The Money and Bond Markets in April

There was a widespread increase in money market rates during April, which reduced somewhat the sizable interest rate differentials that had developed in recent months between yields on domestic and European short-term market instruments. As a result of the more reluctant provision of reserves during April, the effective rate on Federal funds climbed back to its January level of 4.1 percent, after having averaged 3.7 percent in February and March. This firming of money market rates also offered some resistance to the rapid expansion of the money supply. In the Treasury bill market, enlarged supplies resulting from recent offerings and the firmer money market contributed to a rise in most bill rates of 30 to 75 basis points over the month. Rates on other short-term instruments such as commercial paper and certificates of deposit (CD's) also rose.

Although the April volume of new corporate and municipal bonds was lower than in March, the supply nevertheless was quite heavy and helped push long-term rates higher during the month. Scattered signs of strength in the economy and concern about the position of the dollar internationally contributed to a cautious approach by investors. The response to new issues was mixed, and syndicate price restrictions on a number of slow-moving bonds were dropped. *The Weekly Bond Buyer's* index of yields on twenty municipal bonds climbed to 5.69 percent on April 29, up 54 basis points from April 1, and yields on new Aa-rated utilities rose by about 80 basis points over the month.

Prices of intermediate-term Treasury coupon issues gave ground during the month when bank profit taking developed as uncertainty over the future trend of interest rates increased. As the month progressed, the approaching May refunding also prompted holders to sell those maturities which they expected to be augmented in the refinancing. Long-term Treasury issues were depressed by the deterioration in the corporate market and by the discussion of the possibility that the Treasury would use its newly obtained authority to issue long-term debt. Some $8.4 billion of notes, $5.8 billion of which is held by the public, will mature in May. The Treasury announced the terms of the refunding after the close of business on April 28. Holders of the maturing notes were offered in exchange a 15-month 5 percent note priced at par and a 3½-year 5¾ percent note priced to yield 5.88 percent. Subscription books for the offering were open until May 5, and payment and delivery will be on May 17. Cash subscriptions were not accepted.

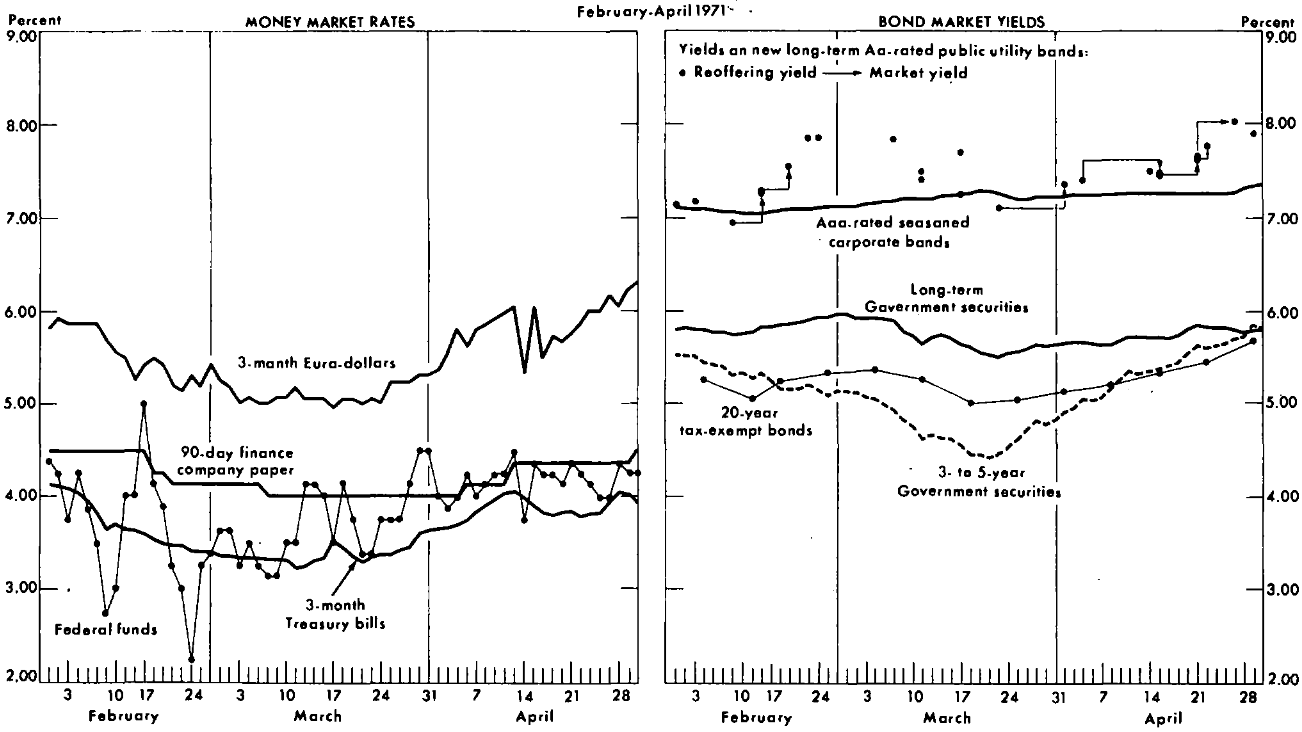
THE MONEY MARKET

Yields on most short-term instruments rose significantly during April (see Chart I). The effective rate on Federal funds averaged 4.16 percent, some 45 basis points higher than the March average, and rates on commercial paper increased substantially in several steps. A rise of ¾ percentage point occurred on prime four- to six-month dealer-placed paper over the month, and increases on some maturities of directly placed paper were as high as 1 percentage point. Bankers' acceptances also posted rate gains amounting to ¾ percentage point, while the most often quoted rate on new 60- to 179-day negotiable CD's at large New York City banks showed about an 88 basis point increase over the month.

Citing overall money market conditions, most major commercial banks lifted their prime rate from 5¼ percent to 5½ percent on April 22 and 23. However, the growth of business loans in large cities continued sluggish, even over the April 15 tax date, and several major banks delayed in following the increase. Excess reserves of $176 million were not substantially different from the $192 million average in March, but member banks reduced their borrowings at the discount window by $160 million to an average level of $152 million in April. As a result, the banks had net free reserves of $24 million on average during the latest period (see Table I).

Expansion of the monetary aggregates tapered off in April, following rapid growth over the two previous months (see Chart II). The narrowly defined money supply (M_1)—currency plus demand deposits held by the public—grew at a seasonally adjusted annual rate of about 7 percent in the seven-month period since

Chart I
SELECTED INTEREST RATES
February-April 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.

September, compared with a 6.0 percent increase over the first nine months of 1970. The growth of time and savings deposits other than large CD's slowed in April from the very rapid rate of the first quarter but remained high by historical standards. M_2, which includes these deposits plus M_1, grew at an annual rate of nearly 14 percent during the past seven months, compared with 7.8 percent during the previous nine months. Primarily as a result of a further decline in liabilities to foreign branches, the adjusted bank credit proxy continued growing more slowly than M_2 in April. During the last seven months the proxy has advanced at about a 9 percent rate, compared with a 10.4 percent rate over the first nine months of 1970.

THE GOVERNMENT SECURITIES MARKET

There was considerable downward pressure on prices of Treasury securities throughout much of April. A major factor contributing to a heavier tone in this market was the unusually large inventories with which Government securities dealers began the month, as well as the relatively high cost of financing these positions. Not only were dealers awarded a sizable volume of bills in the regular weekly and monthly auctions at the close of March, but also they were heavy bidders in two special auctions. These were the March 24 sale of $2.0 billion of tax anticipation bills and the additional $2.2 billion strip of eleven outstanding weekly issues auctioned on March 31.

Commercial banks evinced relatively little interest in the auctions, since they were not permitted to credit their Tax and Loan Accounts for these bills. As the Federal funds and dealer loan rates moved higher during April, along with rates on other money market instruments, Government securities dealers became increasingly anxious to reduce their inventories.

Table I

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

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

Factors	Changes in daily averages—week ended				Net changes
	April 7	April 14	April 21	April 28	
"Market" factors					
Member bank required reserves	+ 171	− 27	− 434	− 263	− 553
Operating transactions (subtotal)	− 469	+ 167	− 111	+ 180	− 233
Federal Reserve float	+ 236	+ 240	+ 336	− 30	+ 782
Treasury operations*	− 243	+ 249	− 131	− 384	− 509
Gold and foreign account	+ 14	− 14	+ 21	+ 1	+ 22
Currency outside banks	− 257	− 483	− 400	+ 590	− 550
Other Federal Reserve liabilities and capital	− 217	+ 174	+ 63	+ 2	+ 22
Total "market" factors	− 298	+ 140	− 545	− 83	− 786
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 215	− 208	+ 414	− 38	+ 383
Outright holdings:					
Treasury securities	+ 128	+ 212	+ 473	+ 30	+ 843
Bankers' acceptances	+ 3	− 3	+ 1	− 1	—
Repurchase agreements:					
Treasury securities	+ 17	− 298	− 50	− 73	− 404
Bankers' acceptances	+ 20	− 51	+ 1	+ 13	− 17
Federal agency obligations	+ 47	− 68	− 11	− 7	− 39
Member bank borrowings	− 59	− 48	− 65	+ 92	− 80
Other Federal Reserve assets†	+ 44	+ 43	+ 124	− 25	+ 186
Total	+ 199	− 212	+ 473	+ 20	+ 489
Excess reserves	− 99	− 69	− 72	− 54	− 294

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash	29,670	29,621	29,973	30,196	29,865‡
Required reserves	29,393	29,417	29,851	30,114	29,694‡
Excess reserves	277	208	136	82	176‡
Borrowings	197	150	85	177	152‡
Free, or net borrowed (−), reserves	80	58	51	− 95	24‡
Nonborrowed reserves	29,473	29,471	29,888	30,019	29,713‡
Net carry-over, excess or deficit (−)§	177	175	172	72	149‡

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 four weeks ended April 28.
§ Not reflected in data above.

Following the sizable inflow of dollars to European central banks in March, participants in the Government securities markets became apprehensive that additional moves might be required for dealing with the nation's balance-of-payments problems. When some firming of short-term rates developed and was allowed to continue, the general interpretation was that a somewhat tighter monetary policy was being pursued in the interest of strengthening the dollar, and this was a further depressant on the market. Moreover, with the approach of the Treasury's May refunding, there was also a substantial amount of selling by dealers and investors alike in those maturity ranges where new offerings were anticipated.

The greatest selling pressure in the Government coupon market was exerted against intermediate-term issues, the prices of which had increased most sharply in recent months. As prices on these issues began to fall below their March levels, a number of sellers appeared, anxious to take profits before further price erosion occurred. In addition, of course, there were many participants who expected the refunding to include an intermediate note and were lightening their positions in preparation. For a while there were also some sales of long-term issues, since it was thought that the Treasury might use its new authority to issue debt outside the 4¼ percent ceiling. However, as rates on long-term corporate and municipal bonds continued to rise, most participants subscribed to the view that real debt lengthening would not be attempted at this time. Over the month of April, yields on Treasury securities with maturities of more than seven years generally increased by 5 to 68 basis points. Those on issues due within seven years jumped by 46 to 123 basis points, carrying them back to the level of late January.

Participants in the Government securities market were initially relieved at the Treasury's decision to keep its exchange offerings within three and one-half years during its May refunding. Prices of longer issues rose and the when-issued securities moved to moderate premiums. However, sizable dealer and bank selling of the longer issues emerged, driving down their prices sharply, before a somewhat steadier tone prevailed at the end of April.

Rates on Treasury bills also advanced on balance during April, but the rise was tempered somewhat during the second half of the month. Primarily as a result of the large dealer inventories, yields increased at the start of the month and bidding at the opening weekly auction was cautious. Sizable foreign purchases provided a temporary boost, but the rise in dealer financing costs and the System's tolerance of a higher Federal funds rate over the long Easter weekend led to an average issuing rate on the new three-month bill of 4.039 percent in the April 12 auction—the first time this rate was above 4 percent since February 1. (This rise led to an increase in the System's rate on repurchase agreements to nonbank dealers in Government securities, since the Federal Open Market Committee requires that rate to be no less than the discount rate or the latest average issuing rate on three-month bills, whichever is lower.) Rates on outstanding issues adjusted upward in response to the auction results, and a sizable investor demand emerged at the higher yields so that over the next several days bill rates trended down.

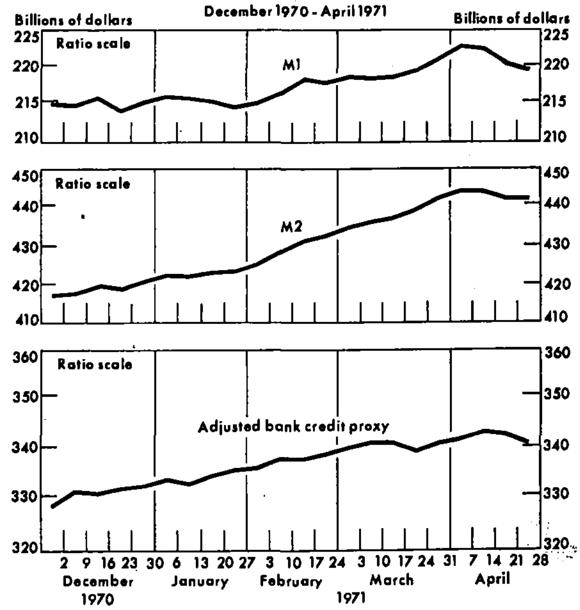
A further source of strength in the bill market after mid-April was the reinvestment demand from some holders of the maturing April tax anticipation bills as well as more than $600 million of Federal Home Loan Bank obligations which were paid off at maturity. In addition, large tax receipts of local governments provided another source of funds. In response to this combination of factors, rates on seasoned bills declined and the average issuing rates on new three- and six-month bills were set at 3.77 percent and 3.96 percent, respectively, in the April 19 auction, 27 and 18 basis points lower than a week earlier (see Table II). Rates continued to decline on balance during the remainder of the week in response to reinvestment purchases and dealer replenishing of shorter term supplies. As the refunding drew nearer, however, apprehension developed concerning the possibility of competition from a new, short-term note, and bill rates trended higher over the final week.

Chart II

MONETARY AND CREDIT AGGREGATES

Seasonally adjusted weekly averages

December 1970 - April 1971



Note: Data for April are preliminary.

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 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.

OTHER SECURITIES MARKETS

The dominant trend in the corporate and municipal bond markets during much of April was a continuation of the price erosion that began in late March. Despite the lower prices, however, investors showed only occasional enthusiasm for the new offerings, and dealer inventories of unsold corporate and municipal bonds mounted steadily during the first half of the month. While the supply of new issues was smaller than in March, when a record $4.2 billion of corporate bonds alone was marketed, the April calendar was still substantial by historical standards. Many investors appeared content to remain on the sidelines, awaiting resolution of some of the domestic and international uncertainties affecting the outlook for interest rates over the months ahead. Confronted with a growing supply of forthcoming offerings and a sizable stock of unsold bonds on their shelves, several underwriter syndicates disbanded and permitted the unsold balances to find their own price in free trading. Yields rose sharply in most instances when these price restrictions were removed, but dealers were able to pare their inventories in this fashion.

The pattern of corporate bond yields and the extent of investor selectivity in recent weeks is well illustrated by the fate of two Aaa-rated Bell System telephone issues. A $125 million offering by New Jersey Bell, priced to yield 7.20 percent on March 30, received only a lukewarm response. The unsold balance of these bonds remained in the market for a couple of weeks, during which it attracted little additional interest, and on April 13 was freed from price restriction as the market prepared for another Bell issue due a week later. In unrestricted trading the yield on the New Jersey balance moved to 7.37 percent from its original 7.20 percent level and buyers began to appear. Subsequently, on April 20, underwriters for $200 million of Illinois Bell Telephone Company mortgage bonds priced these to yield 7.60 percent, several basis points higher than had been expected only a few days earlier. Because the return proved attractive to many investors, some 85 percent of the issue was sold on the day of its initial offering. Over the remainder of April, yields continued to move higher, and a utility issue rated Aa was offered to investors at 7.90 percent at the close of the period. A month earlier a comparable issue was priced to yield 7.10 percent.

Developments in the tax-exempt bond market generally paralleled those in corporate bonds during April, as commercial banks reduced their buying. *The Weekly Bond Buyer's* index of yields on twenty bonds rose from 5.15 percent to 5.69 percent in the April 1 to April 29 period. Municipal bond yields more than retraced their March declines in recent weeks, and the *Bond Buyer's* index closed the month just below its 1971 high of 5.74 percent set on January 7.

The two largest tax-exempt offerings in April were the $258 million serial bonds issued by New York City, the largest such sale in its history, and a $125 million offering by the state of Massachusetts. The Massachusetts bonds were first marketed on the Thursday before the long Easter-Passover holiday weekend. Though these Aa-rated securities were attractively priced, little investor interest was forthcoming on the eve of the holiday. As a result, some $90 million of the bonds remained in dealer inventories for a number of days. Despite the deteriorating market, the sizable New York City offering, by way of contrast, had little difficulty finding buyers after its April 13 sale. While many institutional investors were unable to participate in the New York City offering because the bonds carried only a Baa-1 rating, individuals found the bonds attractive and were the main source of demand.

Following the successful marketing of the New York City bonds, the unsold balance of the Massachusetts issue was resold to a secondary syndicate, which increased the yield to investors by about 20 basis points. This elicited substantial interest and the balance was sold within a brief period. Prices continued to slide in the municipal bond market over the second half of April, as the prospective calendar remained sizable and bank buying was only sporadic. The largest new offering during this period was a $100 million Aa-rated issue of state of California bonds. Despite yields on the bonds some 15 to 20 basis points above the state's previous offering in February, the bonds sold slowly until they were reduced in price.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—April 1971			
	April 5	April 12	April 19	April 26
Three-month	3.703	4.039	3.770	3.865
Six-month	3.754	4.140	3.960	4.087

Maturities	Monthly auction dates—February-April 1971		
	February 23	March 25	April 27
Nine-month	3.691	3.507	4.402
One-year	3.675	3.586	4.422

* 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.