The Money and Bond Markets in March

The decline in short-term interest rates that characterized the past several months continued in March. Most short-term rates decreased only slightly, however, from their levels of the preceding month. The average rate on large-denomination certificates of deposit (CDs) fell by only 25 basis points in March from its level in the previous month. Similarly, the rate on commercial paper averaged but 27 basis points less than its average in February. The Federal funds rate averaged 5.54 percent in March, down 70 basis points from its average in February. Early in the month, the Board of Governors of the Federal Reserve System approved a reduction in the discount rate from 6¾ percent to 6¼ percent at all Federal Reserve Banks.

While private demand for short-term credit remained sluggish in March, huge corporate and Treasury borrowing weighed on the bond market. A record of $4.6 billion of bonds was issued in the corporate sector, and $10 billion net was raised by the Treasury. Among the new Treasury issues was $1.25 billion of fifteen-year bonds. This, in conjunction with the abundance of newly issued corporate bonds, caused long-term yields to rise sharply over the period, in most cases back to their mid-January levels. Estimates of the future Federal deficit were revised upward during the month. Yields on Government coupon securities increased, and Treasury bill rates rose despite declines in other money market rates. The tax-exempt market was also subject to these influences, although new issue activity was moderate. In addition, the effects of the financial difficulties of the New York State Urban Development Corporation (UDC) and concern over the financial position of New York City weighed on the market.

Preliminary data indicate that growth of the narrowly defined money stock (M_1) accelerated sharply in March. This is the second month in a row that M_1 has experienced relatively rapid growth. The strong performance of M_1 in March was accompanied by rapid expansion of the more broadly defined money stock (M_2).

THE MONEY MARKET, BANK RESERVES, AND MONETARY AGGREGATES

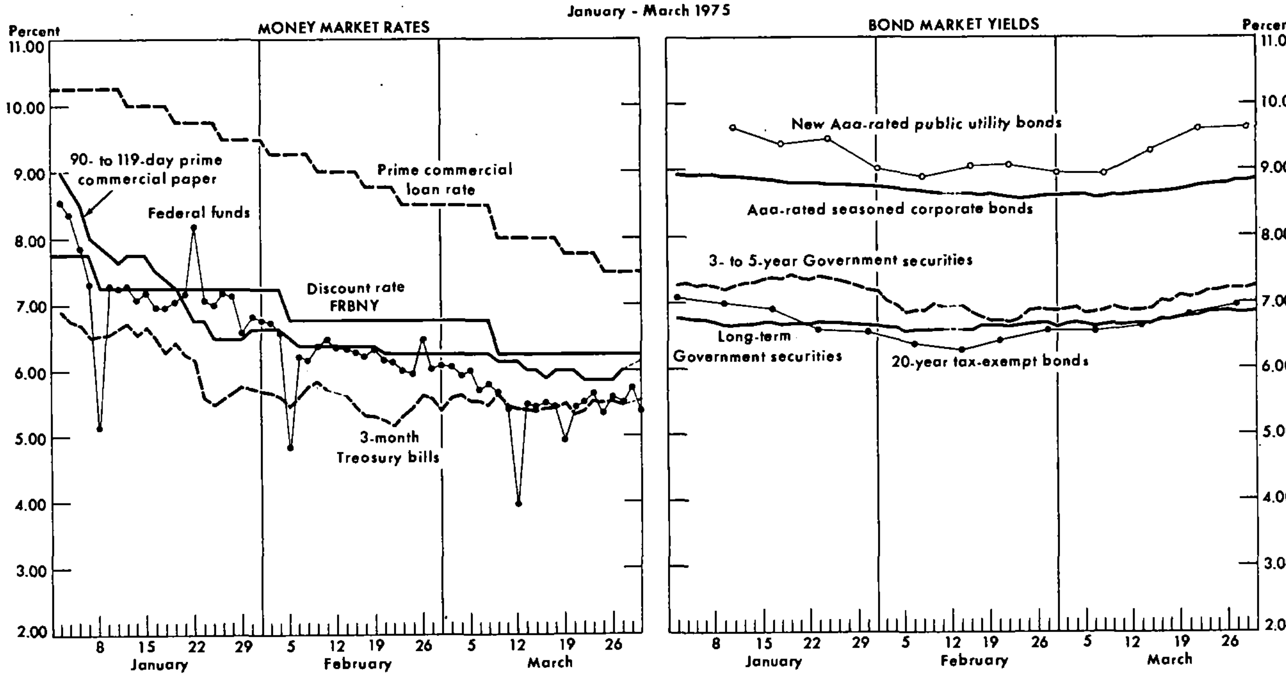
Interest rates on most money market instruments generally followed a downward course in March, as they had in recent months (see Chart I). The effective rate on Federal funds moved about 50 basis points lower at the beginning of the period and then fluctuated around the 5½ percent level for the remainder of the month. For March as a whole, the funds rate averaged 5.54 percent, its lowest level since December 1972. Rates on CDs in the secondary market also moved downward over the month, although they backed up at the end of March. In the commercial paper market, interest rates were unchanged at the beginning of the month but fell as the period progressed. For example, after holding steadily at 6¼ percent early in March, the rate on 90- to 119-day dealer-placed commercial paper moved down by 35 basis points in a series of steps that brought it to 6 percent near the end of the month. The bid rate on bankers' acceptances also declined and closed the month at 5¾ percent, down 30 basis points from its end-of-February level.

Business demands for short-term credit remained sluggish in March. At weekly reporting commercial banks, business loans fell by $179 million over the four statement weeks of the month, bringing the total decline in such loans thus far in 1975 to about $5.6 billion. In part, the drop in business loans at banks over the January-March period resulted from shifts of some business borrowing to the commercial paper market, as banks' prime lending rates have lagged the fall in commercial paper rates. However, over this three-month period, the combined total of business loans at weekly reporting banks plus nonfinancial commercial paper outstanding has fallen $3.5 billion, in contrast to an increase of $6.4 billion over the comparable period of 1974. Along with the weakness in business loan demand in March, most major banks reduced their prime lending rate by 1 percentage point to 7½ percent. Major

Chart I

SELECTED INTEREST RATES

January - March 1975



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.

banks became somewhat more active in issuing CDs, and the volume of CDs outstanding rose in March by $969 million. Member bank borrowings from the Federal Reserve fell by $26 million in the four-week period ended March 26, averaging $113 million for the same period (see Table I).

According to preliminary data, the money stock measures advanced in March at a relatively rapid pace for the second month in a row. After increasing at a seasonally adjusted annual rate of 6.8 percent in February, M_1—private demand deposits adjusted plus currency outside banks—rose at a 14.7 percent annual rate in the four-week period ended March 26 from its average level in the four weeks ended February 26. The demand deposit component of M_1 participated in the surge, rising over the same period at a 15.1 percent pace, while the currency component increased 13.3 percent. However, M_1 had actually fallen sharply in January, so that the rapid growth registered in the subsequent two months left M_1 in March only 3 percent higher, at an annual rate, than its level of thirteen weeks earlier (see Chart II). Over the year ended in March, M_1 rose 4.3 percent.

M_2—which adds to M_1 time deposits less large negotiable CDs—continued to grow rapidly in March. Partly as a result of lower short-term interest rates, which boosted flows into time and savings deposits, M_2 grew at a 13 percent seasonally adjusted annual rate during the four weeks ended March 26 from its level over the four statement weeks in February. In the thirteen-week period ended March 26, M_2 rose 8 percent at an annual rate. In contrast to the money stock measures, growth of the adjusted bank credit proxy—which includes member bank deposits subject to reserve requirements plus certain nondeposit liabilities—remained sluggish in March, as the drop in the seasonally adjusted volume of CDs outstanding partially offset advances in member bank demand and time deposits.

During the month, the Federal Open Market Committee announced that it had voted to speed up publication of the records of policy actions taken at each of its monthly meetings. Henceforth, policy records will be released with a delay of approximately forty-five days, rather than with the ninety-day lag previously followed. At the January meeting, the Committee decided that the economic situation and outlook called for more rapid growth in the monetary aggregates over the months ahead than occurred in recent months. It adopted ranges of tolerance for the growth of M_1 and M_2, respectively, over the January-February period of 3½ to 6½ percent and 7 to 10 percent.

THE GOVERNMENT SECURITIES MARKET

March was marked by a sharp increase in the yields on intermediate- and long-term Government securities. This occurred as the Treasury raised $10 billion in new cash in the month, with clear intentions of raising more in the future. Furthermore, estimates of the Federal deficit in 1975 and 1976 were repeatedly revised upward during the month, and shorter term rates rose in the last stretch of the period as the revised estimates of the prospective Federal deficit affected a wide spectrum of the Government securities market.

Yields in the intermediate- and long-term Government securities markets were fairly steady during the first half of the month, partly because bill rates were edging downward. From the first to the third weekly auctions, the three- and six-month bill rates fell by 26 and 27 basis points, respectively (see Table II), while longer term yields showed little change. Shortly after midmonth, however, long-term rates began to rise sharply, and the advance continued for the remainder of the month. For March as a whole, yields on long-term Government securities rose by about 40 basis points on average, and yields on three- to five-year Government securities increased 23 basis points. Treasury bill rates fluctuated within a narrow band over much of the month. Some upward pressure from expectations of large future Treasury funding was felt at the end of March, although for the entire period the

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MARCH 1975

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

Factors	Changes in daily averages—week ended				Net changes
	March 5	March 12	March 19	March 26	
"Market" factors					
Member bank required reserves	+ 60	+ 143	− 225	− 201	− 223
Operating transactions (subtotal)	− 9	+2,709	− 893	−3,348	−1,541
Federal Reserve float	− 604	+ 425	− 125	− 303	− 607
Treasury operations*	+ 677	+2,260	+ 207	−2,996	+ 148
Gold and foreign account	− 40	+ 30	− 23	− 44	− 77
Currency outside banks	+ 210	− 355	− 827	− 73	−1,045
Other Federal Reserve liabilities and capital	− 252	+ 350	− 125	+ 69	+ 42
Total "market" factors	+ 51	+2,852	−1,118	−3,549	−1,764
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 193	−3,025	+ 677	+3,678	+1,523
Outright holdings:					
Treasury securities	− 232	−1,840	+ 411	+3,024	+1,363
Bankers' acceptances	+ 24	—	− 10	− 3	+ 11
Special certificates	—	+ 238	+ 277	− 515	—
Federal agency obligations	+ 291	+ 53	− 1	—	+ 343
Repurchase agreements:					
Treasury securities	− 63	−1,095	—	+ 838	− 320
Bankers' acceptances	+ 40	− 178	—	+ 159	+ 21
Federal agency obligations	+ 133	− 203	—	+ 175	+ 105
Member bank borrowings	− 111	− 9	+ 106	− 12	− 26
Seasonal borrowings†	− 2	− 2	− 2	+ 2	− 4
Other Federal Reserve assets‡	+ 136	+ 13	+ 132	− 20	+ 261
Total	+ 218	−3,021	+ 915	+3,646	+1,758
Excess reserves‡	+ 269	− 169	− 203	+ 97	− 6
	Daily average levels				**Monthly averages§**
Member bank:					
Total reserves, including vault cash‡	34,825	34,513	34,535	34,833	34,677
Required reserves	34,397	34,254	34,479	34,680	34,453
Excess reserves	428	259	56	153	224
Total borrowings	70	61	167	155	113
Seasonal borrowings†	9	7	5	7	7
Nonborrowed reserves	34,755	34,452	34,368	34,678	34,563
Net carry-over, excess or deficit (−)‖	28	206	141	10	96

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 26, 1975.
‖ Not reflected in data above.

yield on three-month bills averaged 5.49 percent, about unchanged from its average in the previous month. The yields on longer term Treasury bills responded more sharply to expectations of future Government financing. They generally rose by 25 basis points at the tail end of the month and closed at about end-of-February levels.

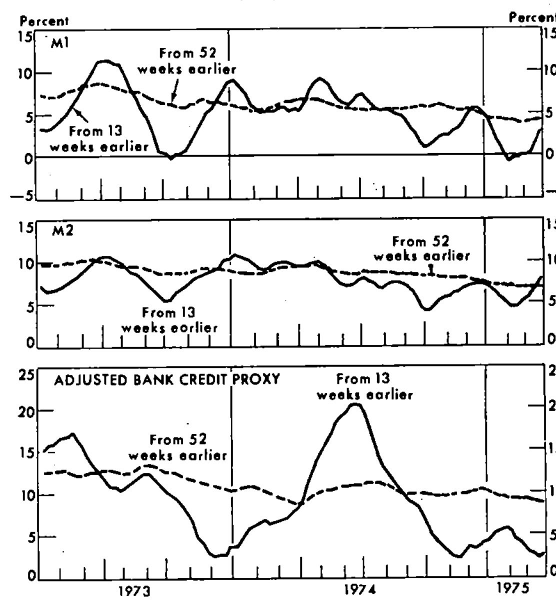
The Treasury held four auctions of coupon issues during the month as part of its program to fund the current Federal deficit. Its new issues were fairly well received, although yields were established at rising levels. On March 11, the Treasury auctioned $1.75 billion of additional 7¾ percent notes due November 15, 1981. Considerable interest was generated among market participants when suggested yield levels rose above 7.50 percent. A total of $3.4 billion of tenders was received, and the average yield was set at 7.51 percent. On March 13 another auction was held, at which $1.5 billion of 6 percent fourteen-month notes was sold at an average yield of 5.98 percent. The sale attracted good bidding interest, with $2.9 billion of tenders being received. Bidding proved to be less than most had expected, however, at the Treasury auction on March 18. An average yield of 6.51 percent was set on a $2.2 billion issue of two-year notes, with the volume of bids being a modest $2.6 billion. In contrast, the widely anticipated Treasury sale of $1.25 billion of fifteen-year bonds, occurring on March 20, went well. With $2.9 billion of tenders being received, an average yield of 8.31 percent was established. On April 1 the Treasury held another auction at which it sold $1.5 billion of twenty-month notes. With tenders totaling $3.8 billion, an average yield of 7.15 percent was set. The Treasury announced on the last day of the month that it might require about $17.5 billion in new cash by June 30.

New Federal agency issues were given mixed receptions in March. In the first week of the month, the Government National Mortgage Association had difficulty attracting buyers for $300 million of 7¼ percent mortgage-backed securities priced to yield 7.96 percent. On the other hand, the Federal National Mortgage Association (FNMA) encountered strong demand for its four-month commitments to purchase home loans at an auction held at midmonth. The average yield on commitments to buy Government-backed mortgages fell to 8.78 percent, the twelfth consecutive decline. However, a $300 million FNMA offering of capital debentures with a 7⅝ percent coupon sold only moderately well. Furthermore, at a second FNMA auction of four-month commitments to purchase Government-backed mortgages, yields rose to 8.85 percent, the first such increase since September 1974. The Housing and Urban Development Department (HUD) entered the market, selling $747.3 million of tax-exempt notes for local public housing authorities. With an average maturity of 8.1 months, the notes yielded on average 3.67 percent, up from the two-year low of 3.49 percent registered last month. Later in the month, HUD sold $553.4 million of tax-exempt urban-renewal notes with an average maturity of 7.7 months at an average interest rate of 3.52 percent, down from the 3.57 percent set at February's auction. A good reception was accorded a $1.7 billion offering of nine-month bonds by the Federal Intermediate Credit Banks (FICB) and a $313.7 million offering of six-month bonds by the Banks for Cooperatives (BC), with coupons set respectively at 6.05 percent and 5.85 percent. These farm credit agencies made additional sales later in the month, with the BC selling $4 million of 8.05 percent bonds due June 2, 1975 and the FICB selling $55 million of 7.35 percent bonds due October 1, 1975 and $15 million of 8.05 percent bonds due September 2, 1975.

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 26, 1975.

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.

THE OTHER SECURITIES MARKETS

Yields on corporate securities rose sharply in March, as a large backlog of undistributed inventories in dealers' hands coupled with a record volume of new offerings weighed heavily on the market. Moody's index of yields on seasoned Aaa-rated corporate bonds rose 20 basis points over the period. Larger gains were registered on newly issued securities, as dealers attempted to quicken their inventory turnover. Over the course of the month, $4.6 billion of new corporate bonds was publicly offered. This represented about $1 billion more than the sizable volume of new issues recorded in February and was nearly twice the average monthly volume of offerings experienced in 1974 as a whole.

New issues received mixed receptions in the corporate market early in the month. A $300 million offering of Aaa-rated debentures, priced to yield 8.33 percent in thirty years, sold out quickly. However, a $250 million issue of Aaa-rated ten-year debentures sold slowly when priced to yield 7.75 percent, a yield that was just a shade above those available on some Federal agency issues with similar maturities. With bulging inventories and with expectations of additional large new offerings, dealers began to release slow-selling issues from syndicate price restrictions, and yields in many cases moved sharply higher. On March 20, General Motors Corporation (GM) brought to market $300 million of 8⅝ percent debentures due 2005 and $300 million of 8.05 percent notes due 1985. This represented the largest financing ever by an industrial firm and was the first time in over twenty years that GM had tapped the bond market. Although both of GM's issues were originally considered to be attractively priced, initial demand for them was slow, as their yields were close to that on the Treasury's fifteen-year issue sold on the same day. The introduction of the new bonds, with huge supplies already existing in the market, further dampened prices in both the primary and secondary markets, and the situation was somewhat aggravated by a greater sense of uncertainty concerning the outlook for peace in the Middle East.

In the last several days of the month, supply pressures eased somewhat in the corporate bond market. Moreover, the Federal Reserve entered the Government securities market to buy intermediate- and long-term Treasury and Federal agency issues. This action, in conjunction with the announced postponement of several corporate offerings, enabled some new issues to meet favorable receptions. A $300 million Aaa-rated offering, consisting of $150 million of 8.2 percent ten-year notes and $150 million of 8.85 percent thirty-year debentures, sold out.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—March 1975				
	March 3	March 10	March 17	March 24	March 31
Three-month	5.637	5.622	5.376	5.542	5.562
Six-month	5.742	5.655	5.478	5.669	5.786
	Monthly auction dates—January-March 1975				
	January 8	February 5	March 5		
Fifty-two weeks	6.378	5.313	5.637		

* 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 issues that moved well included $100 million of Aaa-rated thirty-year first-mortgage bonds with a 9½ percent coupon and $60 million A-rated thirty-year debentures priced at par with a 9⅝ percent coupon. However, expectations of large amounts of new corporate and Treasury issues in the near future continued to depress prices as the month closed.

Uncertainty over the future of the UDC continued to overhang the tax-exempt market in March, although it did not uniformly affect all municipal securities. Early in the month, the State of Tennessee offered $100 million of Aaa/Aa (Moody's/Standard and Poor's)-rated bonds. Although the issue was aggressively priced to yield from 3.70 percent in 1976 to 6.25 percent in 1995, it attracted good demand. A favorable reception was also afforded a $125 million issue of revenue bonds by the Washington State Public Power Supply System. Having recently been awarded Aaa rating, the revenue bonds were scaled to yield between 6.6 percent and 6⅞ percent over a range of maturities. Some price reduction was required, however, to sell unsold balances remaining in dealers' inventories. The New York State Housing Finance Agency was strongly affected by the market's reaction to the financial problems of the UDC. After postponing a $94.8 million sale of new short-term notes, bids were received for only $54 million at the delayed sale. The net interest cost soared to 7.41 percent, compared with 4.29 percent paid to sell $111 million of similar notes on February 5. New York City also fared poorly when it sold $537 million of bond anticipation notes at a net interest cost of 8.69 percent, the highest rate ever paid by the city for this type of borrowing. Later in the month, New York City accepted a somewhat lower interest cost of 7.99 percent in selling a $375 million note issue. Other cities were also hurt by the quality-conscious market; for example, one large city rescinded a bond offer of $22 million when it received a 9.25 percent interest rate bid.

For the month as a whole, The Bond Buyer index of twenty municipal bond yields rose 40 basis points, closing the month at 6.95 percent. The Blue List of dealers' advertised inventories finished the month at $539 million. It declined by $113 million for the month.