The Money and Bond Markets in March

Short-term interest rates rose sharply during the first half of March, as participants grew increasingly apprehensive about the interest rate outlook. Conditions in the money market became firmer, and this was accompanied by marked increases in Treasury bill rates. Continued uncertainty in the foreign exchange markets along with acceleration in the growth of the narrow money supply fostered concern that a shift in monetary policy to a less expansionary posture was imminent, if not already under way. While yields on intermediate-term Government issues were relatively steady at the outset of the month, rising short-term rates and anticipation of sizable Treasury cash needs soon exerted upward pressure on returns in this maturity range. In contrast, yields on longer term Government securities largely resisted the rate advances and, on balance, drifted up only slightly. After some declines in yields early in the month, a hesitant atmosphere emerged in the corporate and municipal sectors and yields worked irregularly higher.

Shortly after midmonth a somewhat more constructive outlook developed throughout the Government securities market, as investors became convinced that a sustainable trading range had been established. The Treasury bill sector benefited from the stability exhibited by the Federal funds rate, albeit at a higher level of trading than had prevailed at the beginning of March, and rates moved somewhat lower. Sentiment was bolstered when it was learned, on March 21, that the Treasury's near-term financing requirements would be considerably smaller than had been anticipated. The Treasury announced that its financing needs before the May refunding would consist of only \$1.75 billion in new cash, with the cash to be raised by auctioning a three-year 5⅞ percent note late in March. At the same time, the Treasury disclosed its intention to discontinue the \$300 million additions to its weekly bill series which had been initiated on February 17.

This news spurred a brief rally in all sectors of the securities markets, but the underlying uncertainty about the future course of interest rates persisted. Investors were uneasy about both the firmer tone evident in the money market and the continuing advance in consumer prices. As a consequence, short-term rates subsequently moved up another notch and, late in March, many large commercial banks raised their prime lending rates by ¼ percentage point to 5 percent. Yields on intermediate-term issues also rose over the remainder of the month; however, returns on long-term Government securities continued to exhibit considerable stability and increased only modestly.

THE MONEY MARKET

Conditions in the money market firmed considerably as the month unfolded. Federal funds, which had traded predominantly around 3⅜ percent early in March, were trading a bit above 4 percent when the period ended. For the month as a whole, the effective rate on Federal funds averaged 3.83 percent, 53 basis points above the February level. Member bank borrowings from the Federal Reserve Banks rose to an average of \$91 million in March (see Table I), compared with an average level of only \$24 million for January and February combined.

Short-term interest rates rose significantly during March, paralleling the trend of the Federal funds rate (see Chart I). Dealers in bankers' acceptances raised rates by ½ percentage point, and rates on most maturities of commercial paper were increased by ⅜ to ⅝ percentage point. At the same time, commercial banks boosted their offering rates on newly issued negotiable certificates of deposit by about ¼ to ⅞ percentage point. The three-month Euro-dollar rate rose ½ percentage point during the month.

A number of major commercial banks raised their prime commercial loan rate from 4¾ percent to 5 percent late in the month, marking the first widespread increase in the prime rate since early July 1971. Subsequent to the July increase, this key lending rate had been steadily reduced and had fallen as low as 4⅜ percent at one large New York City bank that follows a "floating" prime rate policy. Earlier in March, that bank—which relates its prime rate to rates on three-month dealer-placed commercial paper—had increased its minimum business loan rate by 1/8 percentage point to 4½ percent. Shortly thereafter, the four major banks in New York City that had been posting a 4½ percent prime rate lifted their rates to the 4¾ percent level generally prevailing at that time. The move to 5 percent followed and became general early in April.

The increases in the prime rate were accompanied by scattered indications of strengthening in loan demand. In the statement week ended March 15, which included the quarterly corporate tax payment date, business loans (adjusted for loan sales to affiliates) at weekly reporting banks rose by $797 million. This constituted the largest such mid-March borrowing since 1968. Moreover, weekly reporting bank data for the five statement weeks ended March 29 indicate a pickup in business loans relative to their performance during the corresponding periods of 1971 and 1970. Other loan categories, particularly real estate and consumer loans and loans to nonbank financial institutions and to securities dealers, appear to have remained strong in March.

According to preliminary estimates, all of the monetary aggregates grew rapidly in March. The narrow money supply (M_1)—adjusted demand deposits and currency held by the public—advanced at a seasonally adjusted annual rate of about 11 percent in March, bringing first-quarter growth in this measure to an annual rate of about 9 percent. This stands in sharp contrast to the very small expansion in M_1 in the fourth quarter of 1971. Since the aggregates tend to exhibit considerable short-run volatility, it is oftentimes advisable to place more weight on their longer run performance. M_1 grew at an annual rate of about 5 percent in the six-month interval ended in March and at approximately a 6¼ percent pace over the twelve months ended in March.

The broader money supply (M_2)—which includes M_1 plus consumer-type time and savings deposits at commercial banks—grew at a seasonally adjusted annual rate of about 10½ percent in March, slightly slower than its pace of January and February. Over the twelve months ended in March, M_2 grew by about 9¾ percent. Expansion of the adjusted bank credit proxy jumped sharply in March to a seasonally adjusted annual rate of about 17½ percent. Rapid growth in seasonally adjusted United States Treasury deposits accompanied substantial advances in demand and time deposits, thus accounting for the strong increase in the proxy. First-quarter growth of the proxy is estimated at an 11¼ percent annual rate, whereas over the last twelve months the proxy expanded by about 9½ percent.

On March 28, the Board of Governors of the Federal Reserve System proposed two regulatory changes of potential significance for the banking system. The proposed change in Regulation D would restructure reserve requirements applicable to net demand deposits of member banks,

Table I

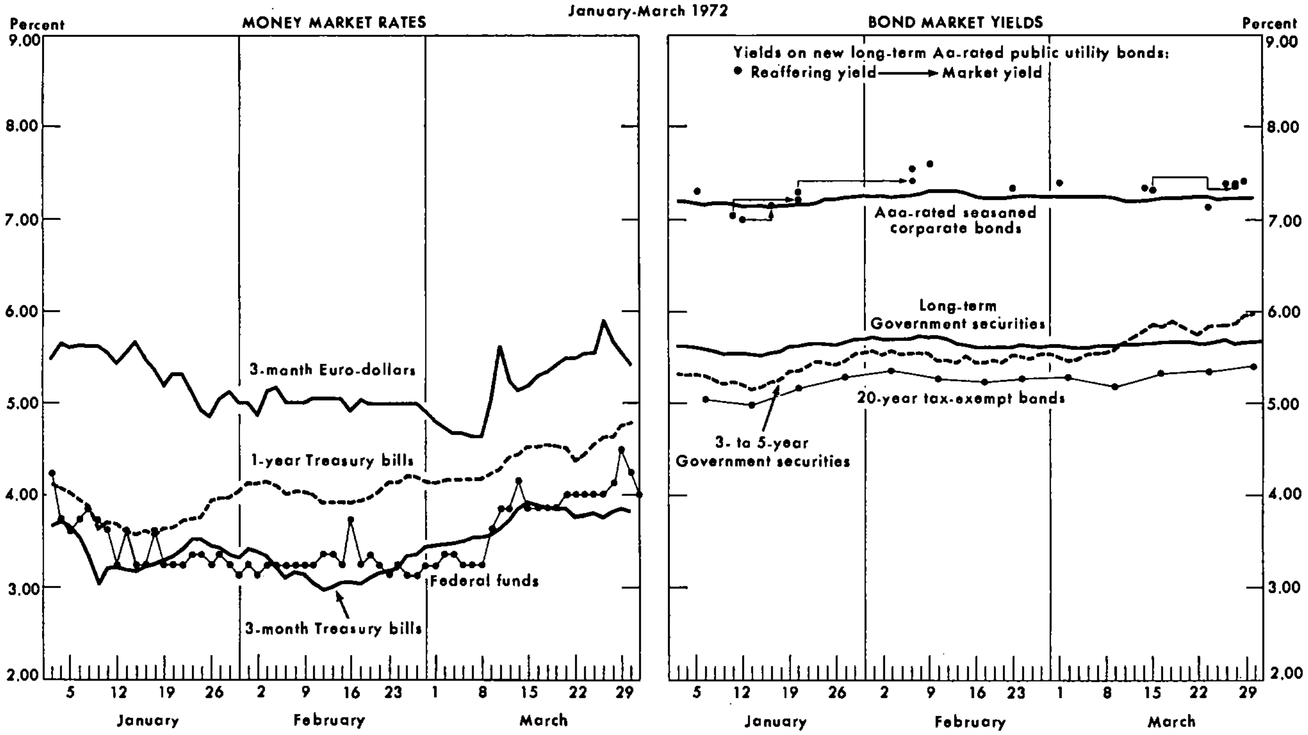
FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MARCH 1972

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

Factors	Changes in daily averages—week ended					Net changes
	March 1	March 8	March 15	March 22	March 29	
"Market" factors						
Member bank required reserves	+ 161	+ 243	− 426	+ 39	− 267	− 250
Operating transactions (subtotal)	+1,355	− 380	+ 320	− 611	− 107	+ 577
Federal Reserve float	+ 427	− 562	+ 47	+ 342	− 546	− 292
Treasury operations*	+ 686	+ 317	+ 290	− 218	+ 91	+1,166
Gold and foreign account	− 52	+ 80	− 32	− 18	+ 11	− 11
Currency outside banks	+ 346	− 149	− 144	− 674	+ 367	− 254
Other Federal Reserve liabilities and capital	− 51	− 65	+ 159	− 43	− 31	− 31
Total "market" factors	+1,516	− 137	− 106	− 572	− 374	+ 327
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	−1,705	+ 150	+ 371	− 45	+ 665	− 564
Outright holdings:						
Treasury securities	−1,649	+ 152	+ 6	+ 234	+ 520	− 737
Bankers' acceptances	− 1	—	—	+ 3	+ 3	+ 5
Federal agency obligations	− 55	− 2	+ 35	+ 48	—	+ 26
Repurchase agreements:						
Treasury securities	—	—	+ 288	− 288	+ 128	+ 128
Bankers' acceptances	—	—	+ 33	− 33	+ 13	+ 13
Federal agency obligations	—	—	+ 9	− 9	+ 1	+ 1
Member bank borrowings	+ 53	+ 36	− 90	+ 101	+ 40	+ 141
Other Federal Reserve assets†	+ 88	+ 45	+ 42	+ 48	+ 53	+ 276
Total	−1,564	+ 231	+ 323	+ 105	+ 758	− 147
Excess reserves	− 48	+ 94	+ 217	− 467	+ 384	+ 180
	Daily average levels					Monthly averages
Member bank:						
Total reserves, including vault cash	31,614	31,465	32,108	31,602	32,253	31,806‡
Required reserves	31,532	31,289	31,715	31,676	31,943	31,631‡
Excess reserves	82	176	393	− 74	310	177‡
Borrowings	67	103	13	115	155	91‡
Free, or net borrowed (−), reserves	15	73	380	− 189	155	87‡
Nonborrowed reserves	31,547	31,362	32,095	31,487	32,098	31,718‡
Net carry-over, excess or deficit (−) §	110	85	70	210	− 17	92‡

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 29.
§ Not reflected in data above.

Chart I
SELECTED INTEREST RATES
January-March 1972



Note: Data are shown for business days only.

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

so that reserve requirements on such deposits would no longer be based on geographical location. Rather, reserve requirements against net demand deposits would be graduated by bank size, as measured by such deposits. No change was proposed in reserve requirements on time and savings deposits, commercial paper issued by bank affiliates, or Euro-dollar borrowings. The revision of Regulation J proposed by the Board of Governors would require all banks served by the Federal Reserve check collection system to pay for checks drawn upon them the same day that they are presented for payment. This proposal would speed check collection procedures and would substantially reduce the daily average level of Federal Reserve float. The two proposals are intended to be neutral with respect to monetary policy and were disclosed by the Board to solicit comments from the banking system by May 15.

THE GOVERNMENT SECURITIES MARKET

A cautious atmosphere prevailed in the market for Government securities during most of March. Investors were concerned about the near-term objectives of monetary policy in light of the acceleration in the growth of the money supply and the continued uncertainty in the foreign exchange markets. Progressively higher Federal funds rates and anticipation of substantial Treasury cash needs further served to dampen sentiment. Yields on long-term issues were essentially steady, but Treasury bill rates, which had risen over the second half of February, continued to trend upward, and yields in the intermediate area joined in this move.

On March 1 the Treasury auctioned a $3 billion "strip" of bills, consisting of $200 million additions to each of the fifteen outstanding weekly Treasury bill series maturing from March 30 through July 6. Depository banks were permitted to credit Treasury Tax and Loan Accounts for 50 percent of the awards for their own and customer accounts. Bidding for the strip issue proved to be relatively aggressive, resulting in an average issuing rate of 3.408 percent for the package. Besides the strip auction, the market supply of bills was increased by $300 million additions to the weekly bill auctions initiated by the Treasury in mid-February. These supply pressures, together with uncertainty over the future course of interest rates, generated a steady, although mild, upward movement in bill rates early in March.

The rise in bill rates accelerated sharply prior to midmonth as increases in the Federal funds rate, and then in the rate on System repurchase agreements, were interpreted as confirming the expected shift in monetary policy. (The repurchase rate was increased in three ¼ percentage point steps from 3¼ percent to 4 percent during the month.) Moreover, dealer inventories of Treasury bills rose to a large $4.9 billion in the statement week ended March 8. In this atmosphere, interest in the weekly bill auction held on March 13 was quite restrained, and average issuing rates for the new three- and six-month bills were set at 3.845 percent and 4.195 percent, respectively, up 29 and 40 basis points from rates set one week earlier (see Table II). Meantime, yields on intermediate-term Treasury notes and bonds had edged upward, and these increases quickened shortly before midmonth. Apprehension that resulted from rising short-term interest rates and data suggesting an expansion in the pace of economic activity contributed to the price declines ultimately experienced throughout the maturity spectrum. By March 15, the three- and six-month Treasury bill rates had increased 47 and 57 basis points, respectively, from the levels prevailing on March 1. Also by midmonth, yields on most intermediate-term issues were 30 to 60 basis points higher than they had been at the beginning of March. In contrast, yields on long-term bonds generally increased by a more modest 2 to 9 basis points, as this sector was not nearly so sensitive to the rise in short-term rates. Moreover, the firm tone of the corporate bond market early in the month helped to stabilize returns on longer term Government securities.

The atmosphere in all sectors of the Government securities market improved noticeably shortly after mid-March. Yields on Treasury coupon obligations receded somewhat, as investors became convinced that a sustainable trading range had been established, and bill rates similarly moved down from the levels reached earlier in the month. The climate was further enhanced when on March 21 the Treasury disclosed that its revenues were running ahead of expectations, apparently because of some overwithholding of personal income taxes following the change in withholding schedules that went into effect in January 1972 under the Revenue Act of 1971. Consequently, the Treasury announced that its financing requirements would consist of only $1.75 billion in new cash before the May refunding, with the cash to be raised through the auction on March 28 of a three-year 5⅞ percent note maturing May 15, 1975. At the same time, the Treasury revealed its intention to discontinue the $300 million additions to its weekly bill series.

Although this announcement elicited a favorable response, the subsequent rally proved to be short-lived. Investors were wary both of the firmer tone evident in the money market and of some discouraging news in the price statistics. The increase in the prime rate to 5 percent also served to rekindle a cautious, sensitive atmosphere. Yields on long-term Government bonds continued to display a good deal of stability and rose rather modestly near the end of March. For the entire month, returns on

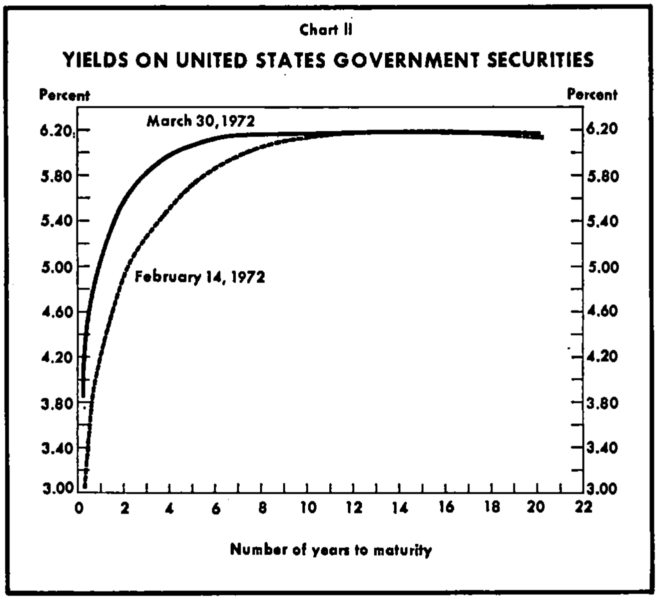
Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—March 1972			
	March 6	March 13	March 20	March 27
Three-month	3.553	3.845	3.920	3.849
Six-month	3.796	4.195	4.322	4.354
	Monthly auction dates—January-March 1972			
	January 25	February 22	March 24	
Nine-month	3.892	3.862	4.511	
One-year	3.936	4.091	4.661	

* 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.



long-term issues gained only 2 to 10 basis points. However, by the end of March, yields on intermediate-term issues had generally climbed above the levels prevailing at midmonth, and over the month as a whole yields in this range increased 40 to 85 basis points. Hence, as is evident in Chart II, the yield curve had flattened considerably by the end of March, relative to the slope prevailing in mid-February when short-term interest rates were at their recent lows. The Treasury's new three-year 5⅞ percent note was auctioned on March 28 at an average issuing rate of 5.78 percent. Depository banks, which were permitted to credit Treasury Tax and Loan Accounts for the full amount of their awards, exhibited substantial interest but, overall, bidding for the new note was somewhat restrained.

Treasury bill rates, particularly for longer maturities, backed up again as the end of the month approached. Because of the uncertain interest rate outlook, investors preferred to stay in the short end of the maturity range. At the month end, the three-month bill was bid at 3.83 percent, 84 basis points above its low of mid-February, while the rate on the six-month bill closed at 4.39 percent. Thus, the spread between the three- and six-month bill rates stood at an exceptionally wide 56 basis points. In the monthly bill auction held on March 24, average issuing rates of 4.511 percent and 4.661 percent were set on the new nine- and twelve-month bills—65 and 57 basis points, respectively, above the rates established in the previous month's auction.

OTHER SECURITIES MARKETS

The corporate bond market, benefiting from a relatively light calendar of new offerings, improved considerably early in March. The quick sellout of a $200 million AA-rated finance company issue priced to yield 7.31 percent on the first day of the month halted the price slide then in progress, and a more constructive atmosphere subsequently emerged. In addition, the sizable underwriter inventories overhanging the market were substantially reduced when two large partially unsold issues, which had initially been offered in February, were released from syndicate price restrictions. Against this background, prices of seasoned corporate securities rose, and other major new corporate issues marketed at the beginning of the month were well received. For example, on March 7, $60 million of A-rated finance company debentures priced at par to yield 7.70 percent sold out almost immediately and, the next day, a $60 million A-rated utility offering which was priced aggressively to yield 7.45 percent encountered strong interest.

However, a hesitant atmosphere developed in the corporate market around midmonth in the wake of the moves to higher yields on Government securities. On Tuesday, March 14, a $30 million Aa-rated utility offering sold well when priced to yield 7.38 percent, but investor appetite for two utility issues marketed the following day was lackluster. A $25 million issue of utility bonds with the same rating and maturity as Tuesday's financing was priced to return 7.35 percent and attracted little response from investors. Similarly, a $50 million A-rated utility issue yielding 7.45 percent sold slowly, although it provided about the same return as that on a comparable issue successfully marketed one week earlier.

Prices of seasoned corporate bonds continued to drift lower over much of the rest of the month as the generally cautious atmosphere persisted. Investors appeared concerned about the prospects for long-term interest rates in light of the continuing rise in short-term rates and statistics suggesting an acceleration in economic activity. Trading was dull and, although new issue activity remained light, the poor reception afforded a $100 million Bell System offering of seven-year notes weighed heavily upon the market. A $50 million Aa-rated industrial offering met an enthusiastic welcome toward the month end, but the warm reception accorded this issue in large part reflected the relative scarcity of new high-quality industrial financings, and consequently the improvement was not sustained.

In contrast to the corporate bond market, the volume of new tax-exempt issues sold during March was substantial, and the market initially handled the heavy calendar of financing easily. On March 8, the Housing Assistance Administration offered almost $225 million of Aaa-rated serial bonds on behalf of local housing authorities. The issue, aggressively priced to yield 5 percent on forty-year maturities, attracted good interest, particularly from commercial banks and casualty insurance companies.

The excellent reception afforded the housing offering, coming on the heels of several other highly successful issues, contributed to the price improvement evident in the tax-exempt market until about midmonth. Thereafter, the firm tone gradually dissipated amid continued heavy new issue activity. Investors became more selective in their response to new tax-exempt offerings, resulting in a backlog of unsold securities, and as inventories grew, dealers reduced prices on a number of issues. Several newly issued municipal bonds were released from syndicate price restrictions after mid-March and subsequently traded at yields as much as 30 basis points above their offering rates. Over the rest of the month, investor response to new tax-exempt securities was mixed, and prices of seasoned issues fluctuated narrowly. *The Weekly Bond Buyer's* twenty-bond index of municipal bond yields closed the month at 5.40 percent, 11 basis points above its level at the end of February and 22 basis points higher than it stood on March 9.