The Money and Bond Markets in April

Interest rate movements in the money and bond markets were mixed during April, as yields on most United States Government securities, municipal bonds, and Eurodollars declined on balance while those on corporate bonds and most money market instruments rose. The increases in money market rates were not so sharp as in March, however, and were partially reversed late in April. Investors displayed little interest in the bond market during the first half of the month, and prices declined fairly sharply as dealers sought to lighten their positions. Sizable amounts of dealer inventories of corporate and municipal issues were released from syndicate price restrictions to clear the shelves for the new issues which were scheduled for sale. Despite the fact that yields on many bonds climbed to their highest levels since last fall, investors remained quite selective during this time. After midmonth, however, a better tone developed in all sectors of the bond market and a number of new issues were quickly sold.

The Government securities market responded exuberantly to the April 26 announcement of the Treasury's plans for its May refunding. Not only did the Treasury decide against raising any new money in conjunction with the refunding of its notes maturing on May 15, but it actually planned to redeem in cash a substantial portion of those securities. Even more significantly, the Treasury indicated that its revenue outlook was so strong that it expected to raise less cash in the money and capital markets in the second half of the calendar year 1972 than in the similar period of last year. The strong rally that was touched off by this announcement accounted for the bulk of the price gains on intermediate-term Treasury securities in April.

THE MONEY MARKET

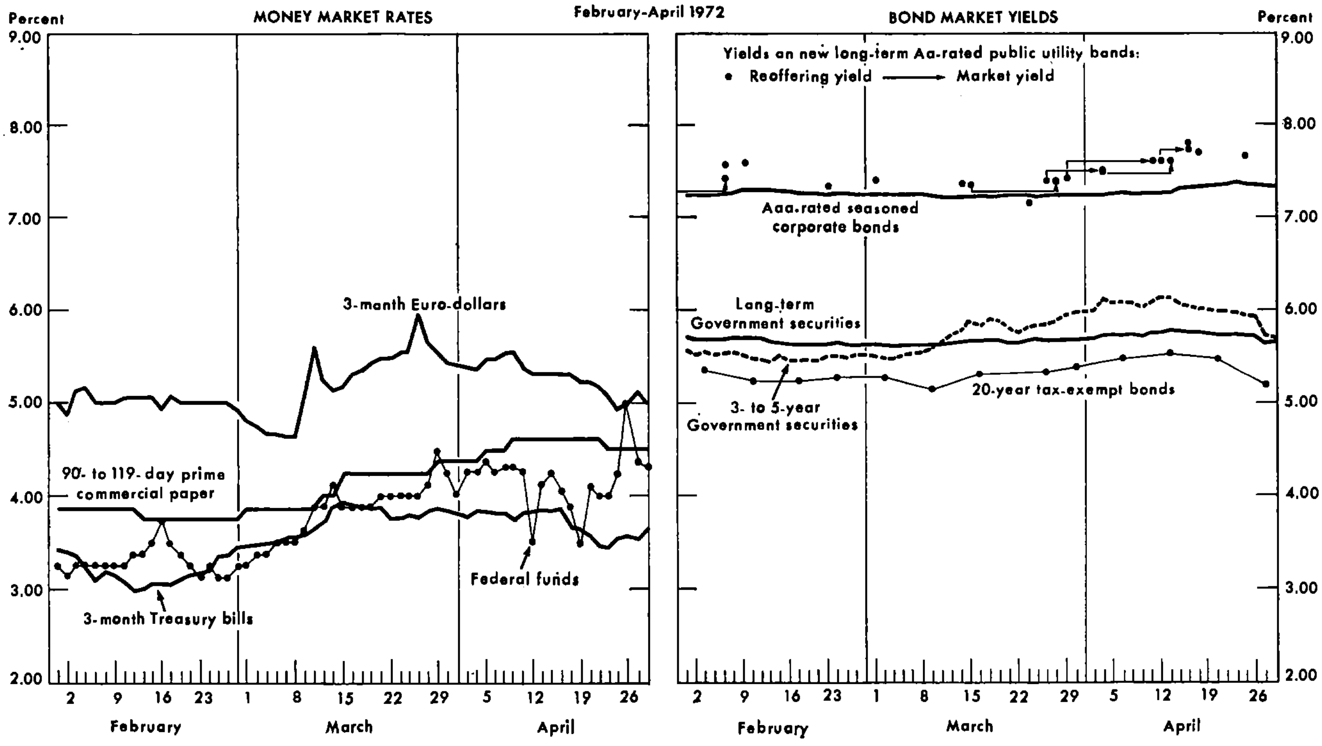
Short-term interest rates—other than those on United States Government securities—generally rose during April, although some decreases were posted toward the end of the month. Over about the first three weeks in April, rates on all maturities of dealer-placed prime commercial paper were raised by ¼ percentage point while the rate on ninety-day bankers' acceptances was increased ⅜ percentage point. These rates were subsequently lowered by ⅛ and ¼ percentage point, respectively, resulting in over-the-month increases of ⅛ percentage point in each case. The net increases on directly placed paper ranged between ⅛ and ½ percentage point. Several commercial banks raised their rates on negotiable certificates of deposit by ⅛ to ⅜ percentage point, and the outstanding volume of these certificates climbed to a new high at the New York City weekly reporting banks. In addition, several major banks raised their prime rate to 5¼ percent from the 5 percent rate which most banks adopted early in April. In the wake of declines in other market rates late in the month, most of these banks reduced their rates to 5 percent or 5⅛ percent early in May.

Federal funds rates, after having moved decisively higher during March, fluctuated around the levels established at the end of March (see Chart I). Consequently, the effective rate on Federal funds averaged 4.18 percent in April, 35 basis points above the average for March. With Federal funds rates still generally below the 4½ percent discount rate, member bank borrowings from the Federal Reserve Banks were negligible on most days. Such borrowings were relatively heavy at the beginning of the month, however, as major banks managed their reserve positions conservatively. In consequence, banks ended the April 5 statement week with unusually large holdings of excess reserves. The large banks grew less cautious in managing their reserve positions thereafter and in some cases found themselves short of reserves on settlement dates. For example, on April 19 the supply of Federal funds dried up late in the afternoon after trading predominantly at 3½ percent during most of the day. As a result, member banks turned to the Federal Reserve for $245 million of borrowings that night, after having borrowed less than $12 million on average earlier in the week. In spite of this experience, banks were again slow in covering their reserve requirements in the following statement week. In the scramble to meet these requirements on the settlement day, April 26, Federal funds were bid up as high as 7 percent—the effective rate was set at 5 percent—and member bank borrowings from the Federal Reserve surged to nearly $1.8 billion. For the four weeks that ended April 26, member bank borrowings from the Federal Reserve Banks averaged $120 million (see Table I), compared with an average of $90 million during the five statement weeks ended in March.

In seeking to counter the undue tautness emerging in the Federal funds market toward the end of the April 26 statement week, the Federal Reserve Bank of New York injected reserves through repurchase agreements with nonbank dealers in Government securities and bankers' acceptances. Under a newly authorized procedure, the rates on the contracts were determined competitively. That is, this Bank indicated to the nonbank dealers the maturity of the agreements sought and asked how much they wished to do at what rates. Offerings were accepted on a competitive basis up to the amount of reserves to be injected. The new procedure is analogous to that used in absorbing reserves through matched sale-purchase transactions. In the past, when this Bank had elected to supply reserves through repurchase agreements, it would specify the rate at which it would enter into contracts.

Based on preliminary estimates, there was a decided deceleration in the growth of all the monetary aggregates during April, but the pace continued strong. The narrow money supply (M_1)—adjusted demand deposits and currency held by the public—grew at a seasonally adjusted annual rate of about 7¼ percent in April, compared with an 11.9 percent rate of increase in March (see Chart II). Over the three months ended in April, the annual growth

Chart I
SELECTED INTEREST RATES
February-April 1972



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 four 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 Aa-rated public utility bonds (arrows point from underwritting 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.

rate was about 10¾ percent, reflecting the more rapid growth in February and March. Since the monetary aggregates tend to fluctuate widely during short-run periods, their growth rate over longer intervals is often more relevant. In this connection the growth of M_1 over the twelve-month period ended in April was about 6¼ percent.

The growth of the broader money supply (M_2) also slowed during April to a seasonally adjusted annual rate of about 7¼ percent from 11.6 percent in March. The deceleration in this aggregate resulted from the fact that both of its components—consumer-type time and savings deposits at commercial banks as well as M_1—grew less rapidly than in the preceding month. In the three months ended in April, M_2 grew at an annual rate of about 11¼ percent, while since April a year ago the gain amounted to approximately 9½ percent.

Largely because of a substantial slowdown in the increase in United States Government deposits at member banks, coupled with an actual decline in their nondeposit liabilities, the adjusted bank credit proxy rose at about a 13½ percent seasonally adjusted annual rate in April, down from the very rapid 17.7 percent rate in March. The absolute gain in the time deposit component of the adjusted credit proxy was larger than in March, but the increase in demand deposits was slightly less. Because of its relatively slow growth rate in February which offset the fast pace in March, the growth in the proxy for the three months ended in April is estimated at a 12½ percent seasonally adjusted annual rate. For the twelve-month period that ended in April, the proxy rose only slightly more rapidly than did M_2, by about 10 percent.

Table I

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

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

Factors	Changes in daily averages—week ended				Net changes
	April 5	April 12	April 19	April 26	
"Market" factors					
Member bank required reserves	− 294	+ 51	− 454	− 224	− 921
Operating transactions (subtotal)	− 650	− 168	+ 119	− 721	− 1,420
Federal Reserve float	+ 155	+ 53	+ 423	− 159	+ 472
Treasury operations*	− 350	− 4	− 258	− 853	− 1,465
Gold and foreign account	− 28	− 49	+ 78	+ 25	+ 26
Currency outside banks	− 255	− 163	− 322	+ 319	− 421
Other Federal Reserve liabilities and capital	− 171	− 6	+ 200	− 53	− 80
Total "market" factors	− 944	− 117	− 335	− 945	− 2,341
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 1,006	− 16	+ 76	+ 524	+ 1,590
Outright holdings:					
Treasury securities	+ 494	+ 447	+ 255	+ 175	+ 1,371
Bankers' acceptances	+ 11	+ 1	—	+ 1	+ 12
Federal agency obligations	—	—	—	+ 144	+ 144
Repurchase agreements:					
Treasury securities	+ 436	− 432	− 132	+ 184	+ 56
Bankers' acceptances	+ 42	− 24	− 31	+ 17	+ 4
Federal agency obligations	+ 23	− 8	− 16	+ 3	+ 2
Member bank borrowings	− 12	− 127	+ 31	+ 234	+ 126
Other Federal Reserve assets†	+ 41	+ 52	+ 53	+ 49	+ 195
Total	+ 1,035	− 91	+ 160	+ 807	+ 1,911
Excess reserves	+ 91	− 208	− 175	+ 310	+ 18

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash	32,604	32,345	32,624	32,710	32,571‡
Required reserves	32,230	32,179	32,633	32,409	32,363‡
Excess reserves	374	166	− 9	301	208‡
Borrowings	141	14	45	279	120‡
Free, or net borrowed (−), reserves	233	152	− 54	22	88‡
Nonborrowed reserves	32,463	32,331	32,579	32,431	32,451‡
Net carry-over, excess or deficit (−) §	123	216	166	− 22	121‡

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 26.

§ Not reflected in data above.

THE GOVERNMENT SECURITIES MARKET

A gloomy atmosphere pervaded the market for Government coupon securities during the first half of April. Expectations of higher interest rates were encouraged by the multiplying indications of a quickening in the pace of the economic recovery, with its implications for eventual stronger demands for credit, and by the generally upward trend of the Federal funds rate throughout March. The deterioration in the corporate bond market also tended to depress prices of longer term Government issues, since it increased the inducement for investors to switch out of Government bonds into higher yielding corporate securities. The intensification of hostilities in South Vietnam further contributed to the nervousness in the market. Against this background, investor demand for Government coupon issues was weak and dealers continued to lighten their positions aggressively. Dealer inventories had been reduced sharply during March and, by early April, dealers who report their inventories and trading activity daily to the Federal Reserve Bank of New York had negative net positions in Treasury issues maturing in more than five years.

The persistent downward drift of prices of Government coupon securities halted about midmonth, however, and prices generally rose during the latter half of April. The leveling-off of the Federal funds rate, together with news of the virtual stability of consumer prices in March and the calm in the foreign exchange markets, encouraged more optimistic expectations of the near-term outlook for lower interest rates. The strengthening of corporate bond prices was also reflected in the market for long-term Treasury bonds. Furthermore, the market's strong technical position was seen as enhancing its capacity to absorb without significant pressure whatever issues the Treasury might offer in the May refunding.

After the close of business on April 26, the Treasury announced the terms of the refinancing. To refund in part the $2.45 billion of publicly held notes maturing May 15, it would auction $1.75 billion of securities on May 2. The remaining $700 million of the publicly held notes would be redeemed through use of the Treasury's available cash. The new offerings to the public included $1.25 billion of 4¾ percent one-year notes and an additional amount of up to $500 million of the 6⅜ percent bonds originally marketed in February. The bonds have a current maturity of nine years and nine months. Any qualified depository bank would be permitted to make settlement for the securities allotted to itself and to its customers by credit to its Treasury Tax and Loan Account. Additional amounts of these notes and bonds would be allotted to Government accounts and the Federal Reserve Banks in exchange for their holdings of $2.5 billion of maturing notes.

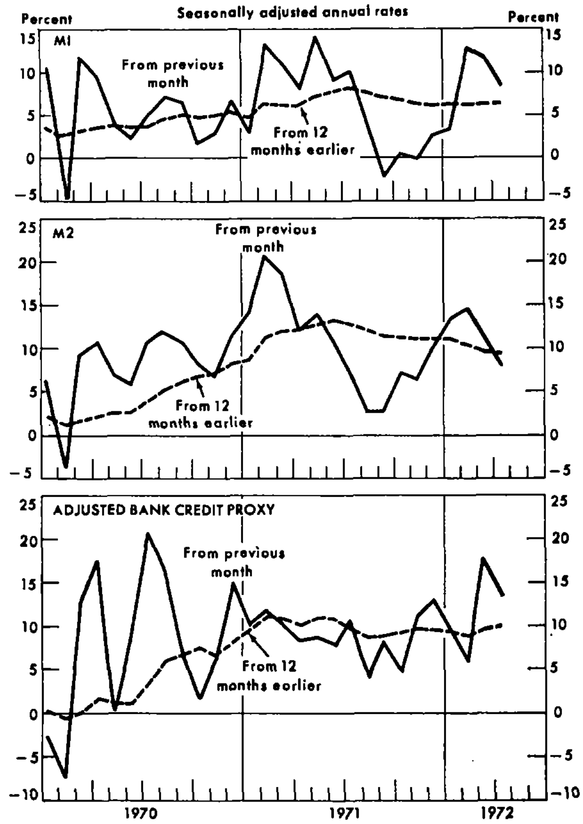
The May financing operation was particularly noteworthy in two respects. First, the $700 million repayment is highly unusual in a cash refinancing. It was made possible by the Treasury's persistently strong revenue position, which has stemmed in large part from the sizable overwithholding of personal income taxes under the revised withholding schedules that went into effect in January 1972. Beyond this, larger than expected tax receipts have also been stimulated by the strengthening economic recovery. Second, the nine-year nine-month issue is the longest maturity that the Treasury has sold at public auction since it resumed auctioning coupon-bearing securities in November 1970.

The Treasury's financing announcement touched off an explosive rally in the Government securities market. Encouragement was derived not only from the relatively small size of the May offering but also from the optimistic forecast of relatively moderate Treasury cash needs for the second half of 1972. Prices of intermediate-term issues rose especially sharply because of the absence of an intermediate maturity among the Treasury's offerings. Over the month as a whole, yields on Treasury securities maturing in three to seven years generally declined 20 to 30 basis points. Yields on shorter term issues dropped even more sharply, by about 25 to 75 basis points. In contrast, yields on long-term Treasury bonds were little changed on balance, ranging from 4 basis points lower to 2 basis points higher. In the auction on May 2, the one-year notes were sold at an average yield of 4.44 percent and the

Chart II

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for April 1972 are preliminary estimates.

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.

nine-year nine-month bonds at an average yield of 6.29 percent.

Sentiment in the Treasury bill market was affected by many of the same factors placing upward pressure on yields of coupon securities during the first half of April. However, sizable investor demand for bills outweighed selling pressure, and bill rates actually edged lower. To a considerable extent, the early April demand for bills was seasonal, including the investment of tax receipts by public authorities. With investor demand continuing strong and dealer inventories becoming relatively depleted, most market participants expected aggressive bidding in the regular weekly Treasury bill auction on April 10. Indeed, the average issuing rates of 3.731 percent on the three-month issue and 4.223 percent on the six-month issue were 12 and 13 basis points, respectively, below the rates that had been established in the last auction of March. However, the range of prices at which tenders were accepted was somewhat wider than most participants had anticipated, and the tone of the market weakened temporarily. Some concern developed over the sustainability of the level of bill rates, which were low in relation to other short-term rates.

The market's hesitancy was short-lived, however, as persistently strong investor demand pressed against a relatively thin market supply of bills. Demand from other sources was augmented by reinvestment demand from some holders of the maturing April 21 tax anticipation bills. Rates declined sharply after midmonth, and the final weekly auction and the regular monthly auction elicited aggressive interest. In the weekly auction held on April 24, the average issuing rates on the three- and six-month bills were 3.513 percent and 4.004 percent, respectively, the lowest such rates since the first week in March. On April 25 the new nine- and twelve-month issues were auctioned at average issuing rates of 4.234 percent and 4.362 percent, respectively, about 28 and 30 basis points below the rates established in the previous month's auction (see Table II). Over the month of April, rates on most Treasury bills maturing within three months declined by about 20 to 25 basis points and rates on longer maturities were generally about 25 to 40 basis points lower.

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—April 1972			
	April 3	April 10	April 17	April 24
Three-month	3.798	3.731	3.849	3.513
Six-month	4.367	4.223	4.278	4.004

Maturities	Monthly auction dates—February-April 1972		
	February 22	March 24	April 25
Nine-month	3.862	4.511	4.234
One-year	4.091	4.661	4.362

* 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.

OTHER SECURITIES MARKETS

There was a considerable amount of investor apathy toward corporate bonds during the first half of April, as the cautious atmosphere which had begun in mid-March continued. During the final week in March, two highly rated utility company bonds had encountered strong investor resistance, and the forward calendar for April—which, though relatively light overall, included the largest volume of utility issues in more than a year—threatened further downward pressure on prices. At the beginning of April, the remaining $120 million balance of four recently offered bonds was released from syndicate and allowed to trade without price restriction. The resultant yield increases ranged between 10 and 28 basis points. At the same time, a new Aa-rated utility issue of $125 million of thirty-year bonds sold slowly even though it bore the highest rate on such an offering since early December. The return of 7.50 percent on these bonds was 10 basis points greater than that on a similar issue a week earlier and 50 basis points above the year's low in January.

Although some buying interest was aroused by the lowered prices on the issues released from syndicate, the purchases were not enough to change the tone of the market and yields continued to rise. On April 10, two issues of Bell System securities totaling $150 million were marketed and, while the seven-year notes sold well, the $100 million of 33-year debentures ran into difficulty despite the fact that their 7.46 percent return was the highest offered on such securities in six months. Two days later, much the same fate befell a $150 million offering of A-rated utility bonds. Disappointed by the lack of investor interest, the underwriters freed the issue from price restrictions on the very next day, and in free market trading the yield climbed to 8.06 percent from the 7.90 percent at which it was originally priced. Over the next few days, several other issues were also released from syndicate with upward yield adjustments in each case.

Market sentiment improved around midmonth, and prices of seasoned corporate bonds began to rise. New issues generally encountered enthusiastic receptions at declining yields. For example, new long-term A-rated utility issues were successfully marketed at yields of 7.85 percent on April 19 and 7.73 percent on April 24. A comparably rated issue encountered some investor resistance, however, when offered on April 26 to yield 7.65 percent.

The market for tax-exempt securities was also in the doldrums during the first half of April, but investors showed some selective interest in new issues throughout the period. Thus, on April 4, two issues totaling $110 million sold very well but a third one from a city that recently had its credit rating downgraded was apparently overpriced and did not move. To elicit investor interest in some of the seasoned bonds, dealers reduced prices on several days and freed some small balances from syndicate price restrictions. Reflecting this situation, *The Weekly Bond Buyer's* index of yields on twenty municipal bonds rose to 5.54 percent on April 13, its highest level since last August.

By far the largest issue marketed in April was the $255 million issue of medium-grade New York City bonds sold on April 11. Despite the size of the offering and its rating, these bonds, which are exempt from the high income taxes in New York City and State as well as from Federal taxes, sold very well. The bonds were priced to yield between 4.00 percent and 6.90 percent, depending upon maturity, and cost the city an average of 6.28 percent. Again in illustration of the selectivity that was shown, on the same day a $90 million Aa-rated Massachusetts issue was offered with yields about 15 to 25 basis points higher than a similar issue two weeks earlier, but the bonds sold slowly and the prices had to be lowered a few days later.

Another large issue, Connecticut's $105 million of Aaa-rated bonds, was marketed on April 18 at yields some 10 to 15 basis points higher than those on Aa-rated bonds the week before and, after the success of these bonds, the municipal market began to firm. On the following day, two smaller new issues were swift sellouts at somewhat higher prices than had originally been planned, and prices on several outstanding issues were raised. As a consequence, the *Bond Buyer's* index declined on April 20, for the first time in six weeks, to 5.50 percent from 5.54 percent the previous Thursday. The better tone continued into the final week when a $147 million issue of New York State bonds was quite successfully marketed and moved to a premium on the second day. The Treasury's financing announcement contributed to the improved climate in the tax-exempt market as the month closed. During the week ended April 27, the *Bond Buyer's* index fell an unusually sharp 30 basis points to 5.20 percent, its lowest level since March 9.