The Money and Bond Markets in March

Interest rates moved substantially higher during March. Yields rose particularly sharply from midmonth on, following more moderate increases early in the period. In the money market, the rate on four- to six-month commercial paper rose about ⅜ percentage point during the first fourteen days of the month and then climbed a full percentage point over the remainder of the period. The average effective rate on Federal funds rose to 9.35 percent from its average of 8.97 percent in February, while the rate on bankers' acceptances increased by more than a percentage point. Most major commercial banks also raised their prime lending rates on loans to large business borrowers ½ percentage point to 9¼ percent.

Yields on Government securities rose over much of March. Expectations of a near-term easing of monetary policy vanished, as the economy exhibited greater than expected strength and inflation continued at a rapid pace. The firmness of the money market served to confirm the System's restrictive stance. The Treasury financing late in the month contributed to the rise in rates, since investor demand had been quite modest and dealers were concerned about a buildup in inventories. Over the month, the rates on three- and six-month Treasury bills each increased by some 85 basis points, while the yield on three- to five-year coupon securities registered about an 80 basis point rise. There was a somewhat smaller increase in the yield on long-term Government securities. Under the pressure of a sizable calendar of new issues and heavy inventories from earlier months, rates on corporate and municipal bonds also increased considerably in March. Over the month, the Federal Reserve Board's index of yields on newly issued Aaa-rated utility bonds increased 34 basis points to 8.64 percent, its highest level since November 1970. At the same time, The Bond Buyer index of municipal bond yields rose 31 basis points to its highest level since last August.

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 March 27 following a sizable increase in February. However, the growth of time and savings deposits at commercial banks, other than large negotiable certificates of deposit (CDs), slowed over the four statement weeks in March, and the broad money stock (M_2)—M_1 plus consumer-type time and savings deposits at commercial banks—rose somewhat less rapidly than M_1. Following a very small increase in February, the adjusted bank credit proxy, which includes deposits of member banks plus certain nondeposit liabilities, expanded more strongly in the four-week period ended March 27 as all its components increased.

THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

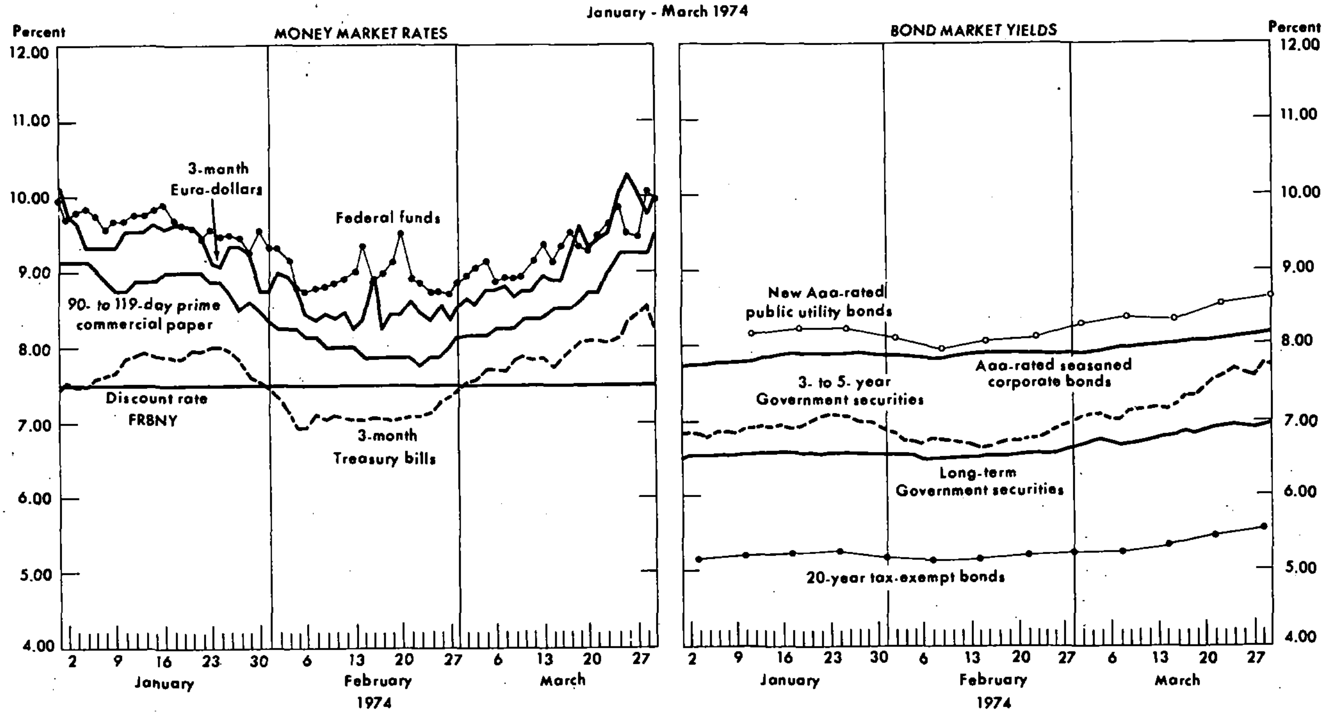
Interest rates on most money market instruments rose sharply in March (see Chart I), after declining on balance during the three preceding months. For the month as a whole, the effective rate on Federal funds averaged 9.35 percent, 38 basis points above its February average. Commercial paper rates registered sizable increases during March as well. These increases ranged from ¾ percentage point on some maturities of directly placed paper to 1⅜ percentage points on some dealer-placed paper. The bid rate on bankers' acceptances closed the month at 9.75 percent, 1½ percentage points higher than at the start of the period. In line with the rise in other money market rates, most major commercial banks raised their prime lending rates to large business borrowers ½ percentage point to 9¼ percent by the end of the month. Early in April, most large banks raised their rates in two steps to 9¾ percent. For the second consecutive month, member banks also increased their reliance on the discount window. The average level of borrowings rose \$83 million in March to \$1,278 million (see Table I).

The secondary market offering rate on large negotiable CDs moved higher in March, as commercial banks attempted to counter the heavy maturities that usually occur around the corporate tax and dividend date. The rate on CDs of three months' maturity closed the month

Chart I

SELECTED INTEREST RATES

January - March 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.

at 9.60 percent, up 1⅜ percentage points over the period. Banks were apparently able to replace the maturing CDs, since the total of CDs outstanding increased slightly during March. However, the rate of growth was modest when compared with the pace of the two preceding months.

According to preliminary data, seasonally adjusted daily average M_1 grew substantially over the four statement weeks ended March 27 relative to its average of the preceding four-week period. From its average of the four weeks ended thirteen weeks earlier to its average of the four weeks ended March 27, M_1 grew at a 6.5 percent annual rate; this is essentially the same as its increase from the average of the four weeks ended a year earlier (see Chart II). The growth of commercial bank time and savings deposits other than large CDs slowed over the four-week period ended March 27, and the advance of M_2 was less rapid than that of M_1. Because of the faster rise in such deposits during previous months, however, M_2 grew more rapidly than M_1 from its four-week average of thirteen and fifty-two weeks earlier.

Growth of the adjusted bank credit proxy accelerated in the four weeks ended March 27 relative to its slow February pace. An expansion in all major components of the proxy accounted for the acceleration. From the average of the four weeks ended a year earlier to the four-week period ended in March, the proxy grew nearly 9 percent.

THE GOVERNMENT SECURITIES MARKET

Yields on Treasury issues rose substantially during March, largely in response to mounting concern over the near-term outlook for monetary policy. Earlier hopes for some further easing of monetary restraint were based on the assumption that the Federal Reserve would act to bolster the economy when the widely forecast slowdown in activity occurred. As matters developed, however, most of the economic indicators reported in March pointed to underlying strength rather than weakness, and the lifting of the Arab oil embargo lent support to this conclusion. Moreover, given the unusually large increase in the money supply in recent weeks and the continuing rapid rate of inflation, participants reasoned that some tightening of System policy was likely in an attempt to check these developments. The higher rate levels at which Federal funds traded during March seemed to many observers to confirm that additional restraint was being applied.

At the beginning of March, yields on Treasury coupon securities continued the advance which had been under way since the middle of the previous month. Statistics available early in the period showing a further rapid rise in the money supply served to depress market sentiment. However, these higher yields attracted some investor interest, and this subsequently imparted a degree of stability to the market. At the end of the first week, the market reacted negatively to reports indicating a stronger than expected labor market and substantial business loan demand. These data were seen as reducing the need for an easing of monetary policy, and yields resumed their advance. At about midmonth, yields rose sharply following news of another large increase in the money supply and of continued strong business loan demand. The weakening persisted for several days, fostered by sluggish investor demand and firm conditions in the money market. Another factor which added to the upward pressure on yields was the expectation and, later, the fact that the Treasury would raise new funds in part by selling a coupon issue.

After the close of business on March 20, the Treasury announced a $4 billion new cash borrowing. This financing consisted of an additional $2.5 billion of 84-day tax anticipation bills and $1.5 billion of two-year 8 percent notes. The borrowing was somewhat larger than many had anticipated, and a number of participants pressed outstanding coupon issues on the market following the announcement to position themselves for the auction. Consequently, yields increased further. At the auction of the notes on March 28, the average issuing rate was set at 8.08 percent. The issue proved attractive to small in-

Table I

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

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

Factors	Changes in daily averages—week ended				Net changes
	March 6	March 13	March 20	March 27	
"Market" factors					
Member bank required reserves	+ 130	— 117	— 494	+ 526	+ 45
Operating transactions (subtotal)	+ 429	+ 35	— 766	— 860	—1,162
Federal Reserve float	— 418	+ 92	— 211	— 150	— 687
Treasury operations*	+ 736	+ 160	+ 469	— 987	+ 378
Gold and foreign account	— 68	+ 51	— 23	— 7	— 47
Currency outside banks	+ 94	— 332	— 832	+ 327	— 743
Other Federal Reserve liabilities and capital	+ 85	+ 64	— 169	— 43	— 63
Total "market" factors	+ 559	— 82	—1,260	— 334	—1,117
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	— 377	— 21	+ 677	+ 136	+ 415
Outright holdings:					
Treasury securities	— 367	— 415	+ 561	— 147	— 368
Bankers' acceptances	— 3	— 2	+ 3	+ 4	+ 2
Federal agency obligations	— 7	— 21	— 25	+ 146	+ 93
Repurchase agreements:					
Treasury securities	—	+ 378	+ 114	+ 96	+ 588
Bankers' acceptances	—	+ 17	+ 28	+ 25	+ 70
Federal agency obligations	—	+ 22	— 4	+ 12	+ 30
Member bank borrowings	— 320	+ 53	+ 500	+ 228	+ 461
Seasonal borrowings†	+ 3	—	+ 15	+ 10	+ 28
Other Federal Reserve assets‡	+ 50	+ 60	+ 23	+ 48	+ 181
Total	— 647	+ 92	+1,200	+ 413	+1,058
Excess reserves‡	— 88	+ 10	— 60	+ 79	— 59

	Daily average levels				Monthly averages§
Member bank:					
Total reserves, including vault cash‡	34,633	34,760	35,194	34,747	34,834
Required reserves	34,515	34,632	35,126	34,600	34,718
Excess reserves	118	128	68	147	115
Total borrowings	931	984	1,484	1,712	1,278
Seasonal borrowings†	19	19	34	44	29
Nonborrowed reserves	33,702	33,776	33,710	33,035	33,556
Net carry-over, excess or deficit (—)‖	132	66	75	36	77

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.
§ Average for four weeks ended March 27, 1974.
‖ Not reflected in data above.

vestors, but reportedly few institutions were among the buyers. Over the month as a whole, yields on intermediate issues rose by about 65 basis points on average, while long-term bond yields advanced by some 35 basis points.

Rates on Treasury bills also experienced sizable increases in March as a result of many of the same factors which affected yields on Treasury coupon issues. Bill rates rose at the start of the month in response to firmer money market conditions and indications of continued rapid growth in the money stock. The average issuing rates for the new three- and six-month bills set at the first weekly auction of the month were some 49 basis points above those of a week earlier. Bill rates moved irregularly lower the next several days and then resumed their rise, initially in response to the report of the stability of the unemployment rate in February. Then, primarily in reaction to an exceptionally large one-week rise in M_1, bill rates moved sharply higher at midmonth and continued their ascent over succeeding days, as participants prepared for the Treasury's expected new cash borrowing. Similarly, rates at the regular weekly auctions advanced as the month progressed (see Table II). On March 26, the Treasury auctioned the $2.5 billion of 84-day tax anticipation bills. Bidding in the auction was good, at least partly reflecting the fact that commercial banks were able to pay for the bills by crediting Treasury Tax and Loan Accounts. The bills were issued at an average rate of 8.31 percent. Over the month as a whole, bill rates generally increased about 87 to 127 basis points.

Yields on Federal agency and Federally guaranteed securities also increased during March. On March 12 the Washington, D.C., Metropolitan Area Transit Authority issued $225 million of Federally guaranteed Aaa-rated bonds priced to yield 8.17 percent in forty years. The bonds encountered buyer resistance and, three days later when the bonds were released to trade freely, the yield increased by about 13 basis points. Later in the month, two farm credit agencies marketed new issues. Specifically, the Federal Intermediate Credit Banks sold $608 million of nine-month 8.15 percent bonds and the Banks for Cooperatives offered $251.2 million of six-month 8.20 percent bonds. These issues were initially well received, but they subsequently traded at slight discounts.

THE OTHER SECURITIES MARKETS

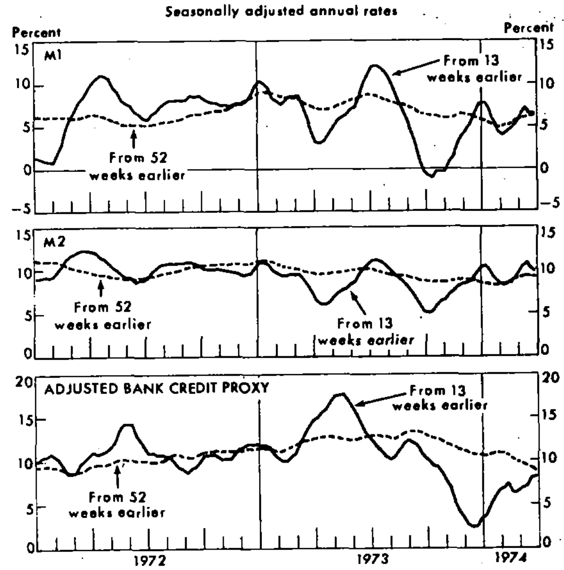
Interest rates on both corporate and municipal bonds climbed substantially during March in the face of a sizable calendar of new issues and a heavy backlog of unsold bonds. Measured by the Federal Reserve Board's series on new and recently issued Aaa-rated utility bonds, yields on corporate bonds rose in March to their highest levels since late 1970. The March schedule of tax-exempt offerings, although not so heavy as the corporate calendar, coupled with the large inventories left from February resulted in upward pressure on rates in this market as well. Consequently, The Bond Buyer index of twenty municipal bond yields rose to 5.57 percent on March 28, compared with a reading of 5.26 percent a month earlier.

Rates on corporate bonds moved higher as the month opened, continuing the pattern that began late in February. The unsold portions of two issues marketed around mid-February were released from syndicate restrictions at the start of the period, and the upward rate adjustments amounted to about 15 basis points. Investor response to the highly rated new issues offered early in the month was favorable, and all of the large Aa- and Aaa-rated bonds sold well at generous yields. Included among these were $125 million of Aaa-rated notes of a bank holding com-

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 March 27, 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.

pany which moved quickly after being priced to yield 7.80 percent in eight years and $125 million of Aa-rated thirty-year debentures which were snapped up at an 8.60 percent initial yield and then moved to a premium. Investors were selective, however, and some lower rated bonds moved poorly despite increased yields. Around mid-March, some general investor resistance developed and, for the second consecutive month, an Aaa-rated Bell System issue encountered difficulty. This occurred despite the fact that the $200 million of forty-year debentures yielded 8.30 percent, 24 basis points more than similar bonds marketed in February and the highest return on an Aaa-rated Bell issue in almost three and one-half years. Late in the day following their flotation, these bonds were allowed to trade without restriction and the initial upward yield adjustment amounted to 8 basis points. The initial response to the next rather large corporate issue was also cool but then, as a result of improved market sentiment, most of the remaining new corporate offerings in March were successful endeavors, albeit at decidedly higher yields than had prevailed in February.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—March 1974			
	March 4	March 11	March 18	March 25
Three-month	7.675	7.920	8.047	8.300
Six-month	7.566	7.637	7.882	8.231
	Monthly auction dates—January-March 1974			
	January 9	February 6	March 6	
Fifty-two weeks	6.948	6.342	6.897	

* 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.

At the beginning of March, the Blue List of unsold municipal bonds totaled a very large $1.14 billion, and these inventories weighed heavily on the market. Two of the largest new offerings during the period were scheduled for March 5 and 6, and participants waited on the sidelines until terms for these were announced. The first of them, $150 million of A1-rated bonds, attracted broad-based demand, with yields ranging from 4 percent in 1976 to 5.60 percent in 2003. On the following day, the market also reacted favorably to the month's largest tax-exempt issue, some $227 million of Department of Housing and Urban Development New Housing Authority bonds. Priced to yield from 3.90 percent in 1975 to 5.25 percent in 2014, the bonds were considered attractive and good demand emerged. The successful marketing of these offerings sparked some interest in older issues, and prices stabilized over the next few days. Demand then began to wane, and rates moved higher throughout the remainder of the month in generally light trading. Dealers were able to pare their stocks during the period, and the Blue List of advertised inventories fell $485 million to a level of $657 million, the lowest this year.