The Money and Bond Markets in April

Interest rates continued to move higher during April. The firm stance of monetary policy, coupled with exceptionally rapid inflation and substantial credit demands, exerted upward pressure on a broad spectrum of rates and led to expectations that rates might climb even further over the near term. In the money market, the rate on four- to six-month commercial paper rose about 1½ percentage points, and the rate on bankers' acceptances also increased. The average effective rate on Federal funds rose to 10.51 percent from its average of 9.35 percent in March, and most commercial banks raised their prime lending rates on loans to large business borrowers to a record 10½ percent during the month. Early in May, most major banks boosted their prime rates further in two ¼ percentage point steps to 11 percent. In recognition of the increases that had already occurred in other short-term rates and in light of a recent rapid rise in money and bank credit, the Board of Governors of the Federal Reserve System approved an increase in the discount rate at seven Federal Reserve Banks, including New York. Effective April 25, the rate at these banks rose to 8 percent from its previous record high of 7½ percent. By April 30, all twelve Reserve Banks had established an 8 percent discount rate.

Bond yields also increased over the month in the face of heavy corporate and municipal calendars and an approaching Treasury refunding. In addition, since the latest economic data showed no letup in inflation and no widespread softening in the economy, hopes for a near-term easing of monetary policy faded. Two statements by Federal Reserve Board Chairman Burns emphasizing the System's determination to curb inflation by moderating the growth of money and credit served to confirm this view. Over the month, the yield on three- to five-year Treasury coupon issues registered about a 50 basis point increase while the increase in the yield on long-term Government issues was somewhat smaller. Rates on Treasury bills were mixed during much of April, but yields on all maturities rose sharply in the final week. In the corporate market, yields on newly issued Aaa-rated utility bonds climbed above 9 percent, reaching their highest level since June 1970. By the end of April, The Bond Buyer index of municipal bond yields stood at its highest level since August 1971.

Preliminary data indicate that the seasonally adjusted narrow money stock (M_1)—private demand deposits adjusted plus currency outside commercial banks—grew at a rapid rate in the four statement weeks ended April 24 following very large increases in both February and March. However, the growth of time and savings deposits at commercial banks, other than large negotiable certificates of deposit (CDs), was more moderate, and the broad money stock (M_2)—M_1 plus consumer-type time and savings deposits at commercial banks—rose less rapidly than M_1 in April. Primarily as a result of a substantial increase in CDs, the adjusted bank credit proxy, which includes deposits of member banks plus certain nondeposit liabilities, rose sharply in the four-week period ended April 24. On April 22, Chairman Burns announced that the Board of Governors would begin to publish, together with the policy record of the Federal Open Market Committee, the numerical specifications that guide open market operations in the period between Committee meetings. (The policy record continues to be published with a three-month lag, and hence publication of the numerical specifications involves a similar lag.) The data cover specifications for M_1, M_2, reserves available to support private nonbank deposits (RPD), and the Federal funds rate. Earlier records had contained specifications only for RPD. In an accompanying staff paper, it was pointed out that, while these short-run specifications are guides in the conduct of open market operations between Committee meetings, they in turn are determined in the context of the Committee's longer run objectives for monetary aggregates and credit conditions generally.

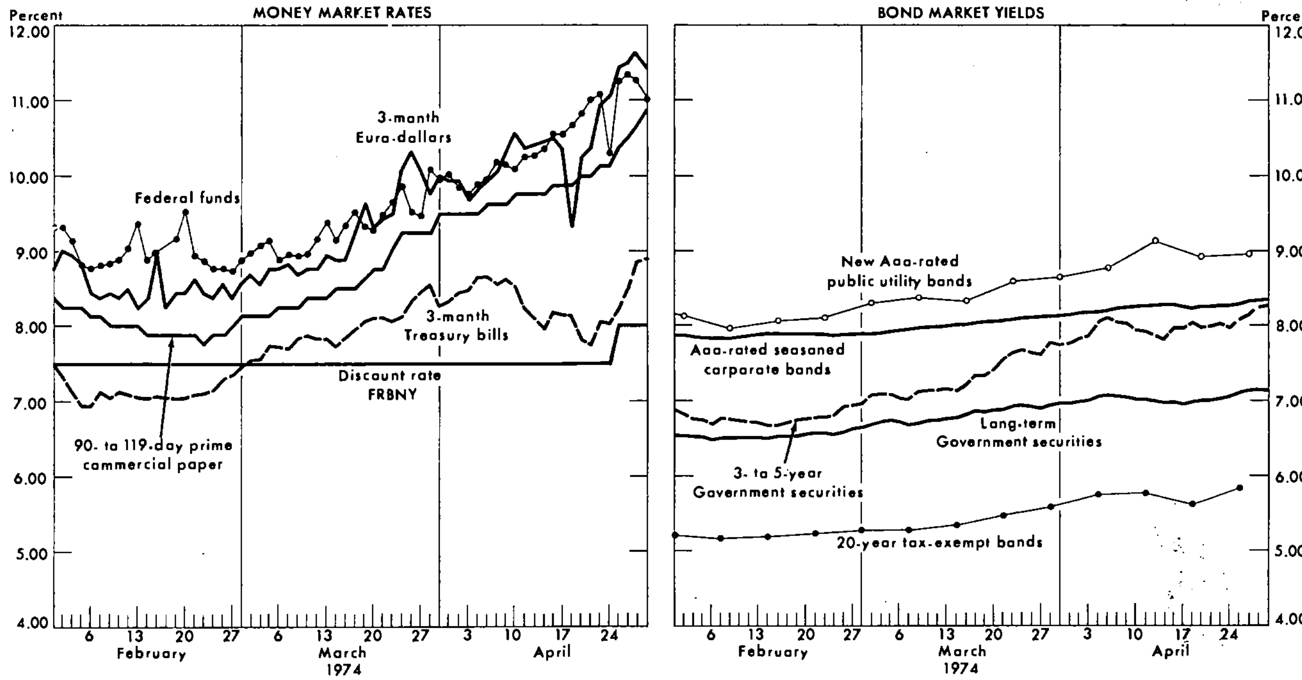
THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

Rates on most money market instruments rose further during April, as the firm stance of monetary policy contributed upward pressure on most short-term interest rates (see Chart I). The effective rate on Federal funds

Chart I

SELECTED INTEREST RATES

February - April 1974



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-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.

climbed to an average of 10.51 percent in April, 116 basis points higher than in March and 154 basis points above the February level. Commercial paper rates registered increases during the month ranging from ⅝ to 1½ percentage points, while rates on bankers' acceptances rose 1¼ percentage points. In line with the rise in other money market rates, most major commercial banks raised their prime lending rate for large business borrowers in several steps during April to a record 10½ percent, up from 9¼ percent at the end of March. As in the preceding two months, commercial banks also increased their reliance on the discount window in April. The average level of borrowings rose $333 million during the month to $1,611 million (see Table I). Effective April 25, the Board of Governors of the Federal Reserve System approved an increase in the discount rate at seven of the Federal Reserve Banks, including New York, from 7½ percent to 8 percent. This was the first increase in the discount rate since August 1973; the 8 percent rate became uniform throughout the Federal Reserve System by the end of the month.

According to preliminary data, M_1 continued to expand rapidly in the four statement weeks of April. As a result, seasonally adjusted daily average M_1 rose at a substantial 10½ percent annual rate in the four weeks ended April 24 relative to its average of the four weeks ended thirteen weeks earlier (see Chart II). From its four-week average of a year earlier, M_1 grew a sizable 6.9 percent. The growth of commercial bank time and savings deposits other than large CDs was moderate in April, and the advance of M_2 was less rapid than that of M_1. However, growth of M_2 in the four weeks ended April 24 relative to its average of the four-week period ended a year earlier was in excess of 9 percent.

Faced with heavy loan demand and rising rates on other short-term instruments, commercial banks raised their offering rates on large negotiable CDs and attracted a substantial volume of funds through this instrument in April. At the end of the month, the secondary market rate on CDs of three months' maturity was 11.03 percent, a rise of 143 basis points over the period. Over the four statement weeks in April, the volume of CDs outstanding increased by about $7 billion. Primarily as a result of this large expansion in CDs, the adjusted bank credit proxy also rose sharply over the four statement weeks in April. Relative to its four-week average level in the period ended thirteen weeks earlier, the proxy grew at a seasonally adjusted annual rate of 14.4 percent in the four-week interval ended April 24. The proxy advanced 10.2 percent from its average level a year earlier.

THE GOVERNMENT SECURITIES MARKET

Yields on Treasury securities increased during April. There was a cautious atmosphere prevailing in the coupon market at the beginning of the month, as a result of the relatively firm conditions in the money market and the announcement of a fairly sizable Federal agency offering. Prices initially drifted lower in light activity, but then the decline accelerated in response to several factors which seemed to preclude any near-term easing of monetary policy. The release of economic data revealed a further rapid rise in wholesale prices and a slight decline in the unemployment rate during March. In addition, Chairman Burns stated that the Federal Reserve System was determined to permit only moderate growth of money and credit in view of the high domestic rate of inflation. Prices subsequently improved briefly, as participants became hopeful that the 10 percent prime rate established by most major commercial banks would reduce credit demands and help to slow the upward spiral of interest rates.

Prices on Government notes and bonds resumed their downtrend after midmonth in the face of only modest investor demand and rising costs of financing inventories. An increasingly cautious tone developed as the month progressed, in part because of the proximity of the May Treasury refunding. Further statements by Chairman Burns to the effect that the System was determined to subdue inflation reinforced concern, since such a course for monetary policy was seen as resulting in higher inter-

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, APRIL 1974

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

Factors	Changes in daily averages— week ended				Net changes
	April 3	April 10	April 17	April 24	
"Market" factors					
Member bank required reserves	− 612	+ 277	− 974	− 5	−1,314
Operating transactions (subtotal)	+ 338	+ 607	− 309	− 524	+ 112
Federal Reserve float	+ 35	+ 233	+ 660	− 198	+ 730
Treasury operations*	+ 435	+ 565	+ 81	− 343	+ 738
Gold and foreign account	− 65	+ 72	− 130	+ 170	+ 38
Currency outside banks	− 23	− 494	− 787	− 158	−1,462
Other Federal Reserve liabilities and capital	− 44	+ 232	− 126	+ 5	+ 67
Total "market" factors	− 274	+ 884	−1,283	− 529	−1,202
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 495	− 785	+ 962	+ 158	+ 830
Outright holdings:					
Treasury securities	+ 157	+ 2	+ 166	+ 198	+ 523
Bankers' acceptances	− 1	+ 1	− 1	+ 5	+ 4
Federal agency obligations	+ 24	—	—	+ 147	+ 171
Repurchase agreements:					
Treasury securities	+ 146	− 558	+ 674	− 247	+ 15
Bankers' acceptances	+ 86	− 131	+ 32	+ 70	+ 57
Federal agency obligations	+ 83	− 99	+ 91	− 15	+ 60
Member bank borrowings	− 210	− 309	+ 622	+ 111	+ 214
Seasonal borrowings†	+ 4	− 7	+ 6	+ 7	+ 10
Other Federal Reserve assets‡	+ 56	+ 46	+ 31	+ 56	+ 189
Total§	+ 331	−1,048	+1,615	+ 325	+1,223
Excess reserves‡	+ 57	− 164	+ 332	− 204	+ 21

	Daily average levels				Monthly averages‖
Member bank:					
Total reserves, including vault cash‡	35,443	35,002	36,308	36,109	35,716
Required reserves	35,217	34,940	35,914	35,919	35,498
Excess reserves§	226	62	394	190	218
Total borrowings	1,503	1,194	1,817	1,928	1,611
Seasonal borrowings†	48	41	47	54	48
Nonborrowed reserves	33,940	33,808	34,491	34,181	34,105
Net carry-over, excess or deficit (−)#	105	143	38	173	115

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 $58 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 $67 million from January 2 to March 27, 1974.

‖ Average for four weeks ended April 24, 1974.

Not reflected in data above.

est rates and heavy borrowing by Federal agencies to support housing. Over the month as a whole, yields on securities maturing within five years were generally 40 to 88 basis points higher, while those on most longer term issues rose 5 to 59 basis points.

After the close of business on May 1, the Treasury announced the terms of its refinancing of the $5.6 billion of publicly held securities which mature May 15. The Treasury will provide funds for retiring some $4.1 billion of the maturing notes and bonds by auctioning three issues to the public. These consist of up to $2 billion of 25 ½-month notes, up to $1¾ billion of 4 ¼-year notes, and up to $300 million of 25-year bonds. The coupon rate on the notes was set at 8¾ percent, while the rate on the bonds was placed at 8½ percent. The Treasury will use available cash to handle the balance of the maturing issues.

Rates on Treasury bills also rose early in April. Investor demand was light, and the market reacted unfavorably to news of underlying strength in the economy and burgeoning growth in money and credit. A limited supply of bills in the six-month maturity range resulted in strong bidding for such bills in the first two weekly auctions of the month, however (see Table II). Rates subsequently fluctuated in a narrow range until shortly after midmonth. Substantial demand, particularly for shorter term bills, emerged when a sizable volume of Treasury tax anticipation bills matured on April 19, and a sharp drop in rates ensued. However, following the increase in the discount rate on April 25, bill rates began moving higher. Rates continued rising over the remainder of the month in response to lackluster demand and concern on the part of some participants that the Treasury would offer additional bills either as part of the May refunding or shortly after the conclusion of that operation. For the month as a whole, bill rates rose 25 to 70 basis points.

On April 23, the Treasury announced that, beginning with the regular weekly auction the following Monday, the Federal Reserve System may exchange the maturing bills it holds for System and official customer accounts for new issues at the average issuing price rather than having to bid competitively for the bills. The amount of maturing bills held in such accounts and eligible for exchange on a noncompetitive basis will also be disclosed each week in the regular auction announcements. On May 1, the Treasury announced that from May 16 through June 13 it will increase the amount of the regular weekly offering of Treasury bills by $200 million each week.

Yields on Federal agency issues moved higher in April, in concert with yields in the Treasury coupon and corporate bond markets. Early in the period, the Federal Land Banks issued three bonds totaling about $1.3 billion. Offered at par, these included $300 million of 8.30 percent fifteen-month bonds, $400 million of 8.25 percent two-year bonds, and $565 million of 8.25 percent three-year bonds. Demand for the two shorter maturities was good, but there was less enthusiasm for the three-year bonds. Around the middle of April, the two other major farm credit agencies marketed new issues which encountered mixed receptions. Specifically, the Banks for Cooperatives offered $211.7 million of six-month 8.65 percent bonds which sold quite well. The initial response was somewhat less favorable to $674 million of 8.80 percent nine-month bonds offered by the Federal Intermediate Credit Banks.

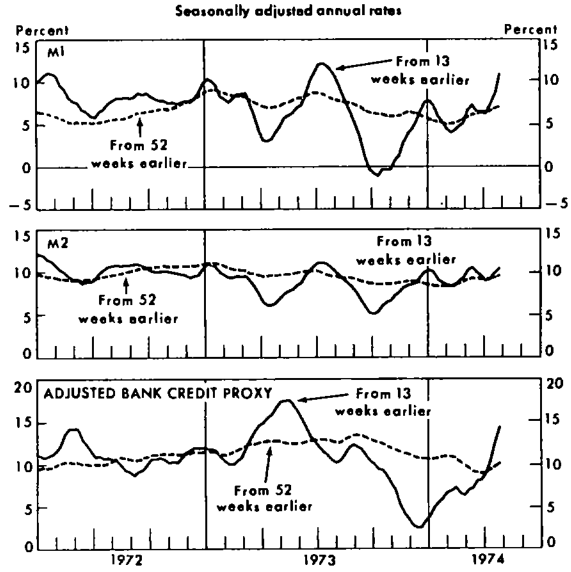
THE OTHER SECURITIES MARKETS

Yields on corporate and municipal bonds rose substantially during the first two weeks of April, as both markets were confronted with the largest calendars in recent

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 April 24, 1974.

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.

months. Investor response to the higher rate levels was generally favorable, particularly in the tax-exempt sector, and the markets steadied somewhat until the final week of the period when prices weakened again. On April 25 the Federal Reserve Board's series on recently offered Aaa-rated utility bond yields reached 9.08 percent, its highest level since June 1970, and The Bond Buyer index of twenty municipal bond yields climbed to a 2¾-year high of 5.82 percent.

As the month began, investors showed little interest in the first large corporate offering, $100 million of Bell System debentures. Despite the fact that this Aaa-rated issue maturing in thirty-five years carried a yield of 8.65 percent, the bonds sold slowly and, when freed from syndicate price restrictions, the yield adjusted upward by some 10 basis points. A much more enthusiastic reception was afforded to the next large taxable issue, $150 million of A-rated debentures. This issue was priced to yield 9.20 percent in thirty years and also had a provision for deferred payment for large investors and an unusually long call protection period. Shortly after this issue was sold, investors evidenced some indifference to an Aa-rated utility company offering yielding 9 percent. However, the following day, in the wake of the successful sales of several new issues which were very attractively priced, additional demand developed for these thirty-year utility bonds, and they also moved well.

The tone in the corporate bond market remained good following the Easter weekend, and three large issues totaling $300 million were first-day sellouts. These included $100 million of debentures of one of the few industrial corporations with an Aaa rating; the debentures provide a yield of 8.44 percent in thirty years. In addition, $125 million of Aa-rated industrial bonds yielding 8.57 percent in twenty-five years sold quickly, as did $75 million of Aa-rated utility bonds paying 8.90 percent in thirty years. Several large corporate issues were marketed during the last week in April and encountered favorable receptions. The largest of these—$300 million of Aaa-rated industrial bonds—was priced to yield 8½ percent in thirty years, an exceptionally high return for such an issue.

There was good demand for most of the new tax-exempt issues which were marketed during April. Yields on the first two large offerings of the month were some 20 to 35 basis points higher than on preceding comparable issues, and investors responded well. On April 10, New York City sold a $436.6 million issue, reportedly the largest offering ever marketed by a local government. The bonds attracted sizable interest, particularly from small investors. The average cost to the city of 6.18 percent was 1 percentage point higher than at its previous sale in January. The A-rated bonds, which are exempt from New York City, New York State, and Federal taxes, were successfully marketed at yields ranging from 5.5 percent in 1975 to 6.5 percent in 2003-14. Their warm reception buoyed the market generally, and several large issues sold well the following week. One of these was a $110 million offering of Aaa-rated tax-exempt securities scaled to return about 25 basis points less than a comparable issue sold eight days earlier. Over the remainder of the period, however, rates on municipal bonds resumed their rise and closed the month some 25 basis points higher, on balance. The Blue List of dealer inventories fell $183 million to a level of $474 million in April.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—April 1974				
	April 1	April 8	April 12	April 22	April 29
Three-month	8.358	8.648	8.051	7.857	8.909
Six-month	8.211	8.393	8.084	7.995	8.706

Maturity	Monthly auction dates—February-April 1974		
	February 6	March 6	April 3
Fifty-two weeks	6.342	6.897	7.886

* Interest rates on bills are quoted in terms of a 360-day year, with the discounts from par as the return of the face amount of the bills payable at maturity. Bond yield equivalents, related to the amount actually invested, would be slightly higher.