The Money and Bond Markets in April

An atmosphere of uncertainty pervaded the money and bond markets during most of April as investors were concerned about the implications of the resurgence of inflation during recent months. There was considerable speculation early in the month that some major new control effort would be undertaken. After the Congress turned down attempts to legislate a price and interest rollback, expectations of immediate action faded. While the indications of accelerating inflation encouraged higher interest rates, the strong technical positions and limited supplies of new debt instruments in almost all of the credit markets served to mitigate the pressure for higher rates. The result was an uneven pattern of interest rate movements. Generally, rates fell early in April but climbed again before the month was over.

Two well-publicized administered rates were increased during the month. Most major commercial banks raised their prime business loan rate for large borrowers ¼ percentage point during the third week of April to 6¾ percent. This increase was made following action by the Committee on Interest and Dividends to remove restrictions gradually from the lending rate charged large borrowers. Rates charged small businesses will continue to be scrutinized. Subsequently, the Federal Reserve discount rate was raised ¼ percentage point to 5¾ percent.

The adjusted bank credit proxy continued to expand more rapidly than the monetary aggregates, although somewhat less rapidly than in the first quarter. On the other hand, M_1—adjusted private demand deposits plus currency outside banks—advanced strongly again after rising only modestly in the first quarter.

BANK RESERVES AND THE MONEY MARKET

Money market conditions remained firm in April with the effective rate on Federal funds averaging 7.12 percent, compared with the 7.09 percent average established in March. The funds rate became somewhat firmer during the latter part of April. The Board of Governors of the Federal Reserve System announced on April 20 that it had approved a ¼ percentage point increase in the discount rate to 5¾ percent at seven of the Reserve Banks, effective April 23. Similar increases at four other Reserve Banks were approved before the end of the month. Effective May 4, the Federal Reserve Bank of New York, with the approval of the Board of Governors, increased its discount rate of 5¾ percent, thereby restoring a uniform discount rate throughout the System. Member bank borrowings from the Reserve Banks remained quite large in April, averaging $1,685 million in the four weeks ended April 25 (see Table I), about $150 million below the average of the four preceding weeks.

Most short-term interest rates changed little over the month. Rates on bankers' acceptances dipped in mid-April but ended unchanged on balance for the month. Rates offered on 89-day negotiable certificates of deposit (CDs) remained around 7⅜ percent during most of April. The rate on 90- to 119-day dealer-placed commercial paper was increased from 7 percent to 7⅛ percent on April 2, and remained at the higher level throughout the month (see Chart I). Very little commercial paper is being issued at these yields, since the commercial bank prime business loan rate has been below the commercial paper rate for several months. With the cost of borrowing from banks relatively attractive, an unusually large share of business credit demand has been channeled through the banking system.

On April 16, the Committee on Interest and Dividends established new criteria for determining interest rate changes by banks. Under these new guidelines the "large business prime rate" is to be allowed to respond flexibly to changes in money market conditions as long as changes are made gradually. The "small business prime rate"—to be applied to firms whose total nonmortgage borrowings over the preceding twelve months did not exceed $350,000 and whose assets do not exceed $1 million—should remain at levels no higher than those prevailing in mid-April unless an increase can be fully justified by higher costs. In any case, increases should be decidedly smaller and less frequent than changes in the rate charged large firms. Increases in loan rates must not raise a bank's profit margin on domestic operations above the average of the best two

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, APRIL 1973

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

Factors	Changes in daily averages— week ended				Net changes
	April 4	April 11	April 18	April 25	
"Market" factors					
Member bank required reserves	— 504	+ 237	— 552	+ 333	— 486
Operating transactions (subtotal)	+ 286	— 66	— 276	— 356	— 412
Federal Reserve float	+ 71	+ 494	— 23	+ 534	+1,076
Treasury operations*	+ 494	— 315	+ 341	— 536	— 16
Gold and foreign account	— 14	+ 39	+ 7	+ 14	+ 46
Currency outside banks	— 133	— 323	— 676	— 294	—1,426
Other Federal Reserve liabilities and capital	— 132	+ 39	+ 75	— 74	— 92
Total "market" factors	— 218	+ 171	— 828	— 23	— 898
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 998	— 572	+ 743	+ 266	+1,435
Outright holdings:					
Treasury securities	+ 515	+ 186	+ 284	+ 41	+1,026
Bankers' acceptances	—	—	+ 2	+ 4	+ 6
Federal agency obligations	—	— 4	— 4	—	— 8
Repurchase agreements:					
Treasury securities	+ 422	— 689	+ 406	+ 169	+ 308
Bankers' acceptances	+ 33	— 49	+ 21	+ 28	+ 33
Federal agency obligations	+ 28	— 16	+ 34	+ 24	+ 70
Member bank borrowings	— 259	— 252	+ 346	— 211	— 376
Seasonal borrowings†	—	—	—	+ 9	+ 9
Other Federal Reserve assets‡	+ 29	+ 30	+ 57	+ 115	+ 231
Total§	+ 662	— 794	+1,146	+ 179	+1,193
Excess reserves‡	+ 444	— 623	+ 318	+ 156	+ 295

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash‡	32,619	31,759	32,629	32,452	32,365‖
Required reserves	32,082	31,845	32,397	32,064	32,097‖
Excess reserves§	537	— 86	232	388	268‖
Total borrowings	1,755	1,502	1,848	1,637	1,685‖
Seasonal borrowings†	—	—	—	9	2‖
Nonborrowed reserves	30,864	30,257	30,781	30,815	30,680‖
Net carry-over, excess or deficit (—)**	29	268	36	154	122‖

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.

§ Adjusted to include $172 million of certain reserve deficiencies on which penalties can be waived for a transition period in connection with bank adaptation to Regulation J as amended effective November 9, 1972. The adjustment amounted to $450 million from November 9 through December 27, 1972 and $279 million from December 28, 1972 through March 28, 1973.

‖ Average for four weeks ended April 25.

** Not reflected in data above.

years in the four preceding calendar years.

Following the announcement of the new loan rate criteria, most major banks increased their large business prime rate to 6¾ percent from 6½ percent. Early in May, a number of major banks increased their large business prime rate by another ¼ percentage point to 7 percent.

On April 5, the Board of Governors announced a revision of Regulation A which covers discount operations, establishing a seasonal borrowing privilege. Traditionally, the privilege of borrowing at the Federal Reserve discount window was designed primarily to help banks adjust to temporary requirements for funds, to cushion more persistent outflows, and to aid banks in emergencies or other unusual situations. Borrowing by an individual bank for an extended period of time is normally discouraged. The seasonal borrowing privilege, on the other hand, is intended to be used to meet stringencies that recur at about the same time each year and persist for at least eight consecutive weeks. It is designed primarily to help the smaller banks that do not have direct access to the national money markets to meet the seasonal borrowing needs of their communities. To use the privilege, the bank must apply in advance of the period of need. In determining its qualification for seasonal credit, the Reserve Bank will review the bank's deposit and loan figures over the preceding five years. The borrowing bank would be expected to finance that part of its seasonal need equal to 5 percent of the preceding year's average deposit level.

In the statement week ended April 25, the first week that the seasonal borrowing privilege was operational, only a few banks took advantage of the privilege, borrowing $9 million. In Table I seasonal borrowings are included with other borrowings and are also listed separately. Free or net borrowed reserves have been dropped from the table, but may be calculated by simply subtracting total borrowings from excess reserves. Alternatively, for some purposes it may be desirable to add back in seasonal borrowings inasmuch as they do not entail the same pressure for repayment as do traditional borrowings.

According to preliminary data that are subject to revision, the growth of the narrowly defined money supply (M_1) is estimated to have accelerated in April to a seasonally adjusted annual rate of approximately 7 percent. Over the three months ended in April, M_1 is estimated to have grown at an annual rate of about 4¼ percent. Over the year ended in April, M_1 rose about 6¼ percent (see Chart II). Savings and time deposits other than large CDs rose at an annual rate of about 9 percent in April, according to preliminary estimates. M_2—which adds these deposits to M_1—is estimated to have increased in April at an annual rate of approximately 8 percent. This brought the growth rates of M_2 during the three and twelve months ended in April to about 6¼ percent and 9 percent, respectively.

The adjusted bank credit proxy decelerated somewhat from the 15 percent seasonally adjusted annual pace established in the first quarter but continued to grow faster than the monetary aggregates. Current estimates indicate a growth rate of about 13¼ percent in April. The first-quarter expansion in the proxy reflected the strong demand for bank credit which led to an explosive increase in large CDs combined with the rising level of deposits in Treasury Tax and Loan Accounts. In April, the Treasury began to run down its deposits, but CDs continued to increase at a rapid pace despite a large decline in the week that included the income tax date. Banks have been offering high rates on CDs with an initial maturity of thirty to eighty-nine days because Regulation Q ceilings on these deposits have been suspended. Reserves available to support private nonbank deposits (RPD) expanded at an estimated seasonally adjusted annual rate of 10 percent in April.

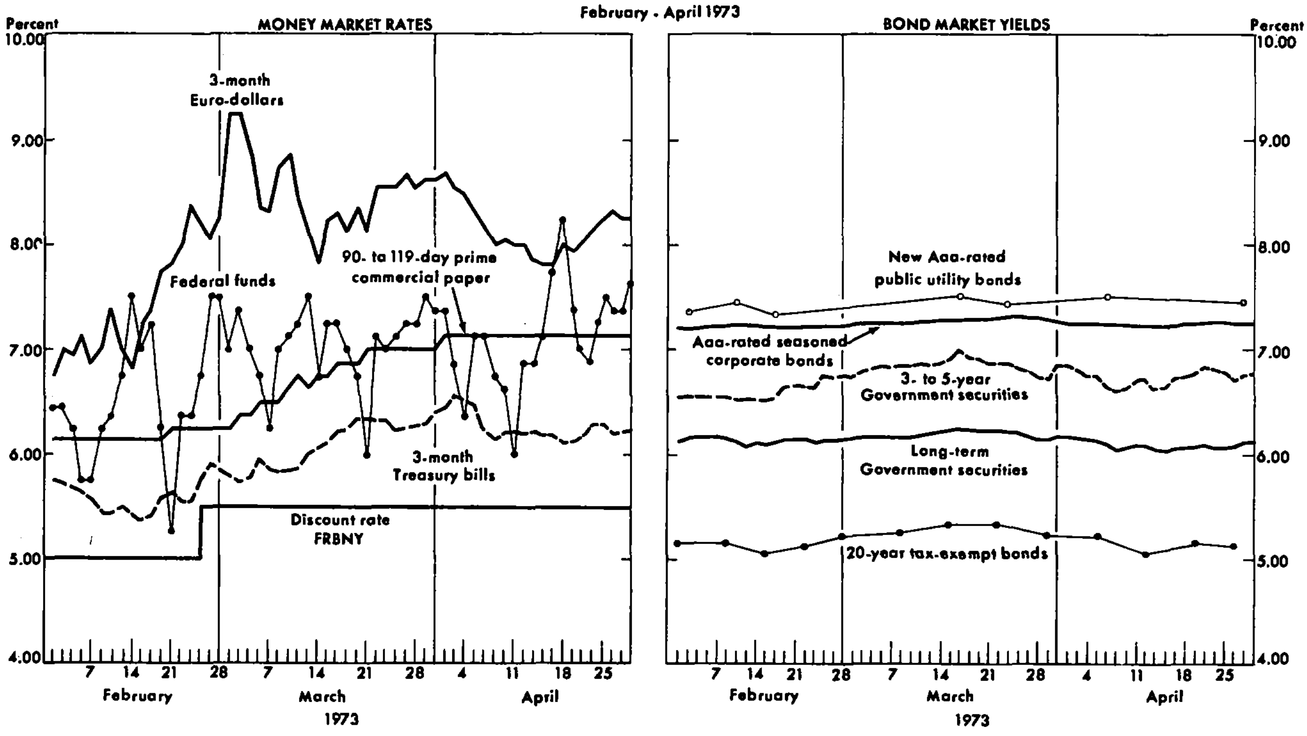
THE GOVERNMENT SECURITIES MARKET

A number of factors combined to produce relatively large swings in yields on Treasury securities during April. A sense of gloom pervaded the markets when the month began, as market participants worried about the signs of accelerating inflation. Yields on Treasury securities had al-

Chart I

SELECTED INTEREST RATES

February - April 1973



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; 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 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).

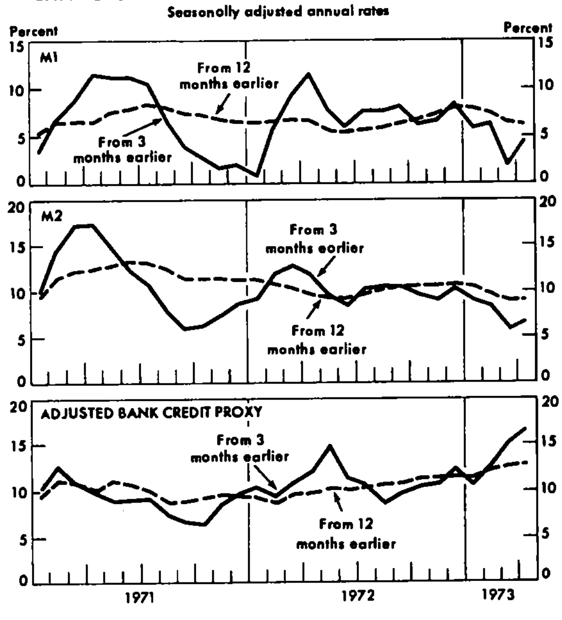
Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, Inc., and The Bond Buyer.

ready risen sharply in March and appeared headed for further increases in April. Then quite suddenly market sentiment changed and rates dropped dramatically at the end of the week. The announcement of a soaring increase in the wholesale price index on Thursday, April 5, might have been expected to extend the apprehensiveness about inflation even further. Instead it apparently lent credence to the rumors that some major new measures would be taken to fight inflation. On April 16, the House of Representatives rejected a bid for price rollbacks and ceilings and passed a bill extending the President's wage-price authority for another year. This action, along with statements by Administration spokesmen about the disadvantages of stricter controls, tended to dampen rumors of immediate action in that area and rates started to move upward again. The announcement of the very large increase in gross national product during the first quarter further contributed to investor caution.

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for April 1973 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 sources of funds, such as Euro-dollar borrowings and the proceeds of commercial paper issued by bank holding companies or other affiliates.
Sources: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York.

Treasury bill rates declined dramatically on April 6, reflecting a thin market supply as well as the improved market sentiment. In line with the declines in yields on outstanding bills, average issuing rates on three- and six-month bills fell about 34 and 55 basis points, respectively, between the April 2 and April 9 bill auctions (see Table II). Subsequent trading activity tended to favor the shorter maturities, while interest in the six-month bill proved limited at the lower levels. By the April 30 auction, the yield spread had increased to about 30 basis points after having fallen to 8 basis points at the April 9 auction. Nevertheless, both rates remained slightly below the yield set at the beginning of April. In the monthly auction of 52-week bills held April 24, the average issuing rate was 6.598 percent, slightly below the rate established in the previous month's auction. For the month as a whole, rates on most outstanding issues declined about ⅛ to ¼ percentage point.

The Treasury coupon market also experienced a rally at the end of the first week of April, but gradual price erosion set in a few days later as expectations of price ceilings and hopes for less restrictive Federal Reserve policy faded. Small floating supplies served to restrain the volume of trading and limited price declines.

There has been a relatively skimpy supply of Treasury securities available in the markets for some weeks. This occurred because of heavy purchases of marketable debt by foreign central banks early in the year and because the only new cash raised by the Treasury in the domestic market since mid-January has come from $100 million additions to the monthly bill auctions. Instead, the Treasury satisfied most of its needs for cash through the issue of almost $8 billion of special securities to foreign official institutions in February and March. Although the floating of most exchange rates has ended the speculation that led the foreign central banks to make large securities purchases, no major redemptions of these securities have as yet taken place.

The Treasury decided to use part of its comfortable cash position to pay off about $1.65 billion of the $4.3 billion of publicly held notes maturing May 15, 1973. On April 25, the Treasury announced that it would auction to the public up to $2 billion of seven-year 6⅞ percent notes and up to $650 million of 25-year 7 percent bonds payable either in cash or in maturing notes. The 25-year bonds have the longest maturity of any Treasury debt issued since 1965. For the bond auction, the Treasury employed the technique, which was used in a sale of bonds in January, of awarding all of the bonds at the price of the lowest accepted bid. The notes were sold at an average issuing yield of 7.01 percent, and the bonds were issued at a yield of 7.11 per-

Table II
AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS
In percent

Maturities	Weekly auction dates—April 1973				
	April 2	April 9	April 16	April 23	April 30
Three-month	6.531	6.187	6.187	6.251	6.278
Six-month	6.814	6.268	6.389	6.630	6.575

Maturities	Monthly auction dates—February-April 1973		
	February 22	March 27	April 24
Fifty-two weeks	6.051	6.615	6.598

*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.

cent. Additional amounts of the notes and bonds were allotted to Government accounts and the Federal Reserve Banks, which hold $5.3 billion of the maturing notes.

Most of the offerings by Federal agencies in April were well received. On April 4, the Federal Land Banks raised $555.6 million of new money with a $988.6 million three-part issue. The 9½-year bonds yielded 7.30 percent. On April 26, a five-year note offered by the Farmers Home Administration sold out quickly at a 7.20 percent yield but a fifteen-year bond yielding 7.52 percent sold slowly.

OTHER SECURITIES MARKETS

Prices in the corporate and municipal bond markets generally advanced early in the month and fell back later on. The rally late in the first week of April aided sales of the two major bond offerings marketed April 5. Strong demand was evident for $50 million of Aa-rated thirty-year public utility bonds offered competitively and priced to yield 7.58 percent. The $125 million of A-rated thirty-year debentures of the Province of Quebec sold quickly at a yield of 7.90 percent.

There was very little new-issue activity in the taxable bond sector again until the last full week of April. A $150 million offering of Aaa-rated 25-year Tennessee Valley Authority (TVA) bonds on April 17 was priced to yield 7.35 percent. These bonds generally sell at rates that are slightly below those offered on utility bonds of a private company with an Aaa rating. The yield offered on the TVA bonds was lower than market expectations and the bonds sold poorly. When the bonds were released from syndicate price restrictions on the following Monday, the yield rose to 7.46 percent.

In contrast, a $125 million issue of Aaa-rated forty-year telephone company debentures sold well on April 24 at a yield of 7.53 percent. The return on the debentures was somewhat below the 7.625 percent yield offered initially on similar debentures sold March 20. The success of the new issue was at least partially attributable to the strong technical position of the market. Prices on older corporate securities were buoyed by the good reception given the telephone securities. A companion issue of seven-year notes, however, sold slowly at a 7.07 percent yield.

Demand was relatively strong in the tax-exempt sector and most new issues sold out quickly. The largest offering of the month consisted of $285.4 million of New York City various-purpose bonds issued April 11. The bonds, which are rated A by Moody's and BBB by Standard and Poor's, were priced to yield from 4.25 percent for 1974 to 6.20 percent for those due 1996-2013, about 70 basis points above the yields on New York City bonds sold last December. Sales benefited from the relative scarcity of tax-exempt debt available. The Blue List of dealer inventories fell to $511 million on April 6, the lowest level this year. Inventories rose later in the month but remained relatively comfortable, closing at $633 million.

Yields on outstanding issues declined at first, with The Bond Buyer index of twenty tax-exempt bonds dropping from 5.26 percent on March 29 to 5.07 percent on April 12, the lowest level in two months. Reflecting the increases in yields in other sectors, the index advanced again the following week and ended the month at 5.14 percent.