The Money and Bond Markets in April

Prices drifted lower in most sectors of the bond market during the first part of April and then dropped sharply after midmonth, in part because indications of economic strength led market participants to revise their expectations of the interest rate outlook. The confidence in lower rates that had developed in late March when the banks' prime lending rate was cut was tested by a record outpouring of new corporate issues. The previously announced $1.6 billion bond offering by the American Telephone and Telegraph Company led to upward rate adjustments on other new and outstanding securities when specific terms of the issue were made known on April 13. Concern also mounted among many market participants that the economy might resume its expansion before inflationary tendencies were contained, especially since fiscal policy seemed to be tilting again toward the expansionary side. A somewhat firmer money market suggested that the monetary authorities were alert to the dangers of overly rapid monetary expansion. While this augured well for the long-run health of the bond markets, dealers had to work off heavy inventories of Treasury bills built up in anticipation of greater investor demands than materialized. Accordingly, short-term rates moved rapidly higher in late April, contributing to the adjustment under way in the bond market in advance of the Treasury's May financing.

With prices of Government securities falling sharply after midmonth, there was growing apprehension concerning the terms and the effect of the Treasury's May refunding in that market as the April 29 announcement date approached. Initial reaction was generally favorable to the terms on which the Treasury's new offerings were made.

The monetary and bank credit aggregates expanded strongly in April, and the Federal Reserve interposed some resistance to the acceleration that developed. A number of unusual developments appear to have contributed to unexpected deposit strength. Normal financial clearings were disrupted early in the period by the effects of European bank holidays and by the aftermath of labor disputes and unseasonable snowstorms, which delayed mail delivery. The early April rise in the aggregates was slow to reverse, however, when these special factors disappeared. In consequence, the System allowed modestly firmer money market conditions to develop during the last half of the month. For the three months ended in April the money supply grew at a seasonally adjusted annual rate of 5 percent, while the adjusted bank credit proxy advanced at a rate of 7 percent and time deposits at 11 percent.

The effective rate on Federal funds averaged 8.1 percent in April, compared with 7.7 percent in March. The rates on three- and six-month Treasury bills closed the month at 6.93 and 7.18 percent, up 55 and 70 basis points from a month earlier. The bid rate on ninety-day bankers' acceptances climbed sharply in several steps to 8¼ percent by April 30 from 7½ percent at the end of March. Rates also moved up on the short maturities of directly placed commercial paper but were unchanged on longer maturities and on dealer-placed paper over the month.

BANK RESERVES AND THE MONEY MARKET

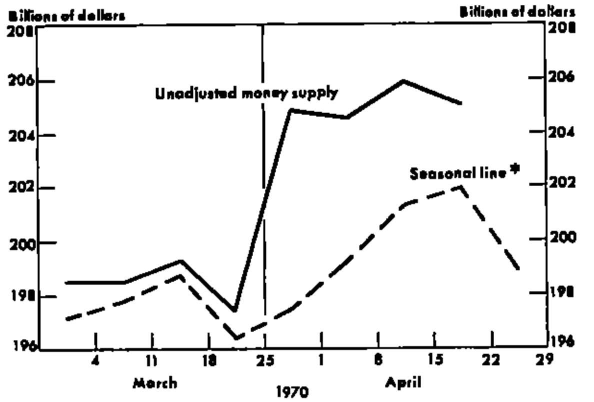
The behavior of the monetary aggregates in April involved a number of uncertainties. Typically, both the money supply and the bank credit proxy tend at times to deviate from average seasonal patterns or longer run growth trends on a week-to-week or even month-to-month basis. Because of special factors at work in late March, April turned out to be a month of unusual uncertainty.

The rise in the money supply in the week ended on April 1 was extraordinary in relation to past seasonal behavior (see Chart I).[1] A major factor responsible for this was a very sharp drop during that week in cash items in the process of collection, which represent a deduction from gross demand deposits in arriving at the demand deposit component of the money supply. In part, this

[1] Since there is no growth factor incorporated in the seasonal line, some difference between the two would usually result if the actual series exhibited a fairly regular growth. The chart shows this type of divergence during most of March.

Chart I

THE MONEY SUPPLY AND SEASONAL EFFECTS



* This line is the average of the seasonally adjusted weekly figures for February multiplied by seasonal factors for March and April, beginning with the week of March 4. It indicates what the unadjusted money supply would have been if just the influence of the seasonal factors—which are drawn from the behavior of the money supply during comparable weeks of previous years—had been operative.

drop was attributable to the closing of European money markets on the Friday and Monday surrounding Easter Sunday.[1] This temporary phenomenon was quickly reversed after the Easter weekend so that cash items in the process of collection rose. However, the money supply did not fall back as promptly as one would have expected after this and other factors affecting the collection system faded in importance.

The average effective rate on Federal funds moved to a higher plateau in the last half of April (see Chart II), as System open market operations offered some resistance to the rapid growth in the money supply and bank credit. Contributing to the firming of the Federal funds rate were the heavy financing needs of Government securities dealers, who held unusually large inventories during much of the period. In addition, the money center banks experienced substantial reserve drains when a large rise in required reserves coincided with deposit outflows and sizable loan demand associated with the mid-April individual and corporate income tax date. Average borrowings by member banks at the discount window totaled some $870 million in April (see Table I), down slightly from the $896 million average in March, while net borrowed reserves declined by an average of $98 million since excess reserves also increased by about $70 million over the period.

The average basic reserve position of the forty-six major money center banks showed virtually no change at the start of the month but then began to deteriorate, with the deficits rising to a record $7.5 billion and $8.0 billion, respectively, in the statement weeks ended on April 15 and April 22. An easing of the deficit occurred during the final statement week (see Table II) in a pattern which has recurred in the past several years. Substantial declines in United States Government balances and private demand deposits and a sharp rise in lagged reserve requirements largely accounted for the deepening of the average reserve deficit of the money center banks during the week of April 15. A sizable inflow of Treasury deposits took place in the following week as tax collections were made, but this was more than offset by a continuation of a buildup in loans and investments which began toward the close of the preceding week.

System open market operations provided $209 million in reserves during April primarily through repurchase agreements involving Government securities. Reserves amounting to $128 million were also supplied by operating transactions, as a large increase in float was only partially offset by other transactions which drained reserves. Required reserves increased by $650 million over the month.

Preliminary data for the monetary aggregates in April show a seasonally adjusted annual rate of growth in the money supply of 13.7 percent following a 13.2 percent rise during March. Over the three months ended in April the seasonally adjusted annual rate is estimated at 5.4 percent, compared with an increase of 4.0 percent in the three months ended in January. The adjusted bank credit proxy grew at a seasonally adjusted annual rate of 7.0 percent in the quarter ended in April, compared with a rate of 3.3 percent in the three months ended in January.

THE GOVERNMENT SECURITIES MARKET

Activity in the market for Treasury coupon issues was rather subdued in April. Based in part on the expectation that the Treasury's May refunding would be a rights offering, some demand developed for shorter dated securities during the first half of the month and prices on issues due within two years improved over that interval. During this same period, prices on longer maturities drifted irregularly lower and at midmonth began to fall sharply in conjunction with the rate adjustments in the corporate bond market following the announcement of the AT&T offering terms. Also around midmonth, dealers began to readjust their positions in preparation for the May re-

[1] For some further details, see pages 104-5.

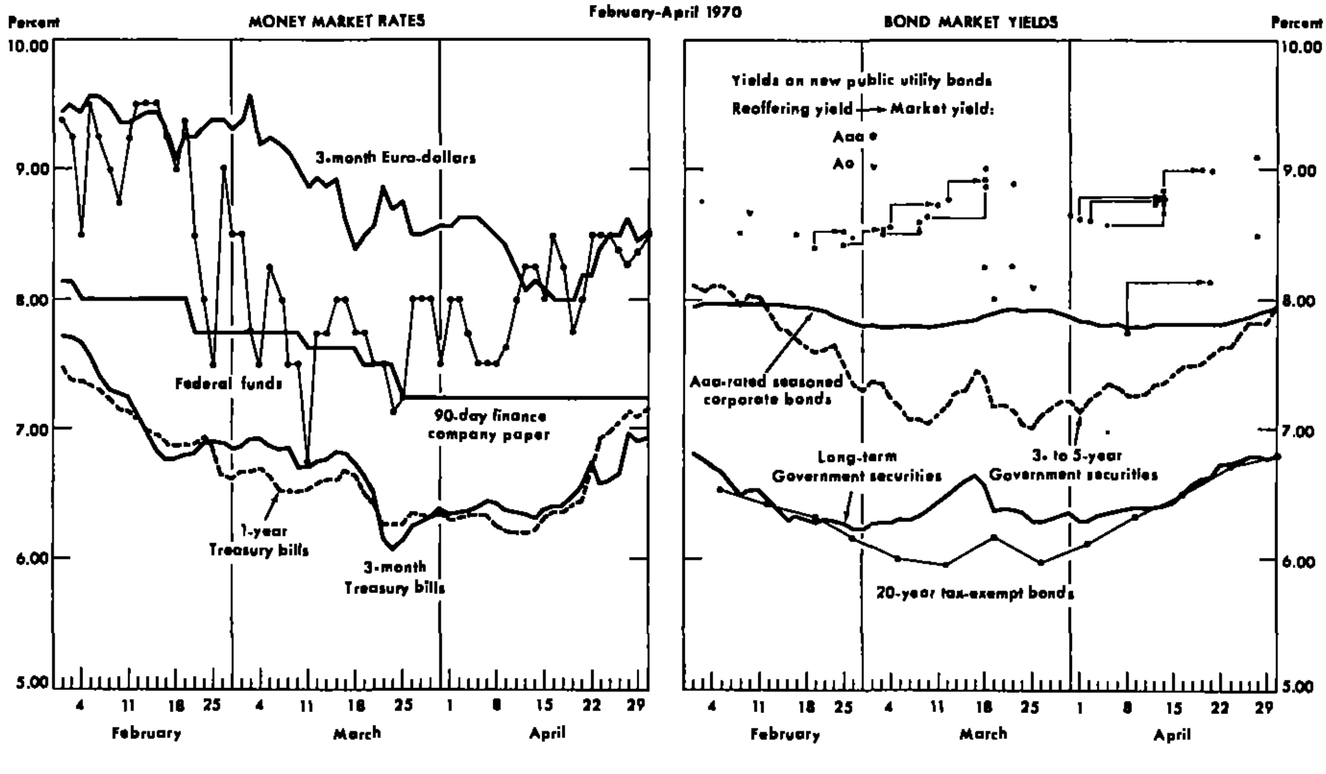
funding, and thereby exerted further downward pressure on the market. This was felt particularly in the intermediate-term area, where dealers attempted to reduce their holdings in anticipation of a new supply from the refunding in this maturity range.

As the month progressed and additional information on the state of the economy became available, many market participants became apprehensive that the economy might begin to expand without the needed check on inflation and that some tightening of monetary policy might be required. In this atmosphere, rates on all coupon issues rose, with the sharpest increases occurring on intermediate- and long-term notes and bonds. As the April 29 announcement of the Treasury's refunding terms drew closer, the tone of the market became increasingly cautious in light of the pronounced deterioration which the market had undergone in recent weeks. The terms of the May refunding were as follows: holders of the $16.6 billion of 5⅝ percent and 6⅜ percent notes maturing May 15, 1970 were offered the right to exchange them for additional amounts of two outstanding issues. These were the 7¾ percent note due May 15, 1973, priced to yield 7.98 percent, and the 8 percent note of February 15, 1977, priced at par. The public held about $4.9 billion of the notes eligible for exchange. Subscription books for the exchange were open from May 4 through May 6. In addition, the Treasury offered for cash or exchange $3.5 billion of a 7¾ percent eighteen-month note in order to meet the attrition on the

Chart II

SELECTED INTEREST RATES

February-April 1970



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; offering rates for directly placed finance company paper; 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 and one-year Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new Aaa- and Aa-rated public utility bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); 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, and The Weekly Bond Buyer.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, APRIL 1970

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

Factors	Changes in daily averages— week ended on April 1	April 8	April 15	April 22	April 29	Net changes
"Market" factors						
Member bank required reserves	— 91	— 72	— 625	— 57	+ 195	— 650
Operating transactions (subtotal)	+ 118	+ 606	— 457	+ 295	— 424	+ 138
Federal Reserve float	+ 221	+ 581	— 584	+ 671	— 426	+ 463
Treasury operations*	— 51	+ 128	+ 218	— 194	— 211	— 110
Gold and foreign account	— 51	+ 34	+ 78	— 7	— 15	+ 39
Currency outside banks	+ 91	— 11	— 231	— 306	+ 295	— 161
Other Federal Reserve liabilities and capital	— 93	— 128	+ 62	+ 132	— 68	— 95
Total "market" factors	+ 27	+ 534	—1,082	+ 238	— 229	— 512
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 166	— 267	+ 426	— 174	+ 58	+ 209
Outright holdings:						
Government securities	— 111	— 40	+ 156	+ 2	— 72	— 65
Bankers' acceptances	— 1	+ 5	+ 1	— 2	+ 2	+ 6
Repurchase agreements:						
Government securities	+ 225	— 182	+ 214	— 134	+ 108	+ 231
Bankers' acceptances	+ 19	— 13	+ 21	— 26	+ 13	+ 24
Federal agency obligations	+ 34	— 37	+ 34	— 14	+ 6	+ 12
Member bank borrowings	+ 14	— 454	+ 524	— 49	— 78	— 43
Other Federal Reserve assets†	+ 36	+ 28	+ 36	+ 49	+ 79	+ 228
Total	+ 216	— 693	+ 986	— 174	+ 59	+ 394
Excess reserves	+ 243	— 159	— 96	+ 64	— 170	— 118

	Daily average levels					Monthly averages
Member bank:						
Total reserves, including vault cash	27,806	27,709	28,238	28,359	27,994	28,021‡
Required reserves	27,467	27,539	28,164	28,221	28,026	27,882‡
Excess reserves	339	170	74	138	— 32	138‡
Borrowings	949	496	1,020	971	892	866‡
Free, or net borrowed (—), reserves	— 610	— 326	— 946	— 833	— 925	— 728‡
Nonborrowed reserves	26,857	27,213	27,218	27,388	27,101	27,155‡
Net carry-over, excess or deficit (—)§	84	192	119	74	81	110‡

	Changes in Wednesday levels					Net changes
System Account holdings of Government securities maturing in:						
Less than one year	+ 414	— 471	+ 816	— 302	+ 7	+ 464
More than one year	—	—	—	—	—	—
Total	+ 414	— 471	+ 816	— 302	+ 7	+ 464

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ Average for five weeks ended on April 29.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS APRIL 1970

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on April 1	April 8	April 15	April 22	April 29	Averages of five weeks ended on April 29
Eight banks in New York City						
Reserve excess or deficiency (—)*	72	96	— 52	39	— 24	24
Less borrowings from Reserve Banks	232	—	322	517	63	227
Less net interbank Federal Funds purchases or sales (—)	1,302	1,640	2,042	2,470	1,358	1,764
Gross purchases	2,202	2,520	2,749	3,073	2,321	2,573
Gross sales	900	880	707	594	963	809
Equals net basic reserve surplus or deficit (—)	—1,462	—1,545	—2,417	—2,948	—1,446	—1,967
Net loans to Government securities dealers	1,031	915	829	675	517	833
Net carry-over, excess or deficit (—)†	25	38	56	— 1	30	28
Thirty-eight banks outside New York City						
Reserve excess or deficiency (—)*	57	— 51	19	— 35	— 17	— 5
Less borrowings from Reserve Banks	264	269	510	253	362	331
Less net interbank Federal Funds purchases or sales (—)	3,023	4,222	4,575	4,704	3,481	4,001
Gross purchases	4,921	5,778	6,077	6,147	5,493	5,683
Gross sales	1,898	1,556	1,502	1,443	2,012	1,683
Equals net basic reserve surplus or deficit (—)	—3,230	—4,541	—5,066	—4,991	—3,859	—4,337
Net loans to Government securities dealers	683	1,117	853	983	427	813
Net carry-over, excess or deficit (—)†	5	54	— 6	17	3	15

Note: Because of rounding, figures do not necessarily add to totals.
* Reserves held after all adjustments applicable to the reporting period less required reserves.
† Not reflected in data above.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—April 1970: April 6	April 13	April 20	April 27
Three-month	6.409	6.310	6.476	6.876
Six-month	6.454	6.347	6.494	7.353

Maturities	Monthly auction dates—February-April 1970: February 24	March 24	April 23
Nine-month	6.094	6.100	6.844
One-year	5.932	6.132	6.814

* 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.

refunded issues and to raise additional funds. Subscription books were open on May 5 for this part of the offering. Although market participants were somewhat surprised by the inclusion of a cash offering, prices on the "when-issued" securities held at a premium during their first day of trading.

Rates on Treasury bills moved somewhat higher during the early days of the month, partly as a result of investor selling following the establishment of positions for quarterly statement purposes. When the volume of such selling proved less than had been feared and some investment demand emerged, rates turned down for about a week. Dealers carried unusually heavy inventories during much of the month but exerted little selling pressure during the first half of the period despite relatively high financing costs. Substantial demand was expected from state and local government investing of tax receipts and from the reinvestment of funds by holders of outstanding tax anticipation bills (TAB's) maturing on April 22.

After midmonth, dealers became somewhat concerned when the demand from state and local governments failed to materialize to the extent that had been expected, and some paring of positions began. Nonetheless, the resulting pressure on bill rates was not too great, since reinvestment demand from the TAB's was still anticipated. The costs of financing these inventories was increasing, however, and when holders of the maturing TAB's also did not purchase bills in the volume expected, rates rose sharply as dealers marked down prices in an attempt to reduce their stocks. Over the three-day period from April 22 to April 24, rates on some outstanding issues increased by as much as 50 basis points. The rise in yields continued during the remainder of the month but at a more moderate pace. On balance for April as a whole, rates on bills due within three months were mostly 30 to 55 basis points higher while longer term bills generally increased by from 63 to 81 basis points.

Reflecting the increased concern over costly inventories in the face of disappointing demand, the average issuing rates on three- and six-month bills jumped by some 57 and 101 basis points, respectively, between the auctions held on April 13 and April 27. In the monthly auction held on the day following the TAB's maturation, rates on the new nine- and twelve-month bills were set at 6.844 and 6.814 percent, up 74 and 68 basis points from the month earlier (see Table III).

Some $1.7 billion of securities was marketed by five Federally sponsored agencies in April, and initial receptions to several of the offerings appeared good. However, a number of the issues later traded below par as a result of the overall worsening in the capital markets.

OTHER SECURITIES MARKETS

The highlight of the corporate bond market during April was the huge AT&T debenture-warrants offering to those owning its shares as of April 10. Until May 18 of this year, holders of thirty-five rights can purchase for $100 a thirty-year Aaa-rated debenture paying 8¾ percent—10 basis points more than the previous Bell System offering on March 31—and receive warrants to purchase two additional shares of stock at $52 each between November 15, 1970 and May 15, 1975. The company plans to raise almost $1.6 billion through its sale of debentures and an additional $1.6 billion over the 4½ years in which the warrants are exercisable. Initial market reaction to the terms was quite favorable: the when-issued debentures traded at a premium, and the prices established on the when-issued rights and warrants also indicated a good deal of investor interest. Four lower rated utility syndicates were disbanded on the day after the AT&T offering, and sizable upward rate adjustments resulted when the bonds were traded without price restrictions. Appreciative of the higher rate levels that were developing, underwriters marketed a new Aa-rated utility issue on that same day to yield investors 27 basis points more th[an] a similar security in the preceding week.

Corporate bond prices drifted somewhat lower over the remainder of the week of the AT&T announcement and then dropped sharply at the start of the following week, prompting underwriters to raise the return on a new A-rated utility issue to 9.20 percent. Despite the fact that this was only 20 basis points below the record for a comparable issue set last December, early sales were disappointing; however, the unsold balance was reduced in the wake of the successful marketing of two more attractive offerings that followed. Under the weight of a record four months' supply, additional announcements of forthcoming new offerings, and concern about indications of an economic upturn, prices continued their decline as the month progressed, with the AT&T debentures beginning to trade at a discount.

On balance the tax-exempt bond market deteriorated during April, though the reception given some particular new issues was quite good. Reflecting the fairly steady overall decline, *The Weekly Bond Buyer's* index rose each week by from 6 to 23 basis points and reached a high of 6.79 percent on April 30, only 11 basis points below its peak of 6.90 percent set on December 18. Starting the month with substantial inventories from the preceding period (the Blue List of advertised dealer inventories stood at $557 million on March 31), the market was confron[ted] with a record thirty-day calendar which had materialized as a result of generally rising prices since the start of the year.

Although prices declined on most tax-exempt issues during the month, investor interest was for the most part restrained and dealer inventories remained large throughout the period. At the close of April the Blue List totaled $521 million, a decline of only $36 million over the month. Adding to the poorer tone in the municipal market was an element of uncertainty which arose at midmonth concerning the tax status of borrowing costs incurred by commercial banks, which might be associated with the purchase of tax-exempt securities.

Despite the generally depressed tenor of the tax-exempt market, two of the month's largest issues met with favorable investor receptions. These were a $165 million issue of New York City bonds, which are attractive to local residents because they are also exempt from state and city taxes, and a $100 million issue of Aa-rated Pennsylvania bonds which were priced to yield as much as 7 percent on a 28-year maturity.