The Money and Bond Markets in April

Interest rates in the money and bond markets declined through most of April but posted sharp increases near the end of the month. According to market analysts, good news on inflation played a part in the declines in long-term rates in March and early April. In mid-April, however, new reports confirmed that a brisk economic recovery was under way, and long-term rates began to rise. Thereafter, underwriters encountered difficulty distributing some new corporate debt issues, which had been priced when market conditions were more favorable. Toward the end of the month, amid reports of substantial growth in the monetary aggregates, many investors came to believe that the Federal Reserve might have adopted a less accommodative stance and money market rates rose sharply. Yields on state and local government debt declined on average for the second straight month.

On April 28, the Treasury announced plans for its current quarterly refinancing. The amount of new cash to be raised and the maturity composition of the offerings were in line with what investors had expected and had little effect on yields in the debt markets. The Treasury ultimately raised $3.4 billion in new cash and refunded $4.1 billion of maturing publicly held debt.

Preliminary estimates of the narrowly defined money stock (M_1) indicate a rapid acceleration in its growth during April. Growth in the more broadly defined money stock (M_2) also increased sharply. Further declines in large negotiable certificates of deposit (CDs) outstanding, however, held the bank credit proxy to a modest advance.

THE MONEY MARKET AND THE MONETARY AGGREGATES

Interest rates on money market instruments ended April little changed on balance, as downward movements during most of the month were reversed by sharp increases in the final week. The effective rate on Federal funds averaged 4.82 percent over the month as a whole. While this was 2 basis points below the average of the previous month, in the final statement week the average rate rose 15 basis points over its average in the previous week to 4.93 percent (see Chart I). At the end of April, yields on 90- to 119-day dealer-placed commercial paper were 5⅛ percent, about the same as at the end of March. Rates on 90-day bankers' acceptances fell by 15 basis points during April to 5.03 percent. The average yield in the secondary market on 90-day CDs closed the period at 5.13 percent, down 6 basis points. Member bank borrowings from the Federal Reserve during the month continued at about frictional levels (see Table I), as other money market interest rates remained well below the discount rate.

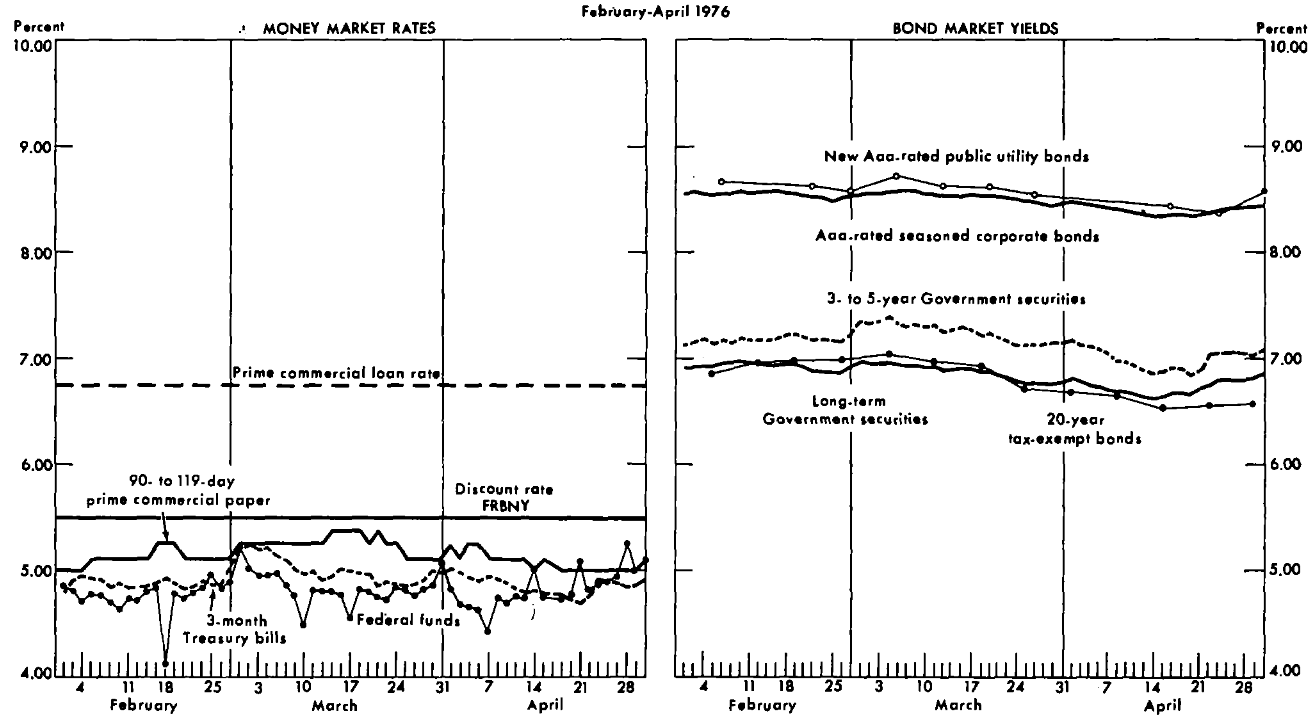
The demand for business loans was again weak in April, and commercial paper outstanding increased only moderately. Commercial and industrial loans at large commercial banks, including loans sold to affiliates, fell by $1.3 billion over the four statement weeks ended April 28. The average increase in these loans during April was about $1 billion in the previous five years. Even in comparison with other postwar economic recovery periods, the demand for business loans has been very weak. Usually business loans increase in the upturn, but since April 1975, about when this recovery started, business loans have declined by 3.8 percent. Some economists attribute this weakness to the large volume of internal funds currently available to corporations. Others point to the fact that inventory accumulation, which is frequently financed by bank loans, has begun rather late in this recovery. The decline in business loans has led, in turn, to the substantial runoff in large negotiable CDs observed in recent months and to an increase in bank holdings of Government securities. Most banks have not, however, responded to the weak bank loan demand by lowering the prime lending rate, which remained at 6¾ percent through the end of April. One major bank did lower its prime rate to 6½ percent on May 3.

Preliminary data indicate that growth in the monetary aggregates accelerated sharply in April. During the four-week period ended April 28, seasonally adjusted M_1—private demand deposits adjusted plus currency outside commercial banks—grew at an annual rate of 9.8 percent over its average in the four-week period ended thirteen

Chart I

SELECTED INTEREST RATES

February-April 1976



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Prime commercial loan rate at most major banks; 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.

weeks earlier. This brought M_1 growth to 6.2 percent over its four-week average level ended fifty-two weeks earlier (see Chart II). The recent high rate of money stock growth has been in part attributable to exceptionally rapid expansion of currency in circulation. In the four-week period ended April 28, currency grew at an annual rate of 14.6 percent from its four-week average level ended thirteen weeks earlier whereas demand deposits adjusted, the other component of M_1, rose at an 8.1 percent annual rate. Growth in M_2—M_1 plus time deposits other than large negotiable CDs—grew at an annual rate of 12.8 percent from the four-week period ended thirteen weeks earlier. Over the same period, the bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—rose by only 2.2 percent at an annual rate, as the volume of CDs continued to decline.

THE GOVERNMENT SECURITIES MARKET

Yields on most Federal Government securities closed the month at about the same levels as at the end of March, after declining through midmonth and then reversing course toward the end of the month. Early in April, the market rallied in response to news of continued moderation in inflation and to downward revisions of projected Treasury borrowing in the months ahead. The optimistic price information released in April included the relatively modest firstquarter increase in the GNP deflator as well as continued moderation in the rate of rise of the wholesale and consumer price indexes. The Treasury's need for new cash in the remainder of the fiscal year is slated to be lower than originally anticipated because expenditures had been overestimated. Later in the month, many investors began to believe that the Federal Reserve had adopted a less accommodative policy stance and this prompted price declines throughout the market.

Treasury bill rates declined during most of the month. The average accepted rates on three- and six-month bills at the regular weekly auction on April 19 were 4.76 percent and 5.09 percent, respectively (see Table II). At the last auction in March, the three-month bill yield had been 17 basis points higher and the six-month bill yield had been 24 basis points higher than at the April 19 auction. Market sentiment was bolstered by the redemption without replacement of $4.7 billion of bills maturing on April 22, including $2.5 billion of fourteen-day cash management bills. However, with firmer Federal funds trading near the end of the month, rates in the secondary market climbed and three- and six-month bills were sold at yields of 4.91 percent and 5.23 percent in the month's final auction. At the regular monthly auction on April 29, the Treasury raised an additional $750 million in new cash with an offering of $3.2 billion of 52-week bills. The issue sold at an average rate of 5.65 percent, down 14 basis points from the rate obtained on March 31. Interest rates on three- and six-month bills ended the month at 4.91 percent and 5.29 percent, respectively, about 6 and 7 basis points below their levels at the end of the previous month.

Returns on Government coupon issues moved down over the first half of April and then increased in the last half, a pattern similar to that shown by the rates on private debt. The upturn of long-term interest rates prior to any rise in short-term rates was attributed by some market observers to news on the recent brisk pace of economic recovery. They argued that this unexpectedly high rate of economic recovery caused upward revision in estimates of what short-term interest rates would be in the near future and thus made investors demand a higher return for holding long-term issues.

In early May the Treasury sold the three coupon issues which comprised its May refunding package. Auctions were conducted on May 4 for $2 billion of 23½-month notes and on May 7 for $800 million of the reopened issue of 23¾-year bonds with 7⅞ percent coupons. Yield bids on the notes averaged 6.61 percent, and a 6½ percent coupon was provided on the issues sold. The average price in the auction of bonds resulted in a yield of 8.19 percent.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, APRIL 1976

In millions of dollars; (+) denotes increase and (—) 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	+ 371	— 111	— 715	+ 21	— 434
Operating transactions (subtotal)	+3,639	+1,158	—4,377	— 189	+ 231
Federal Reserve float	+ 453	— 29	+ 480	— 277	+ 627
Treasury operations*	+3,440	+1,902	—3,546	— 850	+ 946
Gold and foreign account	— 31	+ 16	+ 29	— 6	+ 8
Currency outside banks	— 436	— 829	—1,105	+1,015	—1,355
Other Federal Reserve liabilities and capital	+ 213	+ 98	— 236	— 72	+ 3
Total "market" factors	+4,010	+1,047	—5,092	— 168	— 203
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	—4,396	—1.273	+4,844	+ 138	— 687
Outright holdings:					
Treasury securities	—2,379	—1,592	+2,791	+1,230	+ 50
Bankers' acceptances	— 7	— 16	— 16	— 6	— 45
Federal agency obligations	—	—	—	—	—
Repurchase agreements:					
Treasury securities	—1,513	+ 297	+1,672	— 851	— 395
Bankers' acceptances	— 289	+ 24	+ 296	— 190	— 159
Federal agency obligations	— 208	+ 14	+ 101	— 45	— 138
Member bank borrowings	— 13	+ 38	— 23	+ 14	+ 16
Seasonal borrowings†	—	—	—	+ 1	+ 1
Other Federal Reserve assets‡	+ 129	+ 263	+ 261	— 40	+ 613
Total	—4,280	— 973	+5,083	+ 111	— 59
Excess reserves‡§	— 270	+ 74	— 9	— 57	— 262
	Daily average levels				**Monthly averages‖**
Member bank:					
Total reserves, including vault cash‡§	33,580	33,775	34,481	34,403	34,060
Required reserves	33,449	33,560	34,275	34,254	33,885
Excess reserves§	131	215	206	149	175
Total borrowings	24	62	39	53	45
Seasonal borrowings†	10	10	10	11	10
Nonborrowed reserves	33,556	33,713	34,442	34,350	34,015
Net carry-over, excess or deficit (—)¶	157	66	59	42	81

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 waivers of penalties for reserve deficiencies in accordance with the Regulation D change effective November 19, 1975.

‖ Average for four weeks ended April 28, 1976.

¶ Not reflected in data above.

From April 29 through May 5, subscriptions were accepted for ten-year notes with 7⅞ percent coupons at par. All subscriptions for under $500,000 made with a 20 percent cash downpayment were accepted. A total of $4.7 billion of these notes was sold. This ten-year note issue was the first under recent legislation extending permissible note maturities from seven to ten years.

Spreads between the interest rates on Government agency issues and those on Treasury issues have remained quite narrow. In explaining this, market analysts pointed to the small supply of agency issues, reflecting the highly liquid position of thrift institutions which reduced the need of these institutions to sell mortgages in secondary markets. Near midmonth, the Federal Intermediate Credit Banks (FICB) placed $1,044.5 million of consolidated bonds maturing February 1, 1977 at 5.60 percent, raising $157.0 million in new cash. The Banks for Cooperatives (BC) issued $409.5 million of short-term consolidated bonds maturing May 3, 1976 at 5.20 percent. On April 15, the Government National Mortgage Association issued $335.9 million in mortgage-backed thirty-year securities, of which $175.3 million of 7¼ percent pass-through securities was issued at 7.85 percent and $160.6 million of 7½ percent pass-through securities was sold at 7.87 percent. In additional farm credit financing around midmonth, the BC issued $410 million of six-month bonds at 5.2 percent and the FICB issued $1,045 million of nine-month bonds at 5.6 percent. The rate on the FICB issue was down from 6.1 percent on the March issue and lower than any such issue in the past year. The Department of Housing and Urban Development placed $271 million of notes to finance urban renewal projects at an average interest rate of 2.92 percent, the lowest rate for such a financing since November 1972.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

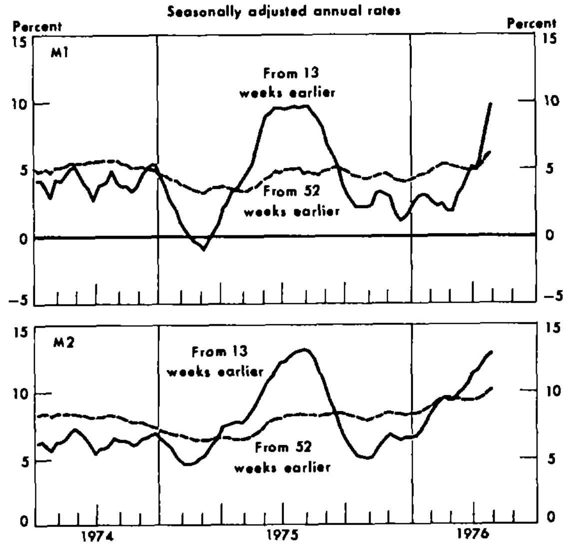
Maturity	Weekly auction dates—April 1976			
	April 5	April 12	April 19	April 26
Three-month	4.957	4.830	4.763	4.909
Six-month	5.293	5.068	5.089	5.230
	Monthly auction dates—February-April 1976			
	February 4	March 3	March 31	April 29
Fifty-two weeks	5.572	6.010	5.781	5.645

*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.

Chart II

GROWTH OF SELECTED MONEY STOCK MEASURES

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 28, 1976.

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.

Source: Board of Governors of the Federal Reserve System.

OTHER SECURITIES MARKETS

In the corporate bond market, the sharp rally that began in the previous month continued through mid-April. During the first half, corporate obligations benefited from the reports of slower inflation, the outlook for less Treasury borrowing, and a small number of new corporate issues. The rally extended to medium-quality issues, as news of strong economic recovery reduced investors' worries about risk. In the latter part of the month, prices declined and some issues, which had been priced earlier and remained in syndicate, did not sell well. Rates on municipal bonds continued to decline over most of the month but stabilized late in the period.

In new issue activity, the bellwether financing of the month was a $450 million issue of Aaa-rated telephone debentures. The forty-year securities were priced shortly after midmonth to yield 8.29 percent. Reflecting the extent of the rally, this return was 27 basis points below a similar issue sold the month before. Distribution of the large offering began successfully, but corporate bond prices fell while some of the bonds were still in underwriters' hands. Syndicate price restrictions were removed shortly thereafter, and the bonds sustained a sharp price drop in the secondary market, bringing the return to 8.47 percent about one week after the issue date. In a key industrial offering, $250 million of Aaa-rated thirty-year debentures was quickly placed with investors just after midmonth at a yield of 8.02 percent. Another Aaa-rated offering in March provided an 8.57 percent return, although that issue had been very generously priced and had a longer effective maturity.

A sizable amount of new tax-exempt obligations of state governments was sold at competitive bidding during April. Two $125 million bond issues rated Aaa/AA (Moody's/Standard & Poor's) met good receptions. State of Oregon bonds provided returns from 4.1 percent in 1981 to 5.6 percent in 1994, while State of Tennessee bonds yielded from 3.2 percent in 1977 to 5.6 percent in 1996. Both issues were placed at rates well below an Aaa-rated state offering in mid-February, which returned from 4.20 percent in 1979 to 5.90 percent in 1991. Bond obligations of the State of Ohio, rated Aa/AA and totaling $45 million, were reoffered at yields ranging from 3.5 percent in 1977 to 6.75 percent in 2001. The Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds fell 14 basis points over the month to 6.55 percent, continuing the declines posted over March. The Blue List of dealers' advertised inventories rose by $48 million to close the month at $797 million.