The Money and Bond Markets in March

Most short-term interest rates moved upward in March amid continuing international monetary uncertainty, pressures on commercial bank reserve positions, and concern about inflationary pressures. A recurrence of intense speculation against the dollar at the beginning of the month brought a temporary suspension of central bank foreign exchange operations followed by the floating of European currencies. Continued economic expansion and the relative attractiveness of the banks' prime lending rate in comparison with other money market rates encouraged strong business demand for bank loans. Banks, in turn, raised funds through heavy sales of certificates of deposit (CDs) as well as by liquidation of securities from their portfolios. Moreover, restrained provision of nonborrowed reserves again forced member banks to meet a larger part of their reserve requirements by borrowing from their Reserve Banks. These developments were reflected in the rapid expansion of bank credit and banks' total deposit liabilities in contrast to little or no growth of the monetary aggregates, which exclude CDs and United States Treasury deposits. Against this background, most short-term interest rates rose about ½ to ¾ percentage point, and several large banks raised their prime lending rates from 6¼ percent to 6¾ percent. After representatives of these banks met with the Committee on Interest and Dividends, a generally prevailing prime rate of 6½ percent was established.

In the bond markets, rising short-term rates and inflationary fears put upward pressure on yields during the first half of March. Bond yields stabilized after midmonth, as money market rates steadied and uncertainties about the international monetary problem eased. The partial rollback of some banks' prime rate increases and talk of the possibility of stiffer price controls helped to steady the bond markets. Bond prices dropped again at the end of the month, however, amid some disappointment over the limited scope of the price controls on meat that were announced by President Nixon on March 29. The Congressional testimony of Chairman Burns was also interpreted as suggesting the possibility of higher interest rates in the future. Over the month as a whole, however, the strong technical condition of the Treasury securities market and the relatively light offerings of new issues of corporate bonds tended to moderate the rise of long-term rates.

BANK RESERVES AND THE MONEY MARKET

Money market conditions were steadily firm in March, with the effective rate on Federal funds averaging 7.09 percent. This compared with averages of 6.58 percent in February and 5.94 percent in January. Member bank net borrowed reserves tightened to an average of $1,656 million in the four weeks ended March 28 (see Table I), compared with $1,418 million in February and $823 million in January. Following the devaluation of the dollar in mid-February, renewed speculation forced foreign central banks to absorb over $3.6 billion on March 1 to maintain the new exchange rate limits. Central bank foreign exchange operations were suspended to permit consultation among members of the European Community and the United States. When the exchange markets reopened on March 19, most European currencies were floated jointly against the dollar, with a few floating independently.

Continued strong business loan demand contributed to higher money market rates. Heavy loan demand stemmed from the rising credit requirements of the rapidly expanding economy and the relatively low bank prime rate in comparison with costs of funds raised through alternative means such as commercial paper. This placed large demands on the banks at a time when the Federal Reserve was keeping nonborrowed reserves on a short tether. The generally firm Federal funds market was characterized by a declining daily pattern of rates in one statement week, followed by a rising trend in the next week, and vice versa (see Chart I). Federal funds often traded on Wednesday at rates well below, or above, the weekly average. In the statement week ended March 21, member bank borrowings at the discount window rose to $2,141 million, the highest weekly level in over fifty years. Borrowings remained high in the week ended March 28, averaging $2,013 million.

In order to raise funds for loans, some banks by the end of March were willing to pay as high as 7⅜ percent on 89-day CDs, which are not subject to Regulation Q maximum interest rate limits. At the same time, offering rates on 90- to 179-day maturity and 180-day to one-year maturity CDs rose to their respective Regulation Q permissible ceilings of 6¾ percent and 7 percent. Posted rates on CDs of longer than one year maturity, however, remained below the 7½ percent ceiling for that category. Fears of possible future credit rationing may also have inspired some companies to take out bank loans while they were available, especially since the proceeds could be reinvested in money market instruments at a profit. Further loan demand came from borrowers shifting out of the commercial paper market at 6¾-7 percent to take advantage of the lower prime lending rate. While outstanding commercial paper issued by nonbank firms and sold through dealers dropped $1.2 billion in the four weeks ended March 28 to a level of $8.8 billion, business loans of weekly reporting large commercial banks rose $3.6 billion to $100 billion.

On March 19 several important banks around the country announced a ½ percentage point increase in their prime lending rate to 6¾ percent. Dr. Arthur Burns, the chairman of the Committee on Interest and Dividends, then invited representatives of these banks to meet with the Committee at his office on March 22. At the conclusion of this meeting, the Committee stated its opinion that although costs of interest-sensitive funds to banks had risen considerably, an increase in the prime lending rate as large as ½ percentage point was not justified at that time. Most major banks subsequently established a prime rate of 6½ percent. Banks appeared to be moving toward the implementation of a dual prime rate system, with one rate applicable to large corporations that have access to national money and capital markets and a second prime rate which would apply to small businesses that rely principally on local sources of funds. It was envisioned that the prime lending rate for large corporations would fluctuate with changes in open market rates, while special moderation would be observed with respect to loan rates to smaller businesses as well as to farmers, home buyers, and consumers.

The adjusted bank credit proxy—which consists of daily average member bank deposits subject to reserve requirements plus liabilities to foreign branches and bank-related commercial paper—expanded at an estimated 20 percent seasonally adjusted annual rate in March, even more rapidly than the 16½ percent rate of advance in February. Much of this surge in the proxy was accounted for by the rapid rise in large-denomination CDs. During

Table I

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

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

Factors	Changes in daily averages—week ended				Net changes
	March 7	March 14	March 21	March 28	
"Market" factors					
Member bank required reserves	— 417	+ 185	— 196	+ 139	— 289
Operating transactions (subtotal)	— 270	— 640	— 666	— 399	—1,975
Federal Reserve float	— 88	+ 214	— 186	— 848	— 908
Treasury operations*	— 86	— 928	+ 400	+ 110	— 504
Gold and foreign account	+ 29	+ 8	— 30	+ 61	+ 68
Currency outside banks	—	— 160	— 772	+ 330	— 602
Other Federal Reserve liabilities and capital	— 124	+ 227	— 77	— 53	— 27
Total "market" factors	— 687	— 455	— 862	— 260	—2,264
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 781	+ 293	+ 376	+ 154	+1,604
Outright holdings:					
Treasury securities	+ 736	+ 162	+ 452	+ 106	+1,456
Bankers' acceptances	—	—	— 1	— 1	— 2
Federal agency obligations	— 10	— 6	— 8	—	— 24
Repurchase agreements:					
Treasury securities	+ 57	+ 128	— 62	+ 56	+ 179
Bankers' acceptances	— 5	— 2	+ 4	— 20	— 23
Federal agency obligations	+ 3	+ 11	— 9	+ 13	+ 18
Member bank borrowings	+ 206	— 197	+ 650	— 128	+ 531
Other Federal Reserve assets†	+ 55	+ 41	+ 86	+ 32	+ 214
Total‡	+1,042	+ 137	+1,113	+ 56	+2,348
Excess reserves‡	+ 355	— 318	+ 251	— 204	+ 84

	Daily average levels				Monthly averages
Member bank:					
Total reserves, including vault cash‡	32,058	31,555	32,002	31,659	31,819§
Required reserves	31,717	31,532	31,728	31,589	31,642§
Excess reserves‡	341	23	274	70	177§
Borrowings	1,688	1,491	2,141	2,013	1,833§
Free, or net borrowed (—), reserves	—1,347	—1,468	—1,867	—1,943	—1,656§
Nonborrowed reserves	30,371	30,064	29,861	29,646	29,986§
Net carry-over, excess or deficit (—)‖	32	170	64	131	99§

Note: Because of rounding figures do not necessarily add to totals

* Includes changes in Treasury currency and cash.

† Includes assets denominated in foreign currencies.

‡ Adjusted to include $279 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.)

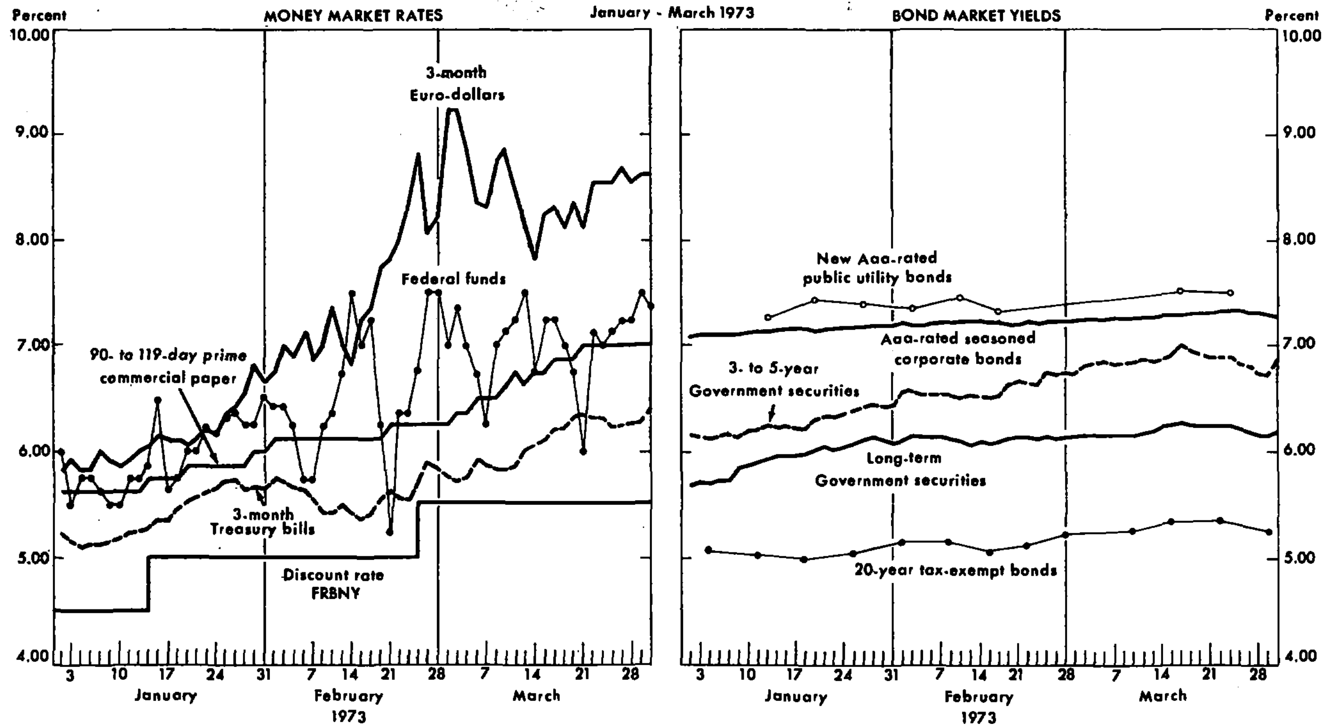
§ Average for four weeks ended March 28.

‖ Not reflected in data above.

Chart I

SELECTED INTEREST RATES

January - March 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.

the past three- and twelve-month periods the proxy has grown at respective rates of 15 percent and 12½ percent (see Chart II). Reserves available to support private nonbank deposits (RPD) rose at a 14 percent rate in March, compared with the 4½ percent rate of decline in February. The March increase in RPD, which brought the growth in the first quarter to 10½ percent, was wholly attributable to the increase in member bank borrowings as seasonally adjusted nonborrowed reserves declined both in March and in the first three months of this year.

The growth of the narrowly defined money supply (M_1)—adjusted private demand deposits plus currency outside banks—halted in March. According to preliminary estimates, M_1 fell at a seasonally adjusted annual rate of about ½ percent in March, compared with a 6 percent growth rate in February. This caused the three-month increase of M_1 to slow to an annual rate of about 1½ percent. Because of the much more rapid growth of M_1 in the last three quarters of 1972, the growth over the twelve months ended in March was 6½ percent. The broadly defined money supply (M_2), which adds commercial bank time deposits other than large CDs to M_1, advanced at an estimated 5 percent rate in March, somewhat less rapidly than in the previous month. M_2 climbed at a 6 percent rate in the first quarter of 1973 and by 9 percent over the twelve months ended in March.

THE GOVERNMENT SECURITIES MARKET

Treasury bill rates moved upward in March as they resumed a more normal relation with other money market rates. In February, Treasury bill rates had been artificially low because of heavy foreign central bank demand to invest the dollars accumulated in defending fixed exchange rates. With the suspension of foreign central bank exchange operations and the agreement for a joint European float against the dollar, some market participants expected that dollar reflows would cause foreign central banks to disgorge Treasury bills. Moreover, there was also some anticipation that there would be another Federal Reserve discount rate increase. Dealers were further discouraged by the large adverse differential between Treasury bill yields and the cost of financing inventories. At the March 19 auction, the three- and six-month bill rates (see Table II) had advanced about ½ and ¾ percentage point, respectively, from the levels of the final February auction. When neither large reflows nor a discount rate increase occurred by the March 26 auction, a relative scarcity of bills led to a mild decline in rates. Market participants were encouraged that foreign central bank purchases of nonmarketable United States Government obligations during past weeks had substantially reduced the Treasury's need to raise new cash in coming months. This result was confirmed on March 30 when the Treasury disclosed that because of its strong cash position, it would postpone the offering of $2 billion of two-year notes that had earlier been expected to come in late March.

The average interest rate for three-month bills rose from 5.81 percent in February's last auction to 6.25 percent at the March 26 sale. In the March 27 auction, $1.8 billion of one-year bills was sold at an average issuing rate of 6.62 percent, 56 basis points above the February 22 auction level. The $1.8 billion sale raised $100 million in new cash in addition to replacing $500 million of discontinued nine-month bills and $1.2 billion of one-year bills coming due.

Yields on United States Treasury coupon securities moved upward in March. The rise in short-term rates and fears of inflation associated with currently rising food prices and important forthcoming labor contract negotiations this year contributed to the higher interest rate levels. Since the end of last year the term structure of interest rates on United States Government securities has shifted markedly into a "humpback" pattern (see Chart

Table II

AVERAGE ISSUING RATES*
AT REGULAR TREASURY BILL AUCTIONS

In percent

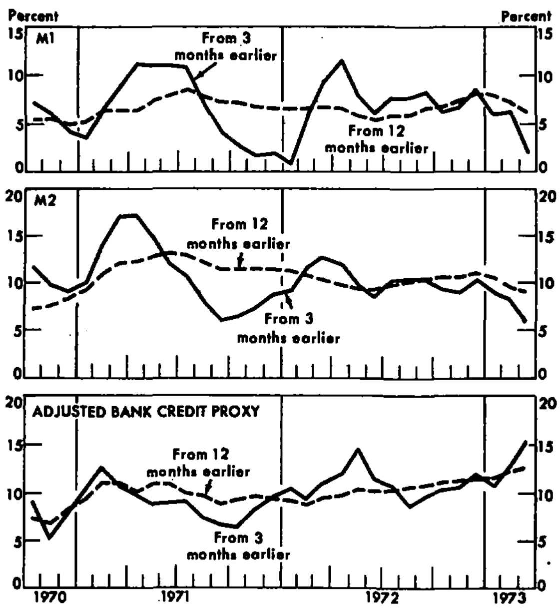
Maturities	Weekly auction dates—March 1973			
	March 5	March 12	March 19	March 26
Three-month	5.879	5.997	6.334	6.251
Six-month	6.272	6.440	6.759	6.632
	Monthly auction dates—January-March 1973			
	January 26	February 22	March 27	
Fifty-two weeks	5.986	6.051	6.615	

* 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

CHANGES IN MONETARY AND CREDIT AGGREGATES

Seasonally adjusted annual rates



Note: Data for March 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.

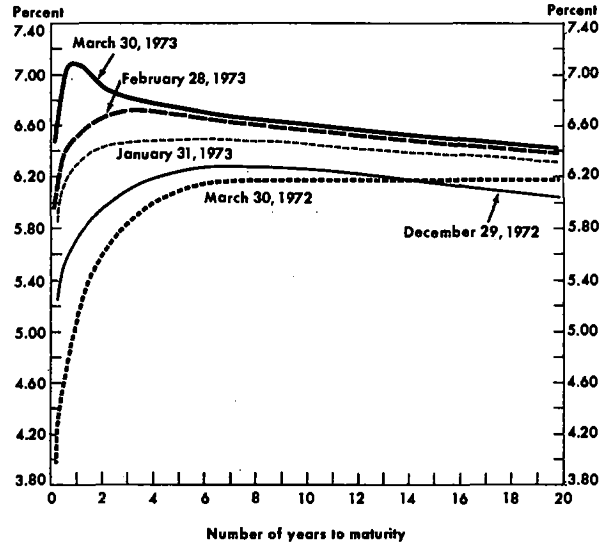
Sources: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York.

III), which is typical of periods of rapidly advancing economic activity and burgeoning credit demands. Commercial banks have been substantial sellers of Treasury securities in the maturity range of the "hump" to raise funds to meet unusually strong business loan demand. These bank portfolio sales have contributed to the rise in yields of the short-term and middle-term maturity issues. Although long-term United States Government bond yields have also moved upward, these increases have been moderated by the strong technical condition of the market and the relatively light calendar of new issues in the corporate bond market.

Federal agency financing in March was a little heavier than in February. The Farmers Home Administration issued $0.5 billion of five-year 7.20 percent and fifteen-year 7.50 percent notes which sold slowly in the early part of the month and were ultimately released from syndicate restrictions, resulting in upward yield adjustments of about 4 and 9 basis points, respectively. Later in the month the Federal Home Loan Banks raised $1.2 billion of new money through the sale of $700 million of two-year and $300 million of four-year bonds at 7.15 percent as well as $200 million of ten-year bonds at 7.30 percent.

Chart III

YIELDS ON UNITED STATES GOVERNMENT SECURITIES



OTHER SECURITIES MARKETS

Corporate bond yields rose in the first part of March but were steadier as the month progressed. The background of rising short-term rates and international monetary uncertainty maintained a depressing effect until these problems had calmed somewhat. New-issue volume, while still relatively small, was above the extremely light offerings of February. Attention was focused on the first major financing in over a month—a $350 million negotiated offering of forty-year telephone debentures. The Aaa-rated bonds were offered on Tuesday, March 20, and were priced at par to yield 7.625 percent, about 33 basis points higher than a similarly rated though smaller telephone issue marketed on February 13. The securities were considered attractively priced and were almost completely distributed within two days. By the end of March, Moody's index of Aaa-rated seasoned corporate bond yields had risen to 7.29 percent, compared with 7.24 percent on February 28.

In the tax-exempt bond market, significantly higher yields were established early in March with the sale of several new state and municipal offerings at concessions to interest rates available on outstanding issues. As in the corporate market, however, yields stabilized toward the latter part of the month. New-issue volume in March was relatively heavy in the tax-exempt bond market. The Blue List of advertised inventories of municipal bonds fell to $592 million on March 30, compared with $807 million on February 28. The Bond Buyer index of twenty municipal bond yields rose 4 basis points during March to 5.26 percent at the end of the month.