's minimum lending rate. With favorable interest incentives for sterling therefore maintained, liquid funds were again drawn to sterling, including OPEC placements. In addition, commercial demand for sterling, along with regular purchases by oil companies for tax and royalty payments and the covering of short positions which had been taken up around the year-end, buoyed the sterling rate. Meanwhile, Britain's trade account showed a striking improvement that was to continue through the first half of the year, as exports rebounded from depressed fourth-quarter 1974 levels and imports fell in response to weakening domestic demand. Thus bolstered by financial and commercial demand, the pound was bid up to as high as $2.43¾ just before mid-March, its highest level in over nine months. Although the rate subsequently eased against the dollar, sterling gained ground against other European currencies and its effective depreciation narrowed to 21.1 percent by late March. Taking advantage of sterling's relative buoyancy, the Bank of England made sizable purchases of dollars which were partly reflected in the $300 million increase in official reserves over February and March.



By early April, however, market sentiment toward sterling was turning bearish once again, as concern over the government's upcoming budget message shifted the market's focus back to the underlying conflicts in Britain's economic situation. Unlike elsewhere, the economic slowdown in Britain was not having a dampening effect on domestic inflation. In fact, the rise in wages had accelerated even further to more than 30 percent per annum. Some of the largest wage settlements had been in the public sector, thereby adding to the burgeoning government deficit and potentially intensifying inflationary pressures all the more. Yet, in the market's view, a major move to narrow the deficit by raising taxes or cutting public expenditures threatened only to aggravate unemployment. By that time the generalized public discussion of Britain's international economic policy, which developed in advance of the June 5 referendum on United Kingdom membership in the EC, was also contributing to exchange market uncertainties.

As a consequence, the pound once again became vulnerable to bouts of selling. A firming of interest rates in the United States and Euro-dollar markets early in April, coupled with a further easing of rates in London, prompted some shifts of funds out of sterling, and over the next two weeks the spot rate declined to $2.35¼, or an effective depreciation of 22.1 percent. On April 15, the government presented a budget designed to limit increases in the public-sector deficit and to improve the balance of payments through higher taxes on personal spending this fiscal year and public spending cuts next year. The market was impressed with its generally restrictive tone but remained concerned over the still large government borrowing requirement, running close to 10 percent of gross national product. The market atmosphere therefore remained unsettled and, in the wake of continued declines in British interest rates including a further reduction in the Bank of England's minimum lending rate, the pound tended to ease.

Then, over the April 19-20 weekend, a report in the London press suggested that the British authorities would not be concerned if the pound depreciated a further 4 or 5 percent. On Monday, April 21, the pound immediately came on offer. Speculative selling cumulated, as the recommended nationalization of the financially troubled British Leyland Motor Corporation and growing evidence of opposition within the Labor Party to British membership in the EC contributed to the market's concern. Against this background, there was little response in the exchanges to Chancellor of the Exchequer Healey's assurances that the government did not favor a further depreciation of the pound. Speculative positions short of sterling and long of Continental currencies were built up, and sizable amounts of OPEC funds were shifted into Continental currencies. The pound was pushed down to $2.30 by mid-

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May. Meanwhile, sterling's trade-weighted depreciation had widened by nearly 4 percentage points from early-March levels.

At this point, the Bank of England, which had been intervening to moderate excessive fluctuations in the sterling rate, stiffened its resistance to a further decline and the immediate pressures began to subside. Meanwhile, a rise in short-term United Kingdom interest rates was validated by an increase in the Bank of England's minimum lending rate to 10 percent. As a result, interest incentives widened once again, stimulating some reflows of funds which, together with oil company and other commercial demand, helped bid the pound back up to above $2.33 in late May. Trading activity then slackened as market participants awaited the outcome of the June 5 referendum.

The referendum passed with a decisive two-to-one majority favoring continued EC membership. Sterling at first strengthened on the expectation that the government was now in a position to take forceful action to deal with the accelerating wage-price spiral. Nevertheless, in the absence of immediate policy proposals, pessimism over Britain's economic prospects quickly resurfaced, and the market atmosphere soured. Sterling fell back on June 10, when a large shift of funds out of sterling and into marks triggered renewed selling pressures. Although discussions were initiated between British trade unions and management representatives on a new voluntary scheme for limiting wage claims, sterling continued to plunge in bursts of heavy selling through the rest of June to a low of $2.17¼ by July 1. This drop of more than 6½ percent against the dollar since late May helped push the trade-weighted depreciation levels to a record of 29.2 percent.

By this time, sterling's erosion in the exchanges had riveted attention in the British press and by the public on the need for urgent trade union, management, and government agreement on new anti-inflation initiatives. In addressing Parliament on July 1, Chancellor Healey promised that, if a voluntary mechanism were not established to limit wage increases to 10 percent, the government would seek legislation on statutory controls. In an initially favorable market response, sterling rebounded to above $2.21 and then held firm after the Trade Union Congress agreed to go along with a voluntary wage-restraint program. The government's specific proposals, outlined to Parliament on July 12, called for strict across-the-board limits on all pay increases. These would be enforced by fiscal spending limits in the public sector and by stricter adherence to the price code in the private sector.

The proposals, drawing support from both labor and employers, were well received in the market, and some of the uncertainties that had been weighing on sterling began to lift. Over the remainder of July, the pound was buoyed by the covering of positions short of sterling and long of Continental currencies that had been built up in previous weeks, as well as by substantial demand for end-of-month oil tax and royalty payments. Although by July 31 the spot pound had eased back to $2.15½ against the dollar, it had gained against major Continental currencies, and the effective trade-weighted depreciation had narrowed to 26.3 percent.

SWISS FRANC

Through much of 1974, Switzerland's economy had operated at almost full capacity, as a continuing buoyancy in the export sector helped maintain production levels even as domestic demand slowed. Meanwhile, the inflation rate held around 10 percent, lower than in many other industrialized countries but still well above that for Germany, its major trading partner. The Swiss authorities, therefore, continued to pursue an anti-inflationary program which, after a proposed tax increase was rejected, depended on a relatively strict monetary stance. This policy was relaxed only gradually as the domestic economy weakened late in the year. As a result, liquidity remained relatively tighter in Switzerland than in the Euro-dollar market or in many other Continental financial centers. Simultaneously, a scramble for francs to cover large open speculative positions, the flight of capital seeking a haven from political uncertainties, and OPEC efforts to diversify their large surplus revenues generated periodically heavy bidding for the Swiss franc. Thus, the franc spearheaded the rise of European currencies against the dollar from November 1974 through January.

The decline in competitiveness resulting from this sharp appreciation of the franc put new strains on many Swiss export industries already hurt by the deepening recession in other countries. To prevent a rise in the rate, the Swiss authorities as early as November 1974 reimposed a ban on interest payments to nonresidents and a negative charge on new inflows of foreign funds. Moreover, to accommodate an expansion of economic activity, the National Bank adopted a target for liquidity expansion in 1975 of 6 percent. When these moves failed to contain a further strengthening of the franc early in January, the Swiss National Bank resumed for the first time in two years outright foreign exchange intervention in Zurich. The National Bank bought dollars repeatedly during the month, at times quite heavily, supplementing its intervention by tightening capital controls further and by requiring banks to balance overall foreign exchange

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positions daily. The Federal Reserve had also intervened to sell francs, raising new swap drawings on the National Bank to $26.6 million. Even so, market forces drove the franc persistently higher, and by January 27 the spot rate had climbed to $0.4195, almost 27 percent above its September 1974 low against the dollar and up 9 percent against the German mark.

With the markets generally nervous and unsettled, the Swiss National Bank joined the Bundesbank and the Federal Reserve in a coordinated intervention approach following the London meeting of February 1. The Federal Reserve followed up operations in Frankfurt and Zurich on February 3 by placing offers of francs, together with other currencies, in the New York market and selling $24.1 million equivalent drawn on the swap line with the National Bank. Later, Swiss National Bank President Leutwiler publicly confirmed the weekend agreement and the Swiss intervention. The market responded favorably to this explicitly coordinated operation, and the rate dropped to $0.3907 by New York's opening on February 4, fully 6¾ percent below its January peak.

Almost immediately, however, generalized pressure on the dollar reemerged. With the franc rising once again, the market came to fear that additional limits on capital inflows would be imposed and funds were increasingly shifted into those Swiss securities still available to nonresidents. The franc's rise accelerated toward late February, and both the Federal Reserve and the Swiss National Bank intervened to maintain orderly market conditions. Operating on ten of the sixteen business days from February 4 through February 27, the System sold $99.2 million of Swiss francs, bringing total sales for February to $123.3 million equivalent, all drawn on the swap line with the Swiss National Bank. Largely reflecting the joint intervention, Swiss reserves increased $321 million during that month.

By end-February, the Swiss franc had peaked at $0.4188 and upward pressure on the rate had tapered off as sentiment toward the dollar began to improve. In response to earlier declines in United States and Euro-dollar interest rates, the Swiss National Bank lowered its discount rate from 5½ percent to 5 percent. Moreover, the National Bank provided for the commercial banks' quarter-end needs, largely through dollar swaps, so that temporary money market strains would not exert upward pressure on the franc. It proposed a gentleman's agreement under which Swiss banks would report large foreign exchange transactions to the central bank to forestall potentially destabilizing speculative inflows. And it raised the overall ceiling for foreign placements in the Swiss capital market to encourage long-term outflows while simultaneously absorbing the remaining liquidity excess that had not been neutralized by February's reserve requirement increase.

Meanwhile, in the exchange market, rumors had begun to circulate, later confirmed, that the Swiss government hoped to associate the franc with the EC snake. This prospect at first unsettled the market, and the Federal Reserve supplemented its intervention in marks during early March with offerings of Swiss francs, selling $9.5 million equivalent financed by further swap drawings. But soon the market came to expect that a potential link with the snake would limit the franc's rise against other European currencies. Moreover, interest differentials in favor of the United States had begun to widen. Consequently, the Swiss franc began a sustained decline that carried through the first half of April, not only against the dollar but also against the German mark. Toward the end of March, the Federal Reserve began a program of moderate purchases of francs from the National Bank against its outstanding swap indebtedness and by April 22 had liquidated all $159.4 million of its 1974-75 debt.

By mid-April the Swiss franc had dropped fully 7½ percent from its record highs of late February to $0.3873. Toward midmonth the Swiss National Bank moved further to prevent renewed upward pressure on the franc and

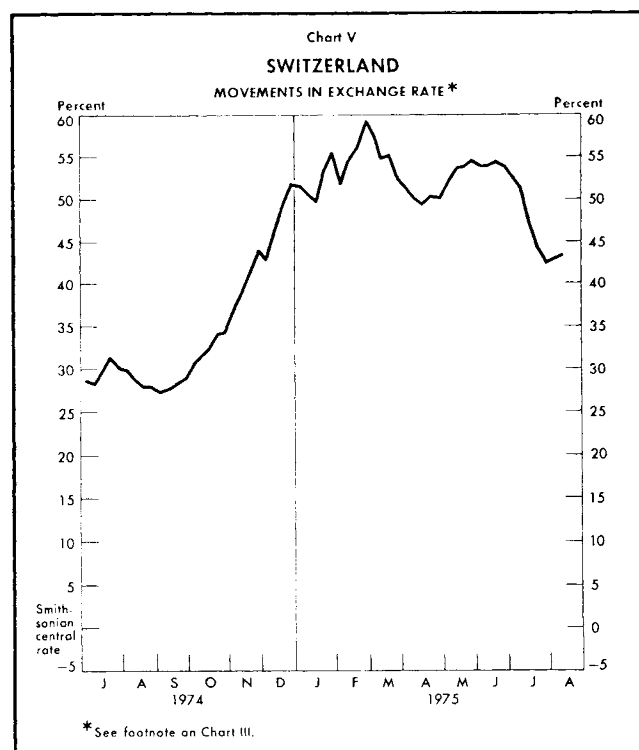

Table IV

UNITED STATES TREASURY SECURITIES FOREIGN CURRENCY SERIES

In millions of dollars equivalent

Issued to	Amount outstanding January 1, 1975	Issues (+) or redemptions (—) 1975			Amount outstanding July 31, 1975
		I	II	July	
Swiss National Bank	1,599.3				1,599.3
Total	1,599.3	-0-	-0-	-0-	1,599.3

to stimulate a lagging Swiss economy by cutting reserve requirements against foreign liabilities, lifting ceilings on bank credit expansion, and instituting specific measures to assist the hardest pressed sectors of the economy. In addition, the National Bank intervened, buying dollars both in Switzerland and through the intermediary of the Federal Reserve Bank of New York. In response, the franc held relatively steady through the last half of April.

In early May, the spot rate was bid up abruptly as pressure against the dollar reemerged. The Swiss National Bank responded to stepped-up bidding for francs by spot intervention and by dollar swaps which provided short-term liquidity assistance. But, as the dollar continued to decline and markets remained unsettled, the franc continued to be pushed up sharply, with only a brief pause after the National Bank further reduced its discount and Lombard rates. The spot franc soon pushed through the $0.4000 level to a peak of $0.4065 on May 13. To moderate the rise, the Swiss National Bank intensified its spot intervention and on May 30, for the second time since April, lowered minimum reserve requirements against foreign liabilities to release additional domestic liquidity.

Early in June, market sentiment began to shift in favor of the dollar on the prospects of an earlier economic recovery in the United States than in Europe and a renewed firming of short-term interest rates here. At the same time, liquidity in Switzerland remained unusually comfortable ahead of the quarter end, and the Swiss National Bank was called upon to provide only about $400 million of the $1 billion quarter-end swap assistance it offered. Even so, the Swiss franc held steady throughout June on market concern that large shifts out of sterling might generate further inflows into Continental currencies.

In July the Swiss franc declined in sympathy with the generalized weakening of European currencies, dropping 9 percent to a low of $0.3697 late in the month. But the Swiss franc's decline lagged behind that of the mark which was depressed by the unwinding of speculative long positions in marks and the liquidation of investments in mark-denominated securities. As the franc-mark rate strengthened, prospects of an early link of the franc with the snake faded, and those who had built up positions in the hopes that the franc would weaken relative to the mark began to cover their open positions. There was, therefore, sporadically heavy bidding in francs at times throughout the month, which the Swiss National Bank countered with frequently sizable purchases of spot dollars. As it turned out, the franc ended the six-month period virtually unchanged *vis-à-vis* the mark. But against the dollar it dropped 7½ percent below early-February levels and fully 11¼ percent below its late-February peak.

FRENCH FRANC

Throughout 1974, France had been pursuing restrictive monetary and fiscal policies to slow domestic inflation and reduce its balance-of-payments deficit. By the turn of the year the pace of price increases, which had reached over 15 percent per annum, had started to decelerate. In addition, the current account, plunged sharply into deficit by a $6 billion higher oil bill for 1974, was benefiting from a striking turnaround in French trade. Indeed, an unusually heavy inventory liquidation, a drop in energy requirements, and an improvement in France's terms of trade resulting from the franc's appreciation since mid-1974 pushed the trade balance back into

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surplus by December 1974—earlier than generally expected—while newly announced export contracts to OPEC brightened prospects for 1975. Meanwhile, a substantial part of France's current-account deficit had been financed both by large-scale borrowings by French enterprises in international capital markets, often with government encouragement, and by short-term inflows induced by the relatively high interest rates available in France.

By late 1974, as economic recession spread throughout the industrial world, business activity in France had also begun to contract. In response, in January 1975, the Bank of France began to relax monetary policy cautiously by cutting the discount rate by 1 percentage point to 12 percent and reducing reserve requirements. But, with inflation still higher than in many other major countries, the monetary stance remained relatively restrictive, leaving interest rates in France above those prevailing elsewhere and providing incentives for inflows of foreign funds and for borrowings abroad by French enterprises.

The combination of an improved trade account and capital inflows thus buoyed the franc in the exchanges, and the spot rate rose almost uninterruptedly in early 1975. In January, some covering of short positions taken twelve months before when France withdrew from the EC snake gave further impetus to the franc's advance not only against the dollar but against other continental European currencies as well. This rise continued in February, as the market responded to the generalized weakness of the dollar and became increasingly sensitive to the possibility of large OPEC shifts into francs. By February 27 the franc had reached a high of $0.2413, up 16½ percent from the September 1974 lows. To moderate the franc's advance, the Bank of France purchased dollars, contributing to the $133 million increase in official exchange reserves in February.

In March and April, as the recession deepened and unemployment rose to twice the level of eight months before, France adopted selective fiscal measures particularly to stimulate private investment and the building sector. The Bank of France continued to move cautiously toward ease, lowering its discount rate in two steps to 10 percent by mid-April. Interest rates abroad were generally lower, however, and arbitrage incentives favoring the franc remained large. In the exchange markets, therefore, the franc held relatively firm even as it joined other currencies in easing against the dollar during late March and early April.

In mid-April, however, the demand for francs intensified. France's trade balance was moving into sizable surplus. High French interest rates were generating substantial prepayments by OPEC and other importers of French goods. In addition, following recently imposed Swiss regulations on foreign currency positions, Swiss banks were unwinding short French franc positions. As these commercial, financial, and technical demands prompted large shifts of funds from other currencies, the franc again rose against the dollar and more generally to within reach of its previous central rate against the mark and other EC currencies. At that point, expectations of a renewed link between the franc and the other members of the EC bloc prompted further speculative demand.

On May 9, President Giscard d'Estaing announced that, in view of the substantial improvement in its trade position, France intended to rejoin the snake at an early date. This evidence of official confidence in the franc further highlighted the remarkable turnaround in the French payments position since early 1974. After an initial hesitant response, traders soon reacted by bidding the franc up even further. Demand became so heavy that the franc began to pull up other currencies with it against the dollar. The Bank of France, which had operated regularly to moderate the franc's rise both against the dollar and against other European currencies, intervened more heavily, thereby contributing to the $860 million increase in official exchange reserves in the March-May period. Market forces nonetheless drove the franc persistently higher in occasionally hectic trading.

By New York's opening on May 22 the franc, at $0.2504, had gained almost 6 percent from mid-April levels and, with the advance accelerating, had risen 1⅛ percent in just a day and a half. At that point, the Bank of France and the Federal Reserve agreed that intervention by the System in the New York market, in coordination with ongoing intervention in Paris by the French central bank, would be appropriate to avoid an outbreak of disorderly trading conditions. Around midmorning, the Trading Desk, which had already placed offers of marks in the market, stepped up its intervention by offering sizable amounts of French francs as well as Dutch guilders and Belgian francs. The dollar soon steadied against other Continental currencies, but the French franc remained well bid. The Federal Reserve, therefore, continued to sell francs throughout the day, bringing total sales to $45.6 million equivalent, financed by a drawing on the swap line with the Bank of France.

These joint operations, widely reported in the press, helped brake speculation in favor of the franc. Except for a brief flurry of demand in Europe on May 26, when the New York market was closed for Memorial Day, the franc fell back, dropping over 2 percent to $0.2470 by May 30 on rumors of possible new French measures to deter inflows of funds to France. The Federal Reserve took ad-

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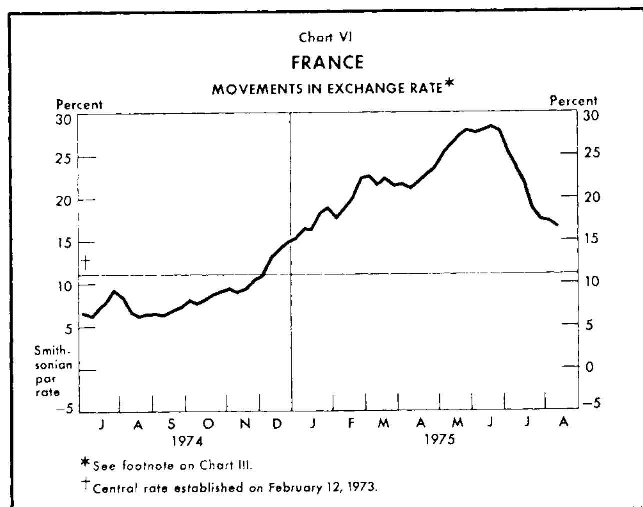

vantage of the franc's decline to purchase francs and liquidate $3.1 million of swap debt.

In early June, the Bank of France moved further to ease monetary policy by, among other things, reducing its discount rate by another ½ percentage point, to 9½ percent, and liberalizing credit ceilings for the banks. Nevertheless, renewed heavy commercial demand and capital inflows soon pushed the franc as high as $0.2516, and the Bank of France again intervened to resist the rise. With trading conditions for the dollar now generally more settled, however, the Federal Reserve did not intervene.

After mid-June the franc began to ease in line with other currencies against the dollar. On June 26, French Finance Minister Fourcade indicated that, in view of the improving conditions in domestic financial markets and the strengthening in the French payments position, there was no need to borrow abroad. Since by then French borrowers had raised well over $1½ billion abroad in 1975, the market immediately began to reassess the outlook for the franc on the expectation that it would no longer be strengthened by substantial capital conversions. Moreover, the franc came under heavy speculative selling pressure in response to rumors that it would be formally devalued before France reentered the EC currency arrangement on July 10. As the spot rate dropped, the Bank of France intervened to cushion the decline through dollar sales, while the Federal Reserve bought sufficient French francs in the market to liquidate the remaining $42.5 million of outstanding swap debt with the Bank of France.

The French government denied any intention of devaluing the franc, and on July 10 the franc returned to the snake at the existing central rate. Speculative pressures against the franc quickly evaporated, and the covering of short positions soon pushed the rate up against other EC currencies to near the middle of the 2¼ percent band. The franc joined in the general decline against the dollar, however, which continued through the rest of July. By the month end the spot rate had fallen back to $0.2288, down 9 percent from its June peak and 1½ percent from the early-February level.

NETHERLANDS GUILDER

The Netherlands was one of the first countries to take stimulative measures last year as the economy turned sluggish. As early as September, the government moved to reduce income taxes, raise investment incentives, and otherwise establish an expansionary course for budgetary policy. On the other hand, the authorities kept monetary conditions moderately firm in an effort to contain inflation which, though less severe than in many other countries, was still at a rate exceeding 10 percent. In addition, the already sizable current-account surplus was expected to be boosted further by higher natural gas export receipts. In view of the strong trade position and relatively taut money market, the guilder attracted funds from abroad at times when the dollar was generally under pressure late in 1974 and early in 1975. Although the Netherlands Bank and the Federal Reserve intervened to buy dollars, the rate had climbed over 13½ percent from September 1974 lows to $0.4175 by the end of January. At that time, $3.2 million of Federal Reserve swap debt remained outstanding with the Netherlands Bank from operations in December 1974.

In early February the guilder joined in the renewed upsurge of Continental currencies. The Netherlands Bank bought modest amounts of dollars in Amsterdam on February 3, and the Federal Reserve followed up in New York by selling $26.9 million equivalent of guilders drawn on the swap line. This operation triggered an immediate drop in the guilder rate. Meanwhile, the Netherlands Bank continued to provide substantial temporary liquidity to the commercial banks, largely by purchasing dollars spot and simultaneously selling them forward, to prevent seasonal cash needs from pushing domestic interest rates any higher. It did not, however, follow other central banks in reducing its discount rate early in February. Thus, as foreign interest rates eased, interest incentives favoring the guilder widened. In response, the guilder rose steadily throughout the month, pushing toward the top of the EC snake. The Federal

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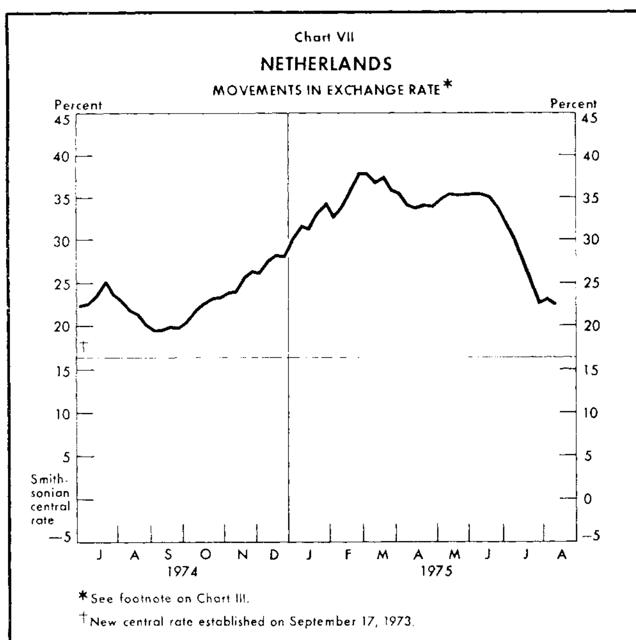
Reserve therefore supplemented its intervention in marks and other European currencies on February 27 with offerings of guilders and sold $20 million equivalent of guilders, financed by a swap drawing on the Netherlands Bank. Nevertheless, the guilder continued to rise, reaching a peak of $0.4285 on March 3.

On March 6, when the Bundesbank announced further cuts in its discount and Lombard rates, the Netherlands Bank signaled a relaxation of Dutch monetary policy with a full percentage point reduction in its discount rate to 6 percent. This larger than expected cut generated an immediate response, both in the domestic money market and in the exchanges where the guilder slipped just below the top of the EC snake while easing back with other currencies against the dollar. The guilder's downtrend proceeded through most of March until March 25, when news of King Faisal's assassination briefly unsettled the markets and prompted an abrupt rise in all European currencies. The Federal Reserve placed small offers of guilders together with marks and Belgian francs in the New York market that day to avoid further sharp declines in dollar rates. The market soon settled down, however, and the System sold only $2.1 million equivalent of guilders, financed on the swap line with the Netherlands Bank.

For the next several weeks, even though seasonal factors were by now substantially easing liquidity in Amsterdam, the Netherlands continuing current-account surplus kept the guilder relatively firm among European currencies, obliging the Netherlands Bank to intervene against the German mark at the bottom of the EC band. In view of the guilder's position within the snake, the Federal Reserve operated in guilders, along with marks, on four occasions from May 7 through May 13 when, first, heavy demand for French francs and, then, the Mayaguez incident threatened to disrupt the exchanges. Guilder sales totaling $29.3 million equivalent were financed by swap drawings on the Netherlands Bank, which for its part purchased dollars in moderating the guilder's rise in Amsterdam. Again on May 21-22, when the guilder was pulled up in an upsurge led by the French franc, this Bank offered guilders along with other currencies, selling an additional $18 million equivalent financed by further swap drawings. By contrast, on days when the guilder eased, the Federal Reserve purchased sufficient guilders to repay $8.5 million equivalent. On balance, guilder swap commitments rose to a peak of $91 million by May 27.



By the end of May, the economic slowdown in the Netherlands was deepening as a result of the continued recession elsewhere in Europe. Consequently, the Netherlands Bank had adopted a generally accommodative monetary stance, although it temporarily absorbed some of the excessive liquidity that emerged from time to time. By mid-June, therefore, favorable interest rate differentials had been eroded sufficiently to weaken the guilder against other EC currencies as well as against the dollar, which was generally gaining against all currencies by that time. In addition, the government was putting into place new stimulative economic measures. But, as the market responded to the gloomier European economic situation which now contrasted sharply with the increasingly optimistic outlook for the United States, the guilder declined rapidly with other Continental currencies in late June and through July. By the end of July, the spot rate had fallen almost 11¾ percent from its March highs to $0.3780, with the Netherlands Bank occasionally selling modest amounts of dollars to moderate the drop. Meanwhile, the Federal Reserve had taken advantage of the dollar's buoyancy to buy sufficient guilders in the market to liquidate fully the outstanding swap drawings on the Netherlands Bank by July 1.

BELGIAN FRANC

As in other countries, business activity in Belgium had begun to slow down late in 1974. Nevertheless, upward pressures on domestic prices had persisted, fueled by a rapid acceleration of wages, rents, and pension payments

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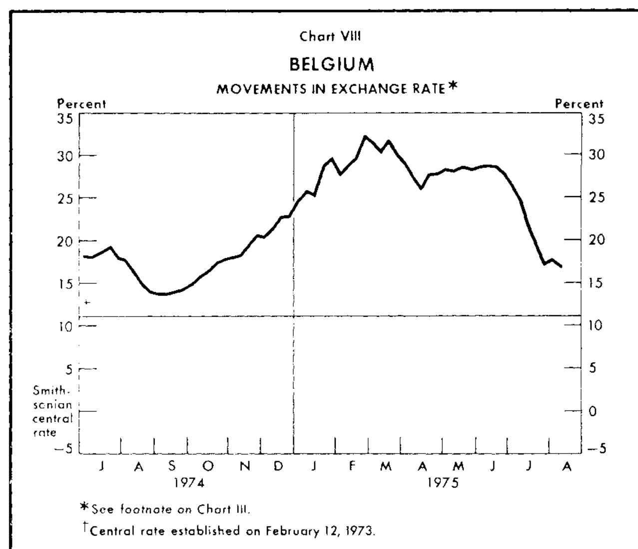
that are automatically adjusted under price-indexation schemes. Thus, the Belgian authorities had proceeded cautiously in relaxing restrictive monetary and fiscal policies. Following earlier reductions in interest rates in other countries, the National Bank cut its discount rate ½ percentage point to 8¼ percent on January 30. In the exchanges, steady commercial demand, reflecting Belgium's widening current-account surplus, helped to strengthen the Belgian franc both against the dollar and against other EC currencies. By the end of January, the Belgian franc had risen almost 15 percent from its September 1974 lows to \$0.029035, while holding firm at the top of the EC snake.



Against this background, the Belgian franc joined in the general rise of European currencies against the dollar in February. As part of the Federal Reserve's multicurrency intervention, the Federal Reserve sold \$10 million equivalent of Belgian francs on February 3. When generalized pressures reemerged later in the month, the Trading Desk followed up with sales of \$6.6 million equivalent on February 27. These sales were financed by drawings on the swap line with the National Bank of Belgium. For its part, the National Bank made small purchases of dollars in Brussels to moderate the advance of the franc rate. It also continued to intervene within the EC snake against the Danish and Norwegian kroner, the currencies then at the bottom of the 2¼ percent band. Partly reflecting these operations, Belgian official reserves rose \$320 million in February. By March 3 the Belgian franc had peaked at \$0.029500, before subsequently easing back with the other European currencies.

By this time, Belgium's economic dilemma had become more acute. By comparison with most other countries, its inflation rate was holding rather steady around 15 percent, now above that of its major trade partners, even as the rate of unemployment increased. Concerned about the potential loss of export competitiveness, the Belgian authorities gradually introduced a series of measures designed both to stimulate the economy and to contain inflationary tendencies. The National Bank reduced its discount rate to 6½ percent in three steps from March 13 to the end of May, scheduled the release of commercial bank reserves held in blocked accounts, and allowed bank credit ceilings to lapse when they expired. In addition, the Belgian government announced a two-month price freeze on May 1, extended in July for another three months, and also outlined various fiscal measures to improve corporate liquidity and to encourage exports.

As monetary conditions in Belgium therefore became more comfortable, the favorable interest differentials *vis-à-vis* Euro-dollar rates narrowed. Short-term funds were again placed abroad, and capital exports by Belgian and Luxembourg residents of nearly \$300 million were recorded by the end of the first quarter. Whereas these outflows weighed on the financial Belgian franc, the commercial rate was benefiting from the further strengthening in Belgium's trade surplus that resulted from a deepening recession at home. Consequently, the commercial rate remained at the top of the EC snake, as the EC currencies retreated from their highs against the dollar. After the German mark settled to its lower intervention point, the National Bank of Belgium and the Bundesbank intervened in moderate amounts to maintain the prescribed limits.

As the dollar generally improved early in April, the Belgian franc continued its downtrend, and the Federal Reserve was able to acquire sufficient Belgian francs in the market from April 8 through April 18 to repay in full the recently incurred \$16.7 million swap debt. By April 21 the Belgian franc had fallen 3¾ percent from its March highs to \$0.028350. It then began to firm with other European currencies against the dollar. In May, therefore, the Federal Reserve supplemented its intervention in other currencies with sales of Belgian francs on two occasions when the markets became unsettled. On May 13, after the markets reacted to Cambodia's seizure of a United States merchant ship by marking dollar rates sharply lower, the System sold \$4.3 million equivalent of Belgian francs along with marks and guilders. Then on May 22, as a further sharp rise in the French franc led to generalized bidding for Continental currencies, the Desk sold \$8.8 million equivalent of Belgian francs along with

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three other currencies. These Belgian franc sales were financed by further swap drawings on the National Bank of Belgium. Subsequently, with the dollar generally steadier, the Belgian franc leveled off and then began to ease in early June. At the same time, the franc remained relatively firm against other EC currencies. As market conditions permitted, the Federal Reserve purchased modest amounts of francs to liquidate swap debt and by June 23 had repaid the drawings incurred in May.

When the dollar rallied against other major currencies in late June and through July, the Belgian franc fell off sharply as well. By the end of July the commercial rate had fallen to $0.026080, some 11½ percent below its March highs. In July the commercial franc also eased somewhat against other EC currencies and settled toward the middle of the EC band.

ITALIAN LIRA

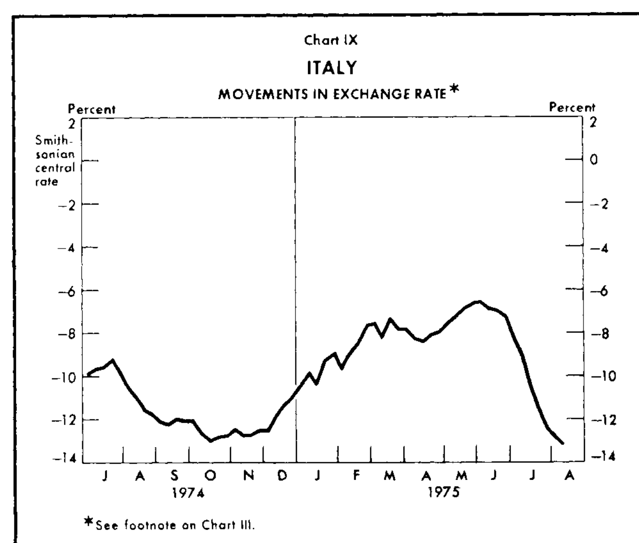
During 1974 the Italian authorities had pursued a policy of severe monetary restraint to deal with a massive oil-induced payments deficit, high and accelerating inflation, and a weakening lira. By early 1975, price inflation was slowing dramatically from the 25 percent level of last year. Moreover, Italy's trade deficit had narrowed sharply, as imports were down drastically and exports were holding up, bolstered by a sharp rise in sales to OPEC countries. These improvements had spurred growing confidence in the lira which, coupled with record-high interest rates in Italy, stimulated substantial reflows of funds that had left the country during recurrent crises last year. The Bank of Italy was therefore able to begin cautiously easing its restrictive monetary policy to counter the deepening domestic recession.

In this generally more favorable climate, the lira joined in the overall advance of European currencies against the dollar during February. It rose 3 percent to a high of $0.001597 by March 3, and the Bank of Italy had resumed purchasing dollars. Accordingly, the Bank of Italy repaid on March 5 the first $500 million instalment of the $2 billion gold-pledged credit it had received from the Bundesbank in 1974. The repayment was financed in part from recent reserve gains and in part by a further Italian drawing of $375 million on its outstanding standby credit tranche with the IMF. Of this amount, $102.3 million was drawn in German marks, which were then purchased by the System to be held in connection with its operations in German marks.

Unlike other currencies, the lira held relatively firm even as the dollar began to recover in March and April. A further narrowing in Italy's trade deficit to $1 billion in the first quarter and continued easing of inflationary pressures provided an improving undertone to the lira. As Italian interest rates remained well above those elsewhere in Europe, the repatriation of previous capital outflows intensified. The Bank of Italy therefore was able to purchase substantial amounts of dollars. Even after Italy's repayment to the Bundesbank, liquidation of some $400 million of Euro-dollar borrowings by Italian public corporations, and large interest payments on foreign debt, Italy's official reserves were by the end of April about $300 million above end-January levels.

Meanwhile, output in Italy in the first quarter had dropped some 13 percent below the previous year's level. A worsening business outlook and a plunge in corporate profits had severely depressed investment, while the prospect of rising unemployment had contributed to a downturn in private consumption. The Italian authorities therefore took further steps to relax gradually some of their restrictive policies. On March 24, they lifted the 50 percent import-deposit requirement, thereby releasing liquidity to the banking system. Furthermore, new selective credit facilities for agriculture, exports, and construction were introduced and the 15 percent ceiling on bank credit growth was suspended. As liquidity eased, the commercial banks lowered their deposit and lending rates, and in late May the Bank of Italy followed up by cutting its discount rate 1 percentage point to 7 percent. Under these conditions, capital imports slowed and the Bank of Italy's net dollar purchases tapered off. But the rise in European currencies

Chart IX
ITALY
MOVEMENTS IN EXCHANGE RATE*



*See footnote on Chart III.

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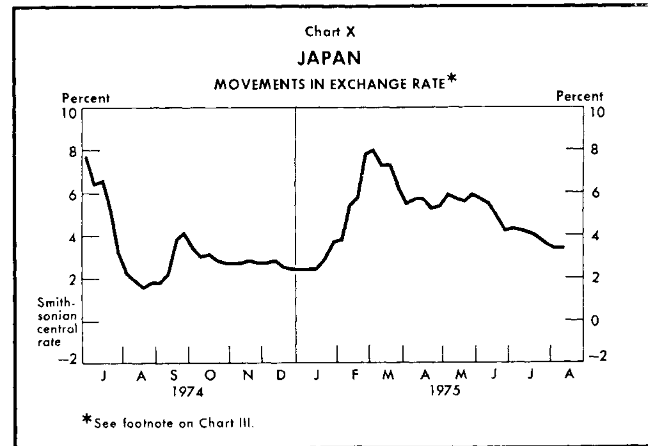
generally against the dollar during May pulled the lira higher to $0.001608 by June 3.

By early summer the deep and protracted slowdown in Europe had dimmed hopes for a strong growth of Italian exports that might lead the country out of its recession. With unemployment in Italy rising and growing dissatisfaction over the economy dramatized by the strong showing of the Communist and Socialist Parties in the June 15-16 local and regional elections, expectations mounted that the government would be forced to take substantial reflationary measures. Market sentiment toward the lira worsened, short-term capital flows reversed direction, and commerical leads and lags shifted against Italy. Consequently, pressure against the Italian lira began to reemerge after mid-June, and the lira joined the subsequent drop of all European currencies. At the end of July the government announced a $5¼ billion package of stimulative economic measures. Amidst warnings from outgoing Bank of Italy's Governor Carli that this new program could reignite inflation and set the stage for a renewed surge of imports, the lira dropped to $0.001505 by the end of July. To cushion the decline, the Bank of Italy resumed heavy dollar sales which contributed to the $1.2 billion fall in gross official reserves during June-July. Nevertheless, the lira closed 4 percent lower on balance against the dollar than its level at the beginning of the reporting period. The lira rate had advanced, however, against other European currencies.



JAPANESE YEN

Faced with virulent domestic inflation, the Japanese authorities had pursued a policy of economic austerity through 1974. By February 1975, consumer price increases had slowed to about 13 percent, just half the rate the year before. In addition, as domestic demand fell off and inventory financing became increasingly burdensome, Japanese manufacturers accelerated their export shipments and curtailed imports, swinging Japan's balance of trade dramatically from a sizable deficit to a $2.2 billion surplus by the second half of 1974. The market was therefore quickly regaining confidence in the near-term prospects for the Japanese yen. Moreover, strong reaffirmations by officials of the Bank of Japan and incoming Prime Minister Miki of Japan's determination to persist in a policy of monetary restraint contrasted sharply with the worldwide trend toward lower interest rates. Consequently, the spot rate began to strengthen by mid-January from the levels around which it had traded for several months.

The yen extended its advance throughout February, partly in sympathy with the sharp rise of European currencies against the dollar. In addition, sizable net capital inflows helped sustain the rise. New foreign issues by Japanese corporations picked up, following the relaxation of restraint on borrowing abroad for domestic financing needs, and part of the proceeds were converted into yen. Foreign purchases of Japanese stocks and bonds also accelerated. As capital inflows built up, the market presumed there was some OPEC diversification into yen, a prospect which further encouraged bidding for the currency. By March 4 the spot rate therefore had advanced 4½ percent to $0.003517, the highest level since June 1974. The Bank of Japan, intervening to moderate the rise, bought dollars during February and early March, which contributed to a $644 million official reserve increase during those two months. Once the generalized pressure against the dollar began to fade during March, however, the yen also began to ease back from its peak. By the month end the yen had dropped by some 3 percent to around $0.003400, before steadying in April.

During the spring, economic indicators gave increasing evidence that Japan was experiencing its worst recession since the war. Output had actually dropped, and unemployment had topped one million persons. At the same time, the rise in consumer prices slackened further to an annual rate of only about 6 percent in the first quarter, wholesale prices remained steady, and annual wage settlements averaged only about 13 percent, compared with close to 30 percent the year before. The government therefore was prepared to shift to a cautiously expansionary policy to stimulate an incipient recovery in industrial production. It accelerated public works expenditures and took other selective relief measures. But, despite two ½ percentage point cuts in the Bank of Japan's discount rate to

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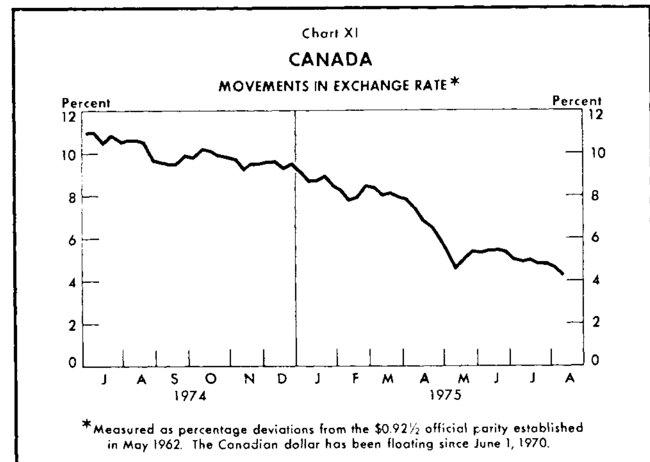
8 percent, monetary policy remained relatively restrictive and Japanese interest rates remained high. In April and May, foreigners took advantage of a premium on the forward yen to place funds in Japanese government securities on a covered basis. Partly as a result of these inflows, the yen firmed again in May, reaching $0.003443 toward the month end. But, as the premium on the forward yen decreased, these inflows tapered off and, with the demand for dollars to meet import settlements increasing, the yen rate began to drift lower in early June.

By that time, revised forecasts in the Japanese press and elsewhere were pointing to a deeper and longer lasting worldwide recession than had been anticipated earlier and, consequently, projections for Japanese exports were drastically revised downward. In addition, OPEC was discussing the possibility of a substantial hike in oil prices in the fall, raising fears of another large bulge in Japan's oil import bill. This significantly worsened outlook for Japanese trade turned the market abruptly bearish toward the yen, and the spot rate dropped back sharply just after midmonth. As the rate fell through the ¥295 ($0.003390) level, Japanese banks moved to buy dollars. The yen then came heavily on offer, and the Bank of Japan intervened to sell dollars to moderate the fall in the rate. These sales reassured the market, and in late June the yen bottomed out at $0.003356 in Tokyo. Trading then quieted and, as the market came into better balance, the yen held steady throughout July to close the period at $0.003362, slightly above last February's levels.



*Measured as percentage deviations from the $0.92½ official parity established in May 1962. The Canadian dollar has been floating since June 1, 1970.

CANADIAN DOLLAR

Market sentiment toward the Canadian dollar grew increasingly bearish in late 1974 and early 1975, as the deepening recession in Canada's major export markets—particularly the United States—led to a serious erosion in Canada's trade balance. Unlike other industrial countries, which were hard hit by costlier oil imports, Canada maintained a small surplus in petroleum and natural gas products. But nonenergy exports fell rapidly and, with imports rising, Canada's current-account deficit widened to over Can.$1.6 billion in 1974. Moreover, that deficit was generally expected to grow further in early 1975 until economic activity abroad began to recover. The deterioration in Canada's trade position exerted a heavy drag on domestic economic activity. As early as November 1974, the government had provided some budgetary stimulus and monetary policy was also relaxed. Canadian money market rates therefore dropped off about in line with declining United States interest rates early this year, providing little inducement for inflows of arbitrage funds. Prospects were also uncertain for a substantial increase in long-term foreign borrowings to finance the mounting current-account deficits.

Against this background, the Canadian dollar generally remained on offer in the exchanges. It fell by some 4 percent against the United States dollar between mid-1974 and early-February 1975, when it slipped below the $1.00 level for the first time since late 1973. The spot rate then stabilized, as Canadian interest rates did not follow further interest rate declines in the United States and as some short positions taken up during the currency's protracted decline were covered. Moreover, OPEC investors, in seeking to diversify the currency composition of their holdings, began making sizable placements in Canadian dollars. Conversions of Canadian provincial issues abroad and positioning ahead of expected future placements also helped buoy the Canadian currency over the rest of February, pushing the rate to as high as $1.0050 by the month end. As these financial demands subsided, the Canadian dollar then settled back to trade quietly around $1.00 through late March.

The market remained pessimistic over the Canadian dollar's near-term prospects, however, leaving it vulnerable to renewed downward pressure. Even as unemployment mounted, large wage settlements raised concern that an upsurge of prices in Canada at a time when inflation was abating elsewhere could undermine the competitiveness of Canadian goods in world markets. Already Canada's trade and current-account deficits had deepened during the first quarter. In addition, unsettled conditions in the United States bond markets early in April led to postponement of several planned Canadian borrowings, which

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left a temporary but sizable shortfall in long-term capital inflows to finance Canada's ongoing current-account deficit. As market participants responded to these developments and attempted to unload the Canadian dollars they had acquired in anticipation of forthcoming borrowings, the Canadian dollar was driven down progressively through most of April and early May. The Bank of Canada intervened with increasing forcefulness to cushion the decline, and the spot rate bottomed out at $0.9659 on May 13, a four-year low.

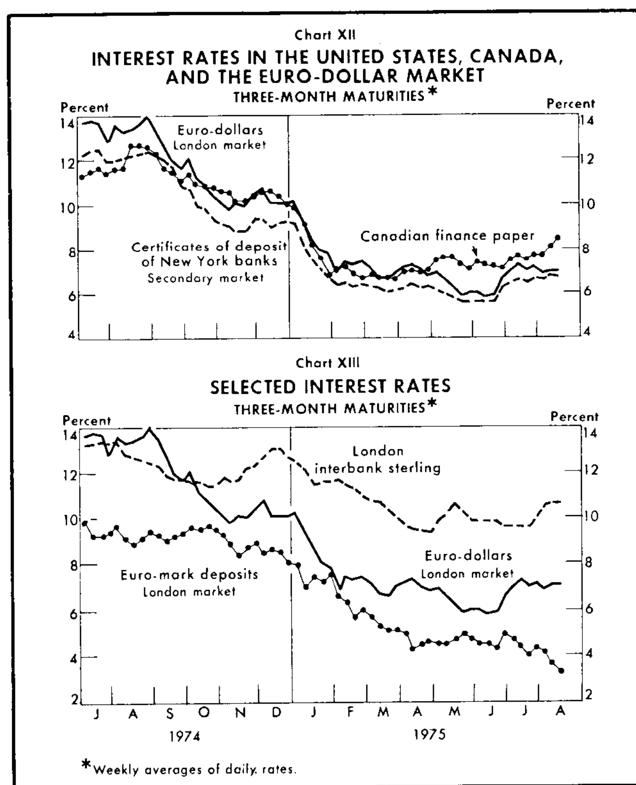
The rate steadied over subsequent days, and by the end of May the bearish market sentiment toward the Canadian dollar began to lift somewhat. By that time, Canadian borrowings abroad had resumed and Canada had announced a small trade surplus for April. Moreover, short-term Canadian interest rates had moved up while United States interest rates were temporarily declining, thereby widening incentives for short-term funds to flow into Canada. In response, the Canadian dollar rebounded to $0.9779 by the end of May. In moderating the rise, the Bank of Canada bought United States dollars and reduced the net reserve loss in April-May to $429 million.

Over June and July the market for Canadian dollars was steadier, with the spot rate drifting gradually lower in less active trading. Prospects for an early recovery of the United States economy bolstered expectations of a recovery of Canadian exports, as did news of potential Canadian grain sales to the Soviet Union and announcement of a large trade agreement between Canada and Iran. Moreover, despite the recession in Canada, the government's broadly neutral budget, announced in late June, was taken as evidence of official concern over the continuing high rate of inflation. The budget message also included the proposed elimination of withholding taxes on foreign purchases of long-term Canadian securities, providing scope for further inflows. Meanwhile, conversion of bond issues picked up and helped buoy the Canadian dollar rate from time to time. These positive factors were more than offset, however, by Canada's continuing current-account deficit. Consequently, the Canadian dollar rate eased to $0.9696 by the end of July, still above the early-May low but some 3 percent below early-February levels. The Bank of Canada continued to intervene to smooth abrupt movements in the rate, and official reserves declined by a net of $577 million for the February-July period as a whole.

EURO-DOLLAR

During the early months of this year the Euro-currency markets continued to recover from the severe setbacks to confidence in international banking that had occurred over much of 1974. The hard-hit interbank segment of the market, which had actually contracted last summer, had begun to expand again, although at a very hesitant pace. The multitiered structure of interest rates that emerged in the wake of several bank failures in major countries had narrowed. The wide premiums of Euro-dollar rates over comparable United States deposit rates had contracted. Many of the banks that had largely withdrawn from the market were cautiously stepping up their activity. As confidence in the market improved, many who had turned away from the market during last year's difficulties began to increase their Euro-currency holdings. With the dollar coming under pressure in the exchange markets in the first quarter, however, much of the expansion in the Euro-currency markets was concentrated in the nondollar sectors, particularly in Euro-marks.

By the second quarter, expansion in Euro-currency activity had become more broadly based and soon began to pick up momentum. The revival in medium-term syndicated loans was especially pronounced. With the worldwide re-



cession deepening and imports dropping in nearly all of the industrial countries, developing countries that had embarked on ambitious projects at the crest of the boom of world commodity demand increasingly looked to the Euro-currency markets to finance a shortfall of receipts. Substantial loans were extended to several Latin American countries, such as Mexico and Brazil. Indeed, with the fall in petroleum demand worldwide, several OPEC countries reappeared on the borrowing side of the market. Eastern European countries were also heavy borrowers. In addition, large sums were raised by institutions and firms of a number of major industrial countries, notably France. A high degree of selectivity continued to characterize the medium-term markets, however, reflecting the banks' concern over mounting balance-of-payments pressures in many parts of the world and the desire of many major international banks to pay more attention to their capital-asset ratios.

Subsequent to the steep decline of Euro-currency rates late last year, investor interest in Euro-bonds revived significantly, too. Thus, borrowers seeking to raise funds for longer terms than they had been able to secure in 1974, or even for medium-term Euro-currency loans in 1975, gradually increased their new issues both through international syndicates and through private placements. A noteworthy feature of these issues was that most were no longer denominated in United States dollars but in the major Continental currencies, notably the German mark and also the Dutch guilder and the Swiss franc. In addition, several issues were denominated in the European unit of account, in the European composite unit, and in special drawing rights until the growing strength of the dollar in recent months reduced the attractiveness of such multicurrency issues. In sharp contrast to past years, virtually all issues were offered by non-United States borrowers, mostly European governments as well as public and private corporations in industrial countries. The acceptance of this flood of issues was facilitated by strong interest by OPEC investors.

Euro-dollar interest rates, having declined sharply along with United States domestic money rates from the fall of 1974 on, leveled off in February and March but eased back again to two-year lows in early June. But in response to a rebound in United States rates later that month, Euro-dollar rates bounced back in July, so that by the month end the three-month rate stood at 7 percent. Reflecting the still strong preferences of many suppliers of funds to the market for short-term maturities, the yield curve for Euro-dollar deposits tended to be steeper than for United States money market instruments, with differentials between one-month and twelve-month rates rising at times to more than 2 percent.

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The Business Situation

There now appears little doubt that the economy is emerging from the most severe postwar recession. Revised estimates of gross national product (GNP) confirm that a turnaround in economic activity occurred in the second quarter.* Even more importantly, the latest readings of the monthly business statistics suggest that the nascent recovery has been picking up momentum. Consumption spending has provided the essential base of the recovery, both directly by adding to the demand for final goods and indirectly by facilitating the liquidation of excessive inventories. Indeed, the massive inventory correction seems to be diminishing, although some inventory imbalances remain in certain sectors. In July, new durables orders rose for the fourth consecutive month and industrial production climbed for the second consecutive month. To be sure, capital spending and residential construction are lagging, but the beginnings of a recovery in home building are visible. Moreover, recent developments in the labor market have been, on balance, encouraging. Although the civilian labor force increased sharply in August, the rate of joblessness remained unchanged from the July level as employment advanced strongly.

The price situation, however, has taken a turn for the worse. After having eased a bit in earlier months of the year, the rise in the consumer price index, propelled by bulges in food and energy prices, advanced more sharply in June and July. Moreover, wholesale prices rose rapidly in August, as fuel and power prices jumped. Further increases are in the offing for some foods and for oil, aluminum, steel, and automobiles, despite the pronounced slack that still remains throughout the economy.

*In contrast to the slight decline in real GNP in the second quarter that had been indicated by the preliminary estimate, the revised data show a modest advance of 1.6 percent at an annual rate, the first increase since 1973. Inventory liquidation was revised downward from the preliminary figure, while final sales were revised upward primarily as a result of an upward revision in net exports. Released along with the GNP revisions was a preliminary estimate of pretax corporate profits (adjusted for changes in inventory valuation). This estimate shows a rise of $6.2 billion during the second quarter to a $100.5 billion seasonally adjusted annual rate.

PERSONAL INCOME, CONSUMER SPENDING, AND RESIDENTIAL CONSTRUCTION

A $5.7 billion decline in personal income in July was the result of a special situation. The previous month, one-time payments of $50 had been made to recipients of social security, railroad retirement, and supplemental security benefits. These transfer payments had amounted to almost $20 billion at an annual rate, approximately three and one-half times the size of the July decline in total personal income. Wage and salary disbursements have been expanding in recent months, after having reached a nadir last February. In coming months, these disbursements should continue to rise, assuming employment continues to increase and the average workweek to lengthen. Aftertax income should grow even faster, as lowered withholding rates take effect in the second half of the year.

Consumption spending has recently been in the forefront of the recovery. Total retail sales increased $1.2 billion in July. Sizable advances had also been recorded in the preceding three months. As a result, for the four months ended July, growth amounted to 26 percent at an annual rate. Durable goods sales, led by a rebound in automobile sales, have accounted for the bulk of this upsurge in consumption spending. No doubt the recent gains in personal income, on an aftertax basis, have been a major factor in this advance. Just as important, but harder to measure, has been the diminution in the manifold uncertainties that have dogged consumers for some time, especially those related to inflation and employment prospects. This development may explain the appreciable improvement in consumer confidence recorded since late last year, as measured by the Conference Board and the Survey Research Center of the University of Michigan. It remains to be seen, however, what damaging effect the latest price acceleration might have on the growth of consumer spending. In any case, it seems clear that the recent strength in consumption spending has been instrumental in enabling retailers to pare their

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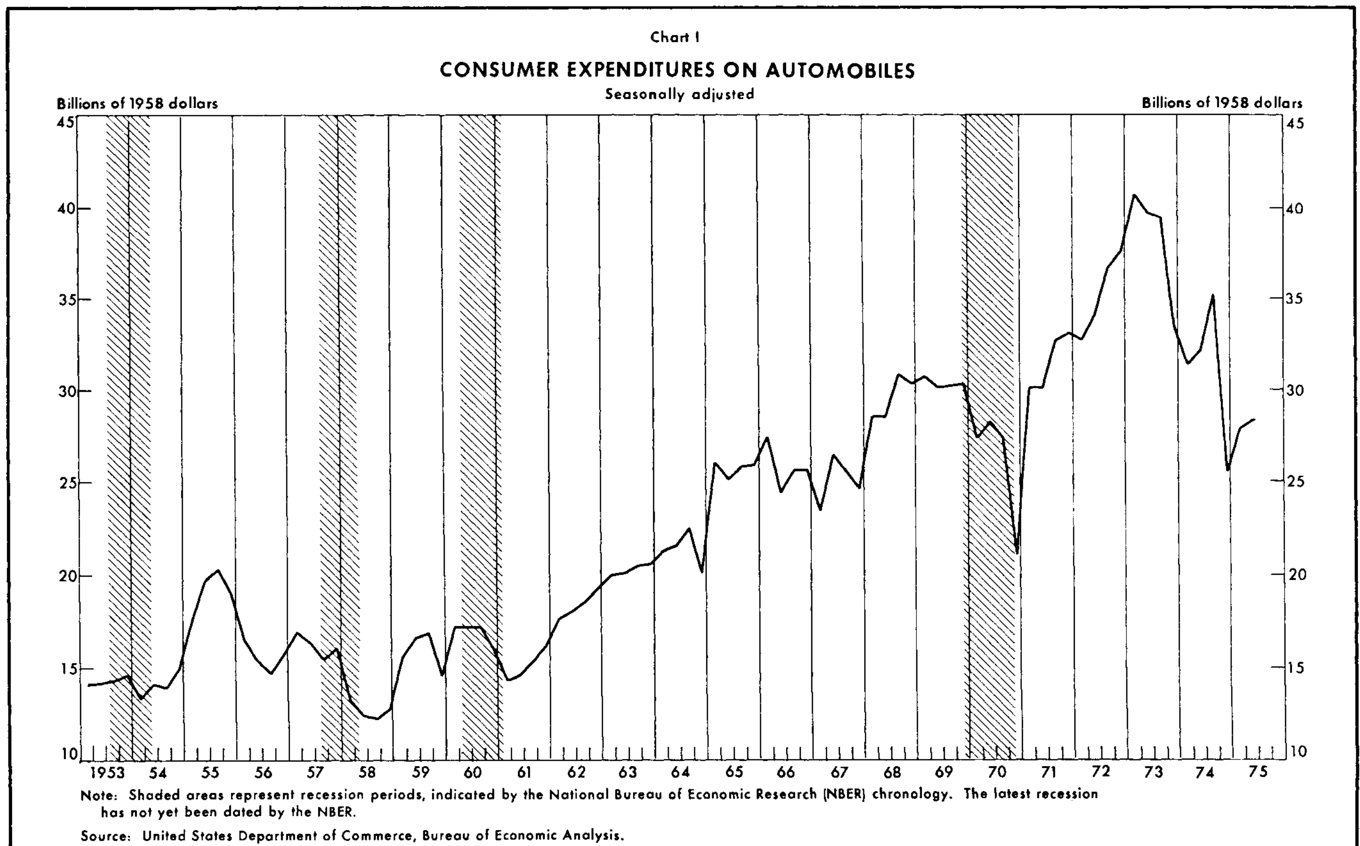
inventory stocks to the point where little imbalance, if any, remains in this sector. Thus, consumption spending is having a dual effect in stimulating the economic recovery.

The sharp rebound in automobile sales in recent months is reminiscent of developments in past recovery periods (see Chart I). In the previous postwar cyclical recoveries, real consumer outlays on automobiles have increased, on average, about 37 percent over the twelve months following the trough. Whether new car purchases in the current recovery will fully conform to this historical pattern remains to be seen. Auguring a strengthening in the demand for new cars is the presumably growing need to replace the aging and less efficient stock of existing automobiles. However, the replacement decision is fundamentally an economic one, based on income and employment expectations and on the cost of purchasing and maintaining the car. In the latter regard, the recently announced price hikes on the new 1976 models, coupled with the prospect that the 1977 models will be more economical to operate, might well induce many car owners to postpone purchasing a new car until the 1977 models become available. Judging by their production schedules and tentative forecasts, the automobile manufacturers themselves do not appear to be overly bullish about sales prospects over the remainder of the year. In the event that purchases of the 1976 car models do not increase very much above those of the previous year, thus departing from the pattern of past recoveries, consumers can either save the retained purchasing power or spend it on other goods. Which option they choose will have a significant bearing on the scope of the economic recovery.

The long-awaited upturn in residential construction now appears to be getting under way. Housing starts rose to a seasonally adjusted annual rate of 1.24 million units in July, up 16 percent from the average rate of the second quarter and 41 percent above the low-water mark recorded last December. Whereas virtually all of the recovery in starts earlier in the year had been in single-family units, the July increase was centered in multiple-unit dwellings. Spurred in part by the 5 percent tax credit,



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sales of new single-family homes by merchant builders have risen substantially in recent months. Although such sales edged down a bit in June, they continued, as had been the case in the previous four months, to exceed the additional new homes put up for sale. As a result, the stock of unsold new single-family homes has receded to the lowest level in three years, and an increasing proportion of this inventory has come to represent homes under construction rather than completed dwellings.

Developments in the mortgage market have played a key role in the recent upturn in home building. The flow of deposits into thrift institutions in the last few months has been heavy, although it is uncertain that the inflow will continue at the recent high pace. In July, the savings flows amounted to a 17.8 percent seasonally adjusted annual rate, about equal to the growth over the first half of the year and almost three times as large as that experienced during the year ended December 1974. While the thrift institutions have, in turn, channeled a large proportion of these funds into securities, they have also been issuing mortgage commitments. Indeed, outstanding mortgage commitments of all savings and loan associations and mutual savings banks in New York State increased at a 63 percent seasonally adjusted annual rate from February to July, whereas they had actually decreased 26 percent over the twelve-month period ended February 1975. Since mortgage commitments must generally be secured before construction financing can be arranged, the recent growth in outstanding commitments suggests that home builders are currently planning to undertake a large number of new construction projects. However, while lending terms for new mortgages eased slightly early in the year, they currently are inching higher. Reflecting this increase in rates on conventional mortgages, the maximum allowable interest charge on Federally insured mortgages was raised at the end of August by ½ percentage point to 9 percent. In addition, at the Federal National Mortgage Association's auction held at the end of August, secondary market interest rates on four-month forward commitments for insured mortgages were 33 basis points above those of the previous month's auction.

INDUSTRIAL PRODUCTION, INVENTORIES, AND CAPITAL SPENDING

The Federal Reserve index of industrial production, which had advanced 0.5 percent in June, increased by an equal amount in July, bringing a halt to the 14 percent decline that had been registered between November 1973 and May 1975. Most of this contraction took place between September 1974 and February 1975, as firms throughout the economy struggled to get out from under the huge overhang of excess inventories. Early in 1974, manufacturers had engaged in an all-out effort to rebuild their stockpiles of raw materials and intermediate products, items that had been in extremely short supply at the end of 1973. As this replenishing was going on, however, the aggregate demand for final goods faltered and then plunged. At that point, what had been an inventory shortage suddenly turned into a glut.

This past June, higher output of both consumer goods and nondurable materials finally more than offset continued declines in other sectors. Output of textiles, paper, and chemicals posted sharp rises in June and again in July, suggesting that inventory liquidation may be nearing completion in these industries. On the other hand, further declines in production of most durable materials and of business equipment indicate continued efforts to pare inventories. The iron and steel industry has been especially hard pressed; in July, output of iron and steel declined for the sixth consecutive month to the lowest level since 1971. In retrospect, it appears that the strong demand for steel in 1973 and through most of 1974 had depleted steel-mill inventories. Thus, when the demand by large steel customers dropped, part of the slack in demand was offset by the rebuilding of steel mills' own inventories. By October, however, the mills had restored their inventories of ingots and semifinished shapes, such as rods and wire. Iron and steel production then plummeted, at about double the rate for all other industries. Despite the continuing sluggish demand, several steel companies have announced that, to offset increased production costs, they intend to raise prices in early autumn. As a result, demand for steel has apparently picked up in an effort by mill customers to beat the announced price hikes.

New orders received by durable goods manufacturers spurted in July by $1.7 billion, or 4.3 percent. The July advance was broadly based and marked the fourth consecutive monthly gain. Indeed, the expansion in new durables bookings between March and July amounted to 15 percent, far greater than the growth in production. As a result, the backlog of unfilled durables orders increased in July for the first time since September 1974.

While nonfarm businesses are probably still in the process of liquidating their inventory stocks, the pace appears to be slackening a bit. The reduction of excessive inventories had begun late last year in the wholesale and retail trade sectors, and had spread from there to the nondurables manufacturing sector and then to durables manufacturing. The liquidation in the retail trade sector seems to have diminished considerably. According to recent data on the book value of inventories, retail and

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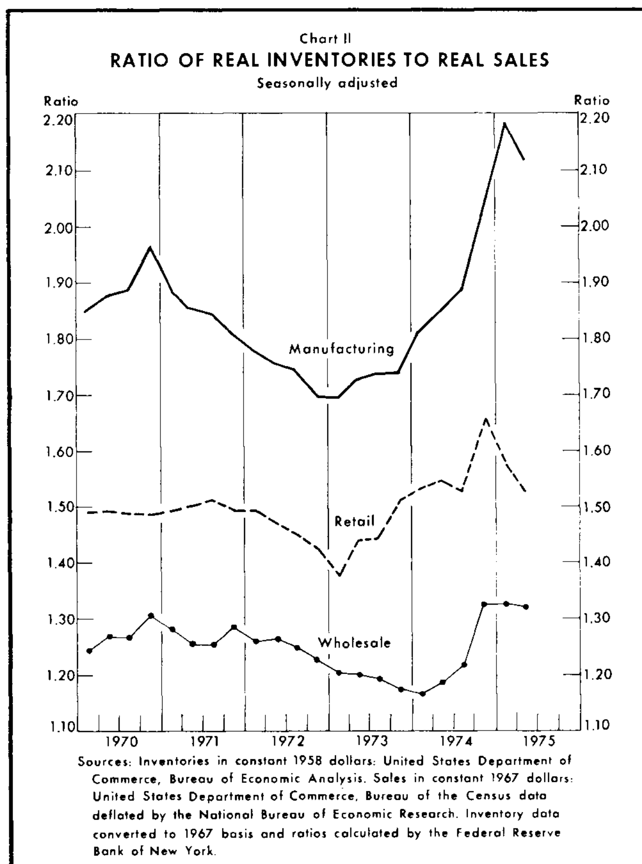

Sources: Inventories in constant 1958 dollars: United States Department of Commerce, Bureau of Economic Analysis. Sales in constant 1967 dollars: United States Department of Commerce, Bureau of the Census data deflated by the National Bureau of Economic Research. Inventory data converted to 1967 basis and ratios calculated by the Federal Reserve Bank of New York.

wholesale distributors, apparently encouraged by the rebound in sales, added to their inventories in June for the first time in the current year. Of late, however, the book value data have tended to be a rather unreliable indicator of inventory conditions. The accounting conventions used to value inventories give rise to distorted measurement during periods of inflation, regardless of whether it is a period of accelerating, decelerating, or steady inflation. Hence, to gauge the extent of inventory imbalance it is more useful at the present time to examine ratios of real inventories (i.e., inventories valued in constant dollars rather than book value) to real sales (see Chart II). Within the retail trade sector, the real inventory-sales ratio had backed off considerably by the second quarter of this year from the peak attained in the last quarter of 1974. On the other hand, hardly any improvement occurred in the real inventory-sales ratio for the wholesale trade sector, with the level in the second quarter just about equal to the cyclical peak. Moreover, substantial inventory imbalances continue to exist in manufacturing; inventories relative to sales fell only slightly in the second quarter after having reached exceedingly high levels earlier in the year. Monthly data on the book value of manufacturers' inventories indicate that the liquidation continued in July. Manufacturing inventories fell that month at an annual rate of $11.4 billion, with the bulk of the decline in the durable goods sector. Moreover, the August survey by the National Association of Purchasing Management indicates a further runoff in the stocks of purchased materials.

According to the Commerce Department survey taken in July and August, businessmen again lowered their planned expenditures on new plant and equipment. Capital outlays over the second half of 1975 now are projected to rise at an annual rate of only 1.9 percent. The weakening outlook for capital spending is also reflected in capital appropriations. As reported by the Conference Board's survey of large manufacturers, capital appropriations were slashed by 17.7 percent in the second quarter, marking the third consecutive quarterly decline and the largest cutback on record. While most manufacturers continued to reduce appropriations, automobile manufacturers raised the level of their appropriations by about 40 percent. This reflected the large retooling expenses associated with the changeover to the 1977 models.

LABOR MARKET DEVELOPMENTS

The labor market showed signs of strengthening in August. Based on the household survey conducted by the Department of Labor, employment rose by 274,000 workers on a seasonally adjusted basis. With the civilian labor force growing by a comparable magnitude, the overall rate of joblessness remained unchanged at July's level of 8.4 percent. Over the five months ended August, the household survey has recorded an increase in nonagricultural employment of 1.3 million (see top portion of Chart III). However, the survey of establishments, the so-called payroll survey, shows a much less favorable employment situation, with an advance of only 667,000 workers. While month-to-month divergences between the two series are not infrequent, these divergences tend to be offsetting over longer periods (see bottom portion of Chart III). The large August gain of 528,000 workers in payroll employment helped reduce the discrepancy that had developed since March between the increases indicated by the two series. The percentage of industries recording employment increases rose above 70 percent, to the highest level since late 1973, underscoring the August pickup in payroll employment.

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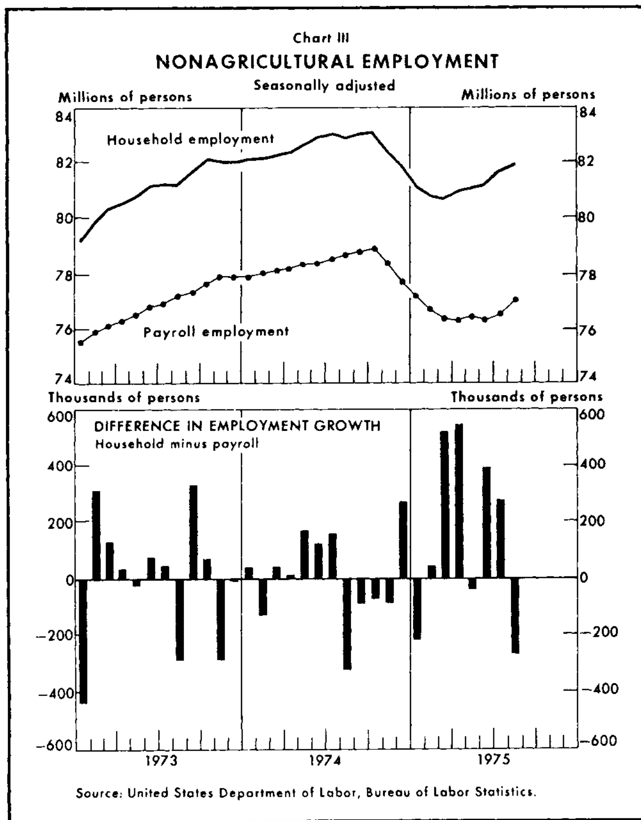
The divergent behavior in recent months of the two nonfarm employment series reflects, in part, differences in sample coverage. The household survey measures the number of persons holding jobs, while the payroll survey seeks to gauge the number of filled job slots. For example, a person holding two jobs would be counted twice in the payroll survey but only once in the household survey. Nevertheless, measured household employment is always greater than payroll employment, since the coverage of the household survey is more comprehensive. While both surveys count employed wage and salary workers, the household survey includes the self-employed, certain unpaid workers of family-operated enterprises, and private household workers, none of whom appear on establishment payrolls. Also, unlike the payroll count, the household survey includes unpaid absences associated with illness, bad weather, strikes, vacation, and other personal reasons. Although there are also other differences in coverage, the above discrepancies are usually responsible for most of the divergent monthly behavior of the two series. However, only some of these elements of disparate coverage can be readily quantified with published seasonally adjusted monthly data. In recent months, the measurable sources of disparity have fallen far short of accounting for the divergent movements in the two series.



Some of the remaining unexplained discrepancies between the two surveys arise from differences in sampling techniques and in collection and estimation methods. The household survey is gathered from a scientifically selected sample of about 50,000 households during the week that includes the twelfth of the month. The establishment survey, reflecting the payroll period that also includes the twelfth of the month, is based upon payroll reports from a sample of firms employing over 30 million wage and salary workers, roughly 40 percent of the estimated total number of workers on establishment payrolls. The large size of the payroll sample reduces sampling variability and results in a more stable monthly data series. Although both series are subject to similar seasonal fluctuations, the monthly patterns of the seasonal adjustment factors do differ somewhat and may contribute significantly to the disparity between the series. In addition, there are also other methodological details that can contribute to divergent monthly behavior of the two surveys.

During periods in which these major surveys are giving different signals, it is important to look at movements in other labor market indicators. Data on labor turnover rates in manufacturing, which are available only through July, suggest some improvement in the labor market. In July there was a jump in the rate at which new workers have been hired, marking the fourth consecutive monthly increase. At the same time, the layoff rate—the number of workers laid off in a month per 100 employees—fell to the lowest level since late 1974. Improving employment prospects are also reflected in the increase in the number of individuals voluntarily leaving their present jobs; in July, such quits exceeded the layoff rate for the first time since October. A gauge of the demand for labor in all industries is provided by the Conference Board's index of the volume of newspaper help-wanted advertising. While still low by historical standards, this index rose in July to its highest level in seven months.

THE PRICE SITUATION

Rapid inflation erupted again in July and August, propelled by a bulge in energy and food prices. Outside these troublesome sectors, price increases remained relatively moderate. But the near-term outlook for an easing of inflation is not very encouraging. Significant increases will probably occur soon for some foods and for oil, aluminum, steel, and automobiles.

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After moderating for several months, consumer prices jumped sharply in June and July. In the latter month, the consumer price index rose 1.2 percent, the sharpest rate of increase in ten months. Food prices, led by price hikes on meat and poultry, surged. Consumer energy prices, primarily on gasoline and motor oil, also rose at extremely rapid rates. Excluding energy prices, nonfood commodity prices rose 0.6 percent. However, the announced increases in auto prices will soon be felt. There could be additional shocks to the consumer price index in the near future as a result of higher energy prices. This would occur if members of the Organization of Petroleum Exporting Countries increase their oil prices this fall. Although the legislation authorizing controls on prices of domestically produced "old" oil lapsed at the end of August, no sharp price increases have been posted—perhaps reflecting expectations of the imminent reimposition of controls for a temporary period. Prices would be expected to rise, however, if a program of gradual decontrol were to be enacted. Such a program might well be accompanied by an excess profits tax on oil companies and by tax credits to consumers to offset, at least partially, the impact of higher prices. In these circumstances, the resulting increase in the consumer price index would exaggerate the inflationary impact on consumers, since fuel costs are a direct component of the consumer price index whereas taxes (and tax credits) are not.

At the wholesale level, prices rose in August at a 0.8 percent seasonally adjusted rate. Prices of fuel and power continued to accelerate, increasing at a rate of about 3 percent; part of this upsurge probably reflects the recently enacted import fees on crude oil and refined petroleum products. Industrial commodity prices other than power and fuel rose 0.3 percent. Over the six months ended August, these prices have risen at an annual rate of only 1.5 percent. Prices of farm products and processed foods and feeds declined nearly 1 percent in August, after having jumped the month earlier. This turnaround was led by prices of fresh meats and vegetables.

Over the four weeks ended August 26, the Bureau of Labor Statistics index of basic commodities jumped 3.5 percent. Industrial commodity prices rose 6.9 percent, as prices surged in mid-August, led by price increases for lead and steel scrap. It is possible, however, that to a large extent the advances in these metal prices was the result of buyers hedging against higher future mill prices. Thus, it need not be expected that these prices will continue to shoot up. Prices of raw foodstuffs have edged down in recent weeks. Improved growing conditions have raised prospects for corn and wheat production, although concern over increased foreign demand for United States exports remains. The latest Department of Agriculture estimates now suggest that carry-over stocks of these key crops may increase only slightly.

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The Money and Bond Markets in August

A cautious atmosphere prevailed in the financial markets in August. The large financing needs of the Treasury continued to be a major source of concern. Investor uncertainty was heightened by reports of recent sharp increases in both consumer and wholesale prices and the surprising drop in July's unemployment rate. Money market participants interpreted these developments as indicating that economic activity was perhaps recovering faster than expected and that underlying inflationary pressures might be building. In addition, the continuing financial crisis of New York City weighed heavily on the municipal sector. The city was able to meet its commitments in August with funds provided from several sources, including loans by the Municipal Assistance Corporation (MAC) and by the major New York City banks. Legislation to provide additional revenues for the city and to establish an Emergency Financial Control Board to oversee the city's fiscal operations was passed by the New York State legislature early in September.

In this problematical environment, most interest rates continued to advance in August until late in the month, when they retraced part of their upward movement. In the money market the increases were generally mild, compared with those of recent months. The Federal funds rate changed little over the period from its average level in July, and the rates on Treasury bills rose by 14 to 25 basis points, less than half the increase in bill rates from June to July. However, as dealers acted to distribute $4 billion of new notes and $2 billion of additional bills issued by the Treasury during the month, sizable increases were registered in yields on intermediate- and long-term Government securities. The heavy volume of borrowing by the Treasury was even larger than had been anticipated by investors as a result of unexpected redemptions of nonmarketable issues and from outlays running ahead of projections. Toward the close of the month, yields on Treasury coupon issues receded somewhat, partly in response to an anticipated lull in borrowing during the remainder of September. Yields in the corporate and municipal sectors also experienced strong upward pressure over most of the month, but the pressure eased late in the period in sympathy with the improved tone in the Treasury market. In reaction to the adverse market conditions that prevailed over most of the month, many planned corporate and municipal issues were reduced in size, canceled, or postponed. Nonetheless, a number of new issues sold well at higher yields.

According to preliminary data, the growth rate of the narrow money stock (M_1) showed a moderate increase in August from the very modest growth registered in July. At the same time, consumer-type time deposits at commercial banks advanced more slowly than in the previous month; thus, growth in the more broadly defined money stock (M_2) was essentially unchanged. Largely because of a further drop in the volume of large negotiable certificates of deposit (CDs), the bank credit proxy continued to decline.

THE MONEY MARKET AND THE MONETARY AGGREGATES

Interest rates on most money market instruments rose in August for the third consecutive month, but the increases were generally mild (see Chart I). The rate on 90- to 119-day dealer-placed commercial paper, for example, advanced only ⅛ percentage point over the period, while rates on bankers' acceptances rose about ⅛ to ⅝ percentage point. The average rate on ninety-day CDs in the secondary market continued to show considerable fluctuation and closed the month up 28 basis points from its end-of-July level. Most money-center banks boosted their prime lending rate ¼ percentage point to 7¾ percent, following an increase of ½ percentage point by most banks in the previous month. In contrast to other money market rates, the Federal funds rate showed no uptrend in August. For the month as a whole, the effective rate on Federal funds averaged 6.14 percent, compared with 6.10 percent in July.

Weakness was still quite evident in business demand for short-term credit in August. At large commercial banks, commercial and industrial loans declined by $1,527 million over the four statement weeks of the month. This contrasted with an average increase of $325 million during comparable periods in the previous four years. Thus far in 1975, business loans at large banks have

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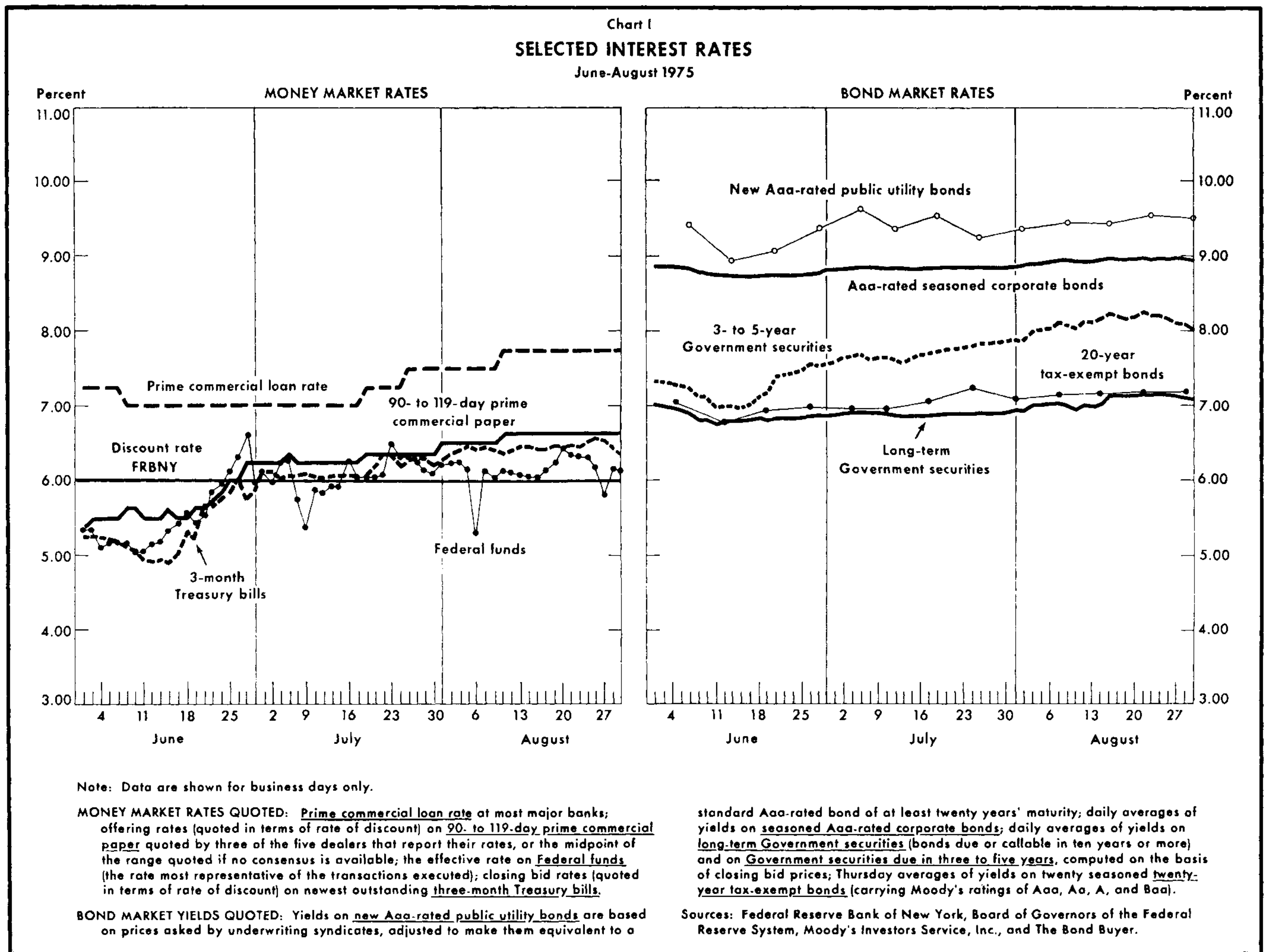

Note: Data are shown for business days only.

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.

dropped by $12.3 billion. In the last two months, however, after allowance for normal seasonal variations, the declines have been much smaller than in earlier months of the year. This may indicate that a turning point in business demand for short-term credit is close at hand.

In response to the continued weakness in business loan demand at banks, major commercial banks allowed a further large runoff of CDs in August. The volume of CDs outstanding has paralleled movements in business loans all year. Over the eight months ended in August, CDs dropped $11.8 billion. In recent months, however, as in the case of business borrowing from banks, the declines in CDs have been comparatively small.

Preliminary data indicate that the growth rate of M_1—private demand deposits adjusted plus currency outside commercial banks—rose moderately in August from its very low growth rate in July. In the four-week period ended August 27, seasonally adjusted M_1 averaged 5.3 percent at an annual rate above its average during the four weeks ended July 30. The change from June to July had been much smaller. Indeed, the fluctuation in monthly M_1 growth has been particularly sharp this year, ranging from double-digit growth in May and June to negative or near-zero growth in January and July. Changes in M_1 over longer periods are shown in Chart II.

The expansion of consumer-type time deposits at commercial banks slowed considerably in August, compared with its growth over recent months. The deceleration prob-

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ably reflected, at least in part, the rise in interest rates on competing market instruments relative to rates on consumer-type time deposits. The latter are of course constrained by the legally set rate ceilings. As a result of the slowdown, the expansion of M_2—which includes these time deposits plus M_1—was little changed in August from its growth in July. The adjusted bank credit proxy—a measure which encompasses all deposits at member banks subject to reserve requirements plus certain nondeposit sources of funds—declined in August for the second consecutive month. The drop was largely due to the decline in the volume of CDs outstanding. This decline offset demand and consumer-type time deposit growth. Member banks continued to make little use of the discount window in August, when borrowings averaged $208 million (see Table I) as compared with the revised figure of $326 million for July.

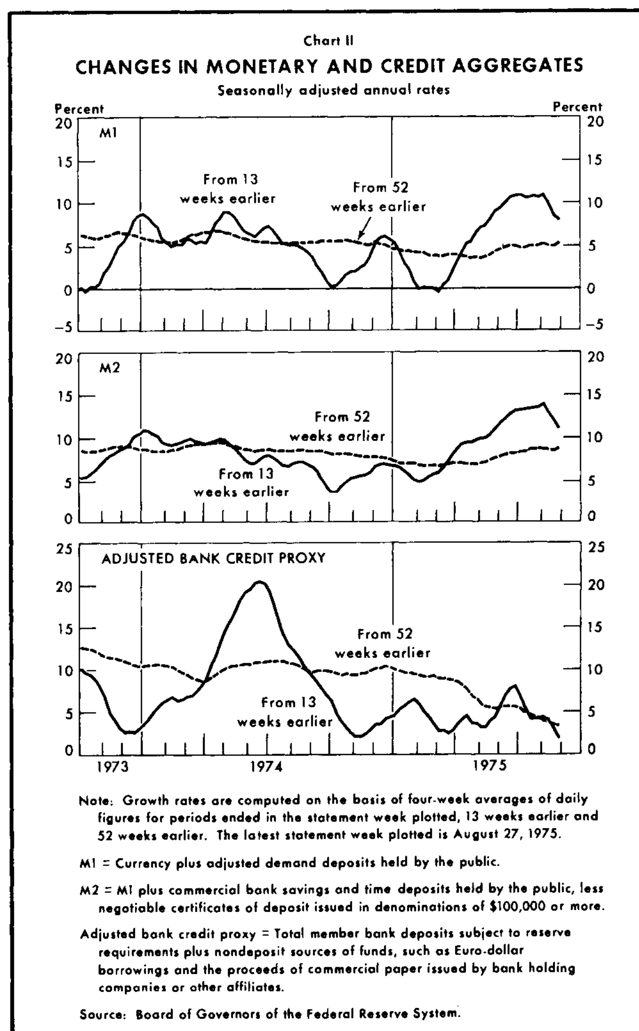
THE GOVERNMENT SECURITIES MARKET

Yields on Treasury securities rose sharply during August. Investor uneasiness was heightened by growing concern about renewed inflationary pressures. This concern was nurtured by substantial increases during July in both wholesale and consumer prices as well as by a sharp, unexpected drop that month in the unemployment rate. The large financing needs of the Treasury also contributed to the cautious tone in the market for Treasury securities. On August 6 the Treasury announced plans for meeting the bulk of its cash needs through early September. The level of borrowings, even larger than had been anticipated, called for $6 billion in new cash. The package of new money included the immediate sale of $1 billion in eighteen-day bills, which were subsequently to be added to the auction on August 20 of the outstanding 52-week bill issue. Also included in the package were the addition of $1 billion to the auction of three- and six-month bill issues on August 18 and the auction of $2 billion of new two-year notes on August 14 and of $2 billion of new 49-month notes on August 21.

The large supply of Treasury securities, as well as expectations that the supply would continue heavy throughout the year, reduced the incentive for investors to bid aggressively. Each of the auctions for coupon securities was characterized by investor wariness and the need for the Treasury to offer substantially higher yields than it had during June and July. Much attention was focused on the auction of $2 billion of two-year notes on August 14. Looking ahead to large auctions in almost every week of August and early September, investors held back, and the average yield on the securities at the August 14 auction rose to 8.25 percent; this was 75 basis points above the average yield at the July auction of securities of comparable maturity. The auction of $2 billion of 49-month notes on August 21 encountered similar investor resistance, resulting in an average yield of 8.54 percent, the highest rate on a Treasury-backed note in over a year.

At the close of the month, yields on coupon issues declined as dealers found their inventories to be modest, given the expected reduction in Treasury borrowing. Market participants were also encouraged by Chairman Burns's comment in a letter to Henry S. Reuss, Chairman of the House Banking Committee, that the Federal Reserve would continue purchasing coupon securities in coming months. Over the month as a whole, the index of yields on intermediate-term Government securities rose

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 August 27, 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.

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14 basis points to 8.02 percent. The yield on the 8½ percent Treasury bond of 1994-99 rose to 8.43 percent at the end of August, up 9 basis points from its level at the end of July.

Movements in Treasury bill rates paralleled movements in rates on coupon securities. During early and mid-August, rates on bills rose. The average yield on 52-week bills at the monthly auction on August 20 was 7.33 percent (see Table II), up 55 basis points from the average yield at the July auction. At the weekly auction of three- and six-month bills on August 25, the average yields on three- and six-month bills were 6.59 percent and 7.09 percent, the highest rates on three- and six-month bills since January of this year. But, as in the case of coupon securities, rates declined during the final week of August, and the average rates on three- and six-month bills at the August 29 auction were 6.38 percent and 6.87 percent, 14 and 15 basis points above the rates on these bills at the final auction in July. Over the month as a whole, yields on most bills rose 14 to 25 basis points.

Rates on agency securities also rose during August. On August 7, the Federal Home Loan Banks issued $500 million of seven-year bonds at 8⅝ percent. These bonds traded near par during most of the month. Later in the month the Federal National Mortgage Corporation issued $650 million of five-year debentures at 8¾ percent. These rates compare with a yield of 8.20 percent on 7½-year bonds issued by the Federal Land Banks early in July. During the month, the Banks for Cooperatives issued $505.6 million of 7.4 percent bonds due March 1, 1976, and the Federal Intermediate Credit Banks issued $725.2 million of 7.6 percent bonds due June 1, 1976. Both issues were reasonably well received.

THE OTHER SECURITIES MARKETS

Investor uncertainty over the financing needs of the Treasury as well as increased concern over inflation affected the corporate and municipal bond markets in August. The tax-exempt sector was additionally troubled by the financial problems of New York City. Yields came under strong upward pressure throughout the month, although a number of cancellations and postponements of new issues served to limit the advance.

Throughout the year, corporations have been issuing bonds in order to lengthen the maturity structure of their liabilities. Since corporations can postpone the issuance of bonds that are used to restructure their liabilities, several corporations, including the New Jersey Bell Telephone Co., postponed bond offerings indefinitely because of adverse market conditions. Analysts estimated that at

Table I

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

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

Factors	Changes in daily averages— week ended				Net changes
	Aug. 6	Aug. 13	Aug. 20	Aug. 27	
"Market" factors					
Member bank required reserves	+ 373	+ 190	— 267	+ 241	+ 537
Operating transactions (subtotal)	+ 811	+1,102	— 828	— 858	+ 227
Federal Reserve float	+ 105	+ 300	+ 101	— 348	+ 158
Treasury operations*	+ 667	+1,017	— 79	— 879	+ 726
Gold and foreign account	— 18	— 8	— 32	+ 60	+ 2
Currency outside banks	— 119	— 433	— 731	+ 577	— 706
Other Federal Reserve liabilities and capital	+ 176	+ 226	— 87	— 268	+ 47
Total "market" factors	+1,184	+1,292	—1,095	— 617	+ 764
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	—1,155	—1,522	+1,866	+ 575	— 236
Outright holdings:					
Treasury securities	—1,113	—1,506	+1,496	— 207	—1,330
Special certificates	+ 231	—	— 25	— 206	—
Bankers' acceptances	— 1	— 16	+ 2	+ 7	— 8
Federal agency obligations	—	—	—	+ 336	+ 336
Repurchase agreements:					
Treasury securities	— 243	—	+ 368	+ 568	+ 693
Bankers' acceptances	— 13	—	+ 10	+ 71	+ 68
Federal agency obligations	— 16	—	+ 15	+ 6	+ 5
Member bank borrowings	— 77	+ 2	+ 25	+ 68	+ 18
Seasonal borrowings†	+ 9	+ 6	—	+ 5	+ 20
Other Federal Reserve assets‡	— 29	+ 5	— 541	+ 23	— 542
Total	—1,261	—1,515	+1,350	+ 666	— 760
Excess reserves‡	— 77	— 223	+ 255	+ 49	+ 4
	Daily average levels				**Monthly averages§**
Member bank:					
Total reserves, including vault cash‡	34,563	34,150	34,672	34,480	34,466
Required reserves	34,345	34,155	34,422	34,181	34,276
Excess reserves	218	— 5	250	299	191
Total borrowings	176	178	204	272	208
Seasonal borrowings†	29	35	35	40	35
Nonborrowed reserves	34,387	33,972	34,468	34,208	34,259
Net carry-over, excess or deficit (—)‖	180	141	25	96	111

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Included in total member bank borrowings.
‡ Includes assets denominated in foreign currencies.
§ Average for four weeks ended August 27, 1975.
‖ Not reflected in data above.

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the time of the postponement on August 6 the yield on the $75 million Aaa-rated issue of New Jersey Bell bonds would have been about 35 basis points higher than the yield of 8.80 percent on approximately comparable bonds issued by the Bell Telephone Co. of Pennsylvania on July 15. Other postponements of Aaa-rated issues included $150 million of seven-year notes of J. P. Morgan & Co. Incorporated. A lesser rated issue of $80 million of Consolidated Edison Co. of New York, Inc. bonds was also postponed on two separate occasions during the month.

A number of corporate issues brought to market during the month at relatively high rates sold fairly well. On August 4, the Chicago-based Commonwealth Edison Co. sold $125 million of Aaa-rated eight-year bonds at 8.85 percent. During that same week, Public Service Co. of Indiana, Inc., an Aa utility, sold out an $80 million issue of thirty-year bonds at 9.6 percent, compared with a yield of 9.43 percent on a comparably rated thirty-year issue in late July. On August 12, British Petroleum North American Finance Corporation successfully negotiated a two-part sale of Aa-rated securities, guaranteed by the British Petroleum Co. Ltd.: $50 million of five-year notes yielding 9 percent and $100 million of 25-year debentures yielding 10 percent. On August 19, Pfizer Inc. sold $100 million each of ten-year notes and 25-year debentures. The Aa-rated securities were priced to yield 8⅞ percent and 9.30 percent, respectively, and were quickly sold out. In comparison with the yields of 9 percent and 8⅞ percent on the intermediate-term Aa-rated issues of British Petroleum and Pfizer, a similarly rated issue of eight-year bonds had been sold by Arco Pipe Line Company to yield 8.46 percent in mid-July. Over the month, the Federal Reserve Board index of yields on recently offered Aaa-rated corporate securities rose 7 basis points to close the period at 8.94 percent.

During most of August, attention in the tax-exempt sector was centered on the need for New York City to raise $960 million to meet current expenses and to pay $791 million on notes and interest due on August 22. The $960 million aid plan for New York City arranged by MAC consisted of the placement of $350 million of bonds with New York City banks (including $100 million in exchange for maturing New York City notes), purchases of $215 million of bonds by various city and state pension funds, $120 million in advance aid from the state, and the negotiated public sale of $275 million of bonds on August 14. After a one-day delay because of insufficient presale demand, the negotiated sale, consisting of $70 million of 10 percent bonds due in five years, $65 million of 10½ percent bonds due in six years, and $140 million of 11 percent bonds due in eight years, was completed on August 15. The success of this second public offering of A-rated MAC bonds was assured when a group of underwriters agreed to take any unsold bonds. Subsequently, prices on outstanding MAC issues weakened as market participants focused on the city's September cash needs.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—August 1975				
	Aug. 4	Aug. 11	Aug. 18	Aug. 25	Aug. 29
Three-month	6.456	6.349	6.452	6.593	6.381
Six-month	6.864	6.809	7.000	7.085	6.866
	Monthly auction dates—June-August 1975				
	June 24	July 24	Aug. 20		
Fifty-two weeks	6.292	6.782	7.331		

* 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.

The problems faced by New York City, and earlier in the year by New York State's Urban Development Corporation, have had a particularly adverse effect on the market for state agency issues. During the month, the Massachusetts Housing Finance Agency was forced to reject all bids on a $63.8 million issue of bond anticipation notes maturing in 1976 and 1977. The New York State Housing Finance Agency twice postponed its $110 million note offering and finally scaled it down to $92 million. The net interest cost to the agency on these notes was 10.848 percent, compared with an 8.87 percent cost on a similar sale in July.

In the municipal sector, the largest issue of the month (except for MAC)—$180 million of Commonwealth of Pennsylvania bonds—was well received. These A-1 (Moody's) bonds sold out on August 7, with yields ranging from 4.80 percent for the 1977 maturities to 7.25 percent for those maturing in 1995 or about 10 to 40 basis points higher than a similar sale by Pennsylvania last May. The Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds on August 28 was 7.18 percent, up from its level of 7.09 percent on July 31. The Blue List of dealers' advertised inventories rose by $84 million and closed the month at $631 million.

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