The Money and Bond Markets in March

Interest rates in the capital markets fell substantially in March, although they reversed direction and rose somewhat toward the end of the month. A record volume of $4.2 billion of new corporate bonds was publicly offered during March. Yields on new Aa-rated utility issues declined by about 60 basis points over the first three weeks of the month and then backed up by about one fourth of that amount. Yields on long-term Treasury bonds fell by 19 to 57 basis points. *The Weekly Bond Buyer's* index of twenty municipal bond yields fell by 31 basis points over the month. Indeed, except in the corporate sector, the decline in yields erased the increases posted during February and left yields on some long-term securities near their lowest levels in more than two years.

In contrast to long-term yields, most short-term interest rates were relatively steady in March. However, the sharp drop in short-term interest rates over recent months has brought them to levels far below comparable rates in many European countries. This has prompted United States banks to reduce further their liabilities to their foreign branches. Foreign corporations and subsidiaries of United States corporations operating abroad have drawn on Euro-dollar credits, as rates have fallen, and many of these have then been converted into foreign currencies. Such conversions have led to an accumulation of dollars by foreign central banks and have increased the United States balance-of-payments deficit on the official settlements account basis.[1]

Beginning in January 1971, sales of notes by the Export-Import Bank to foreign branches of United States banks helped to prevent the reduction in commercial bank liabilities to their foreign branches from adding to the accumulation of dollars by foreign central banks. During the first quarter of 1971, two such sales were held totaling $1.5 billion. However, as short-term interest rates in the United States dropped over the first quarter, commercial banks reduced their liabilities to their foreign branches by $3.6 billion, substantially more than the $1.5 billion absorbed by the Export-Import Bank note issues. Partly as a result of this, dollar holdings of foreign central banks continued to swell. Marketable United States Government securities held in custody by the Federal Reserve Banks for foreign and international accounts rose to $15.1 billion on March 31, up $1.9 billion from four weeks earlier and an increase of $3.8 billion since December 30, 1970. To help avert an additional increase in foreign central bank dollar holdings, on April 1 the Department of the Treasury announced plans to offer $1.5 billion in three-month certificates of indebtedness to foreign branches of United States banks.

THE MONEY MARKET

Most rates were relatively steady in the money market during March, in contrast to the precipitous declines experienced in other recent months (see Chart I). The effective rate on Federal funds averaged 3.71 percent in March, virtually unchanged from February's average. Unexpected firmness developed on the eve of the quarterly statement date at the month end. But, in general, the steadiness in the money market climate allowed most short-term rates to move in a trading range that consolidated the sharp declines of earlier months. Rates on three-month Treasury bills, bankers' acceptances, and directly placed commercial paper moved narrowly, ending somewhat higher over the month.

To align their lending rates more closely with other market interest rates, commercial banks cut the prime rate in March by ½ percentage point to 5¼ percent. This was the fifth consecutive month in which the prime rate was lowered, and the reduction brought the rate to its lowest level since March 1966. Despite the prime rate reductions in November and December, commercial bank business loans actually declined during the last quarter of 1970 on a seasonally adjusted basis. Although modest growth resulted in January and February, demand was

[1] For a further discussion, see Charles A. Coombs, "Treasury and Federal Reserve Foreign Exchange Operations", this *Review* (March 1971), pages 43-57.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MARCH 1971

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

Factors	Changes in daily averages— week ended					Net Changes
	March 3	March 10	March 17	March 24	March 31	
"Market" factors						
Member bank required reserves	+ 227	+ 50	− 371	+ 255	− 121	+ 40
Operating transactions (subtotal)	− 700	+ 152	− 288	+ 46	− 68	− 858
Federal Reserve float	− 749	+ 183	− 392	+ 348	− 337	− 947
Treasury operations*	− 99	− 105	+ 508	− 186	− 60	+ 58
Gold and foreign account	+ 17	+ 2	− 5	+ 20	− 41	− 7
Currency outside banks	+ 220	+ 92	− 628	− 177	+ 421	− 72
Other Federal Reserve liabilities and capital	− 89	− 20	+ 230	+ 42	− 53	+ 110
Total "market" factors	− 473	+ 202	− 659	+ 301	− 189	− 818
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 271	− 438	+ 892	− 559	+ 578	+ 744
Outright holdings:						
Treasury securities	+ 327	− 310	+ 132	+ 122	+ 158	+ 429
Bankers' acceptances	− 5	− 2	—	+ 6	− 1	− 2
Repurchase agreements:						
Treasury securities	− 41	− 104	+ 604	− 554	+ 372	+ 277
Bankers' acceptances	− 1	− 15	+ 66	− 43	+ 13	+ 20
Federal agency obligations	− 9	− 7	+ 90	− 90	+ 36	+ 20
Member bank borrowings	+ 8	+ 163	− 131	+ 43	− 76	+ 7
Other Federal Reserve assets†	+ 47	− 15	+ 50	+ 43	+ 44	+ 169
Total	+ 326	− 290	+ 811	− 472	+ 546	+ 921
Excess reserves	− 147	− 88	+ 152	− 171	+ 357	+ 103
	Daily average levels					Monthly averages
Member bank:						
Total reserves, including vault cash	29,542	29,403	29,927	29,501	29,979	29,670‡
Required reserves	29,372	29,322	29,693	29,438	29,559	29,477‡
Excess reserves	170	82	234	63	420	194‡
Borrowings	258	421	290	333	257	312‡
Free, or net borrowed (−), reserves	− 88	− 339	− 56	− 270	163	− 118‡
Nonborrowed reserves	29,284	28,982	29,637	29,168	29,722	29,359‡
Net carry-over, excess or deficit (−)§	187	147	41	106	52	107‡

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 March 31.
§ Not reflected in data above.

quite sluggish again in March. Over the four statement weeks ended March 24, which include the March 15 corporate tax payment date, business loans (adjusted for sales to affiliates) at weekly reporting banks grew by only $0.5 billion. This contrasts with increases of $1.3 billion and $1.0 billion during the corresponding periods in 1969 and 1970, respectively.

The monetary aggregates continued to grow very rapidly in March, although at rates somewhat below the extraordinarily high growth rates posted in February. Since these series are erratic and subject to revision, longer time spans are more useful than monthly movements in examining the behavior of the monetary aggregates. In this vein, over the first quarter of 1971 the narrowly defined money supply (M_1)—currency plus demand deposits held by the public—expanded at a seasonally adjusted annual rate of about 8 percent (see Chart II), compared with the 5.4 percent increase recorded over 1970 as a whole. This brought the growth rate in M_1 over the last six months to about 5½ percent. Commercial bank savings and time deposits other than large certificates of deposit (CD's) have been growing much faster than the narrow money supply. Consequently, M_2—a broader measure of the money supply which includes commercial bank time deposits held by the public less CD's—rose at an extremely rapid seasonally adjusted annual rate of about 17½ percent over the first quarter of 1971, compared with an 8.3 percent growth posted over 1970. Over the last six months, this aggregate expanded at a seasonally adjusted annual rate of about 13½ percent. Largely reflecting the decline in liabilities to foreign branches and commercial paper issued by bank holding companies or other affiliates, the adjusted bank credit proxy has grown less rapidly than M_2 in recent months. Over the first quarter of 1971, the adjusted bank credit proxy increased by about 10½ percent, bringing the growth rate over the last six months to about 10 percent.

THE GOVERNMENT SECURITIES MARKET

Treasury bill rates edged downward in the first half of March but at a much slower pace than in recent months. A somewhat cautious atmosphere prevailed, as market participants appeared uneasy about the recent sharp rate declines that brought them to their lowest levels in seven years. The hesitancy was partially dispelled when one major bank slashed its prime rate by ½ percentage point. However, the March 16 announcement of offerings of new Treasury bills totaling $5 billion without Tax and Loan Account privileges caused a brief reaction in rates.

The Treasury's offering was divided into three segments: $200 million increments to the regular weekly offering of six-month bills for four weeks beginning March 22 through April 12, a $2.0 billion issue of April 22 tax anticipation bills auctioned on March 24, and a strip totaling $2.2 billion auctioned on March 31 (comprising additions of $200 million each to eleven outstanding regular issues due from July 8 to September 16). The new financing package was somewhat larger than had been expected, and rates on many bills rose by nearly ¼ percentage point on the day after the announcement.

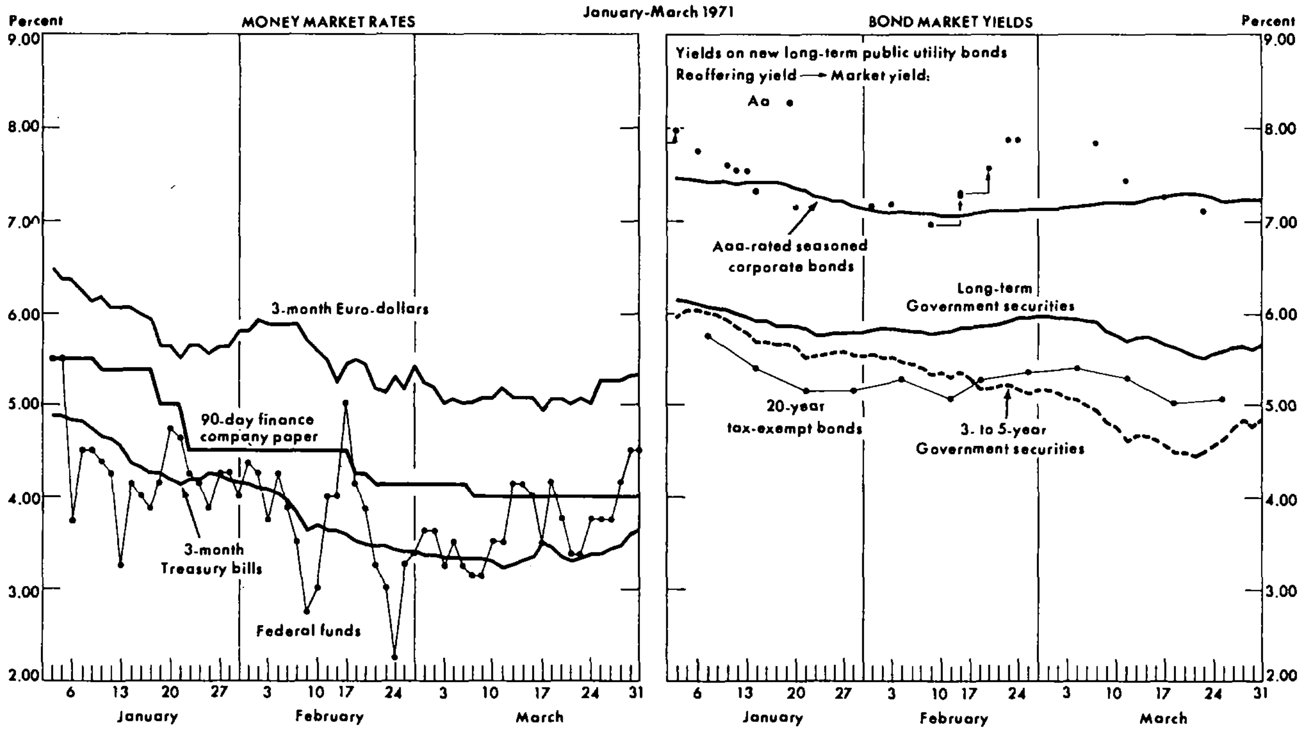
A more cautious tone prevailed in the Treasury bill sector during the remainder of the month, as the weight of additional supply was felt. By the month end, rates on most issues were 10 to 20 basis points higher than at the beginning of the month. The rise in yields over the second half of March followed the downward trend that dated from the beginning of 1970, but still left Treasury bill rates at the close of the month near their lowest levels since 1963.

Yields on Treasury notes and bonds fell steadily until late in the month. Market sentiment was bolstered early in the month by System purchases of coupon-bearing issues and discussion of possible cuts in the commercial bank prime rate. There was also talk of possible reductions in reserve requirements and the discount rate. On March 11, one major bank cut its prime rate to 5¼ percent and yields on Treasury securities plunged in brisk trading. The effect of the prime rate reduction was especially pronounced in the intermediate-term securities market, where yields on some issues dropped as much as 15 basis points in a single day. The rally faltered briefly, as most major banks lowered their prime rates to only 5½ percent. However, yields resumed their downward trend on March 15, when several other major banks reduced their prime rates

Chart I

SELECTED INTEREST RATES

January-March 1971



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 Treasury bills.

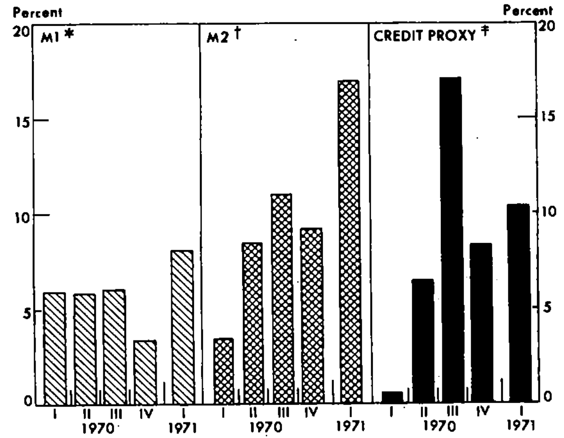
BOND MARKET YIELDS QUOTED: Yields on new Aa-rated public utility bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); daily averages of yields on seasoned Aaa-rated corporate 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.

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates of change



Note: Data for 1971-I are preliminary.

* Currency plus demand deposits held by the public.

† Currency plus demand and time deposits held by the public less negotiable certificates of deposit issued in denominations of $100,000 or more.

‡ Total member bank deposits subject to reserve requirements plus nondeposit liabilities, such as Euro-dollar borrowings and commercial paper issued by bank holding companies or other affiliates.

Source: Board of Governors of the Federal Reserve System.

to 5¼ percent, and the Federal Reserve Board announced that the industrial production index had declined in February by 0.4 percent following a two-month gain.

Market participants were also encouraged by favorable developments in the corporate and municipal bond markets, and yields continued to fall until the last week of the month. However, yields rose moderately at the close of the month, in part because of profit taking by short-term investors. On balance, yields on intermediate-term Treasury securities declined by 33 to 44 basis points over the month, while yields on long-term issues fell 19 to 57 basis points. The decline in long-term bond yields more than erased the rise in February; by the end of the month the average yield on long-term Treasury bonds was at the lowest level since December 1968.

OTHER SECURITIES MARKETS

Strong investor demand reemerged in the corporate and municipal bond markets in March. A record volume of new issues was marketed at declining yields until late in the month, when a cautious atmosphere reemerged and yields moved higher. Investors responded enthusiastically to reductions in the commercial banks' prime rate, the modest rate of increase in the consumer price index during February, and the decline in the industrial production index. The decline convinced many investors that the economy was still weak, that monetary policy would remain stimulative, and that corporate securities offerings would decrease over the next few months. Some evidence that the supply of new corporate issues was beginning to wane was already apparent, and this further bolstered investor confidence. The schedule of dealer-placed corporate bond offerings for April is about $2 billion, less than half the record monthly volume for March but about equal to the monthly average in 1970.

Encouraged by these favorable developments, underwriters bid aggressively for new issues. Yields on newly issued prime corporate bonds plunged 62 basis points over the first three weeks of the month, nearly retracing the 70 basis point increase for February. During the final week of the month, however, yields backed up by about 15 basis points. *The Weekly Bond Buyer's* twenty-bond index of municipal bond yields fell to 5.00 percent in the third week of the month, the lowest level since February 1969. Although the index rose over the remainder of March, by the month end it stood at 5.03 percent, 31 basis points below its level at the end of February.

The fundamental tone of the corporate and municipal sectors was still weak at the beginning of the month, as the market labored under mounting supply pressure and heavy dealer inventories. Investors were cautious and a number of new issues were released from syndicate price

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—March 1971				
	March 1	March 8	March 15	March 22	March 29
Three-month	3.347	3.307	3.307	3.331	3.521
Six-month	3.467	3.359	3.416	3.481	3.695

Maturities	Monthly auction dates—January-March 1971		
	January 26	February 23	March 25
Nine-month	4.268	3.691	3.507
One-year	4.248	3.675	3.586

* 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.

restrictions, resulting in sharp upward yield adjustments.

However, strong investor demand developed on March 9, when a large telephone company offering met an excellent reception. Two days later, when the ½ percentage point reduction in the prime rate was initiated, many other new securities issues sold quickly. The prime rate reduction prompted underwriters to offer an electric utility issue, rated Aa and priced to yield 7.42 percent, 45 basis points below two similarly rated corporate utility bond issues marketed on February 24. The aggressive pricing caused investors to hesitate, and less than half of the bonds were sold on the first day. But with further optimistic news, including announcements that several other major banks had reduced their prime rates by ½ percent, sales picked up. The remainder sold on March 17, when another Aa-rated utility issue was marketed at a yield of 7.25 percent. This new issue also met first-day buyer resistance but sold out one week later.

Investor resistance to further rate declines stiffened toward the end of the month. For example, a $40 million Aa-rated utility bond issue drew a cool response from buyers, when priced to yield 7.10 percent on March 23. At the end of the month, this issue was only about 40 percent sold. When the issue was released from syndicate price restrictions on April 1, its yield rose to 7.42 percent in initial trading.