The Money and Bond Markets in May

The money and bond markets rallied for most of May in the wake of the Treasury's May 1 announcement that higher than expected revenues in April had reduced its borrowing needs through the end of June. Furthermore, the view of market participants that the decline in the Federal funds rate early in the month reflected Federal Reserve desires bolstered the rally. Market sentiment was also aided by the approval by the Board of Governors of the Federal Reserve System of a reduction in the discount rate from 6¼ percent to 6 percent at all Federal Reserve Banks. Short-term rates declined in response to these developments as well as in response to continued weakness in business demand for short-term credit and a diminution in Treasury borrowing in the bill market. Late in the month, however, the rally stalled in the absence of further declines in the Federal funds rate.

The long-term markets benefited early in the month from the reductions in short-term rates, the modest amount of new cash raised in the Treasury refunding operation, and an announcement that a large amount of maturing debt would not be refinanced by the Federal Home Loan Bank (FHLB). Although rates rose somewhat in the second half of the period, they remained below the levels reached at the end of April in the Government and corporate sectors. The municipal market also displayed a firmer tone initially. However, with investor demand at a low ebb and New York City's financial problems weighing on the market, yields moved up sharply late in the month and closed above their end-of-April levels.

According to preliminary estimates, the growth of both M_1—private demand deposits adjusted plus currency outside commercial banks—and M_2—which adds time deposits other than large-denomination negotiable certificates of deposit (CDs) to M_1—picked up substantially in May, owing in part to the distribution of income tax rebates by the Treasury. In contrast, the volume of CDs outstanding continued to fall, resulting in sluggish growth in the credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds. The money stock series were revised in May to include the most recent call report data. The revision, which reduced M_1 in April by about $1 billion, covers the last half of 1974 and the first four months of this year. Growth rates for most monetary aggregates over the first months of this year were reduced slightly as a result of the revision.

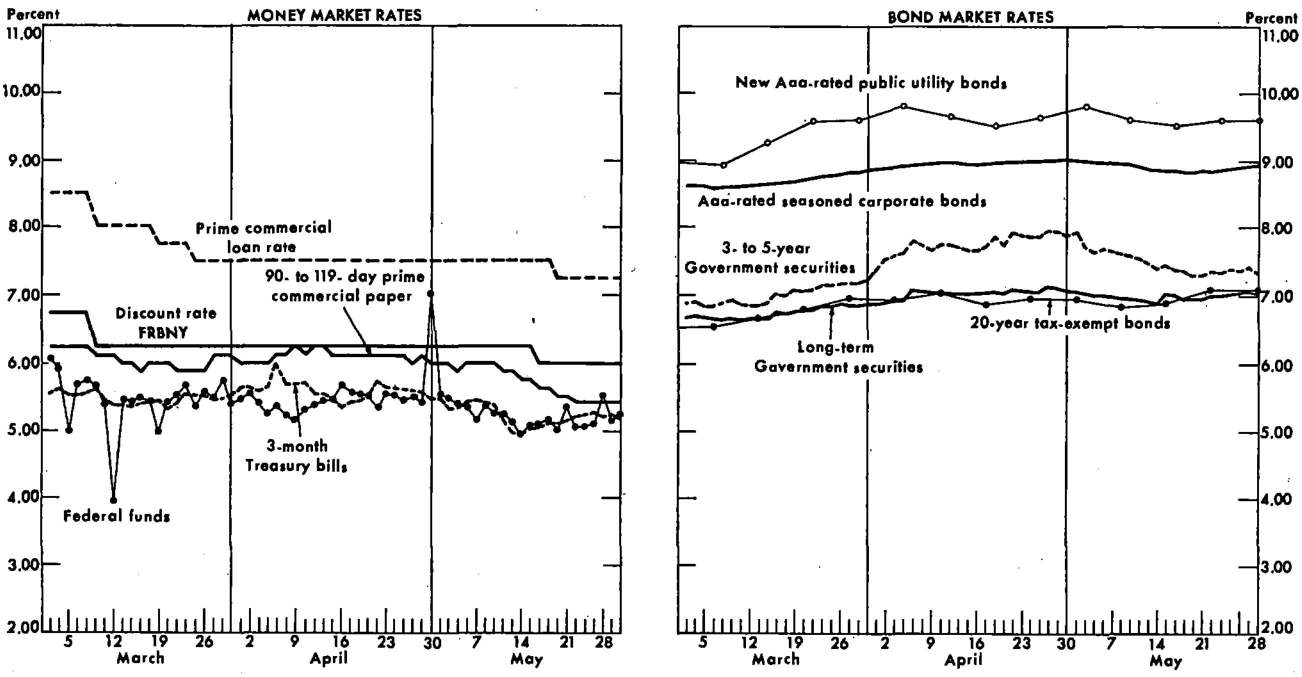
THE MONEY MARKET, BANK RESERVES, AND THE MONETARY AGGREGATES

After leveling off for over a month, money market interest rates declined in May, with particularly pronounced declines in the first half of the month (see Chart I). The effective rate on Federal funds averaged 5.22 percent in May, 27 basis points below April's average. Rates on 90- to 119-day dealer-placed commercial paper fell by ⅝ percentage point to the 5⅜ percent level at the month end. Comparable declines occurred in other short-term rates, as rates on three-month CDs in the secondary market ended May at 5.40 to 5.60 percent and rates on bankers' acceptances were in the 5.05 to 5.75 percent range at the end of May. After remaining constant for about six weeks, the commercial bank prime lending rate declined by ¼ percentage point late in the month, with most major banks quoting 7¼ percent and one bank posting 7 percent. Early in June, the prime rate was lowered again to the 6¾ to 7 percent range.

Business demand for short-term credit, which is generally sluggish in May, displayed considerable weakness during the month. Business loans at all weekly reporting banks declined about $2.5 billion in the four statement weeks in May, and the amount of nonfinancial commercial paper outstanding fell by about $900 million over the same period. The overall decline in the first five months of this year in the combined total of business loans and nonfinancial commercial paper was $8.1 billion, in contrast to increases of $10.8 billion and $12.5 billion in the comparable periods of 1973 and 1974, respectively.

After slowing sharply in April, most monetary aggre-

Chart I
SELECTED INTEREST RATES
March-May 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.

gates grew at rapid rates in May, according to preliminary data. M_1 advanced at a 13.1 percent seasonally adjusted annual rate from the average level in the four statement weeks ended April 30 to its average over the four weeks ended May 28. This rapid expansion raised the growth rate of M_1 in the four weeks ended May 28 from its average level over the corresponding period thirteen weeks earlier to 9.2 percent, the most rapid such advance in almost two years (see Chart II). In contrast, growth in M_1 over the latest 52-week span was only 4.4 percent. Time deposits other than large CDs grew at a 14.8 percent rate from the average level in the four weeks ended April 30 to the average level in the four weeks ended May 28, and thus the rate of growth of M_2 over this period was 14.4 percent. Large banks continued to let their CDs run off at a substantial pace in May, and consequently the credit proxy grew only sluggishly over the same period. There was little pressure on bank reserve positions in May, and member bank borrowings from Federal Reserve Banks averaged \$64 million in the four weeks ended May 28 (see Table I), down \$38 million from the average of the five statement weeks in April.

In May, the Federal Reserve Board revised its estimates of the monetary aggregates for the period July 1974 to April 1975 to incorporate the data on nonmember bank deposits obtained in the December 1974 call reports. Demand deposits adjusted were revised downward, reducing the growth of M_1 in the first four months of 1975 to a 2.8 percent seasonally adjusted annual rate (the rate had been 4.1 percent before the revision). The other time deposit component of M_2 was raised somewhat, however, resulting in only slightly slower growth of M_2 than previously reported.

THE GOVERNMENT SECURITIES MARKET

The United States Government securities market was buoyant early in May after the Treasury's announcement that its borrowing needs over the May-June period would be less than expected. With investor demand picking up, yields on Government securities moved lower even though the Treasury raised only slightly less new cash in May (about $8.5 billion) than it had in April. Steady price gains were registered through midmonth, buttressed by both investor and professional demand. However, some of these gains were retraced late in the month, when participants concluded that Federal Reserve operations might not provide much further stimulus to the downward movement in rates. Participants noted the statement by Arthur F. Burns, Chairman of the Federal Reserve Board, that sufficient stimulation may have already been applied to the economy.

Treasury bill rates generally declined in May. The Treasury raised approximately $3.8 billion of new cash in the bill market during the month, about $2 billion less than in April. With bill rates falling in a favorable market climate, the first weekly bill auction attracted good interest. The average issuing rates were set at 5.36 percent for the three-month bill and 5.72 percent for the six-month bill (see Table II), about 36 and 43 basis points lower, respectively, than the rates established at the last auction in April. Bill rates continued to decline in response to investor demand (including Federal Reserve purchases for foreign customer accounts), and the average issuing rates for the bills at the second weekly auction moved slightly lower in aggressive bidding. Although demand for bills was reasonably strong late in the month, rates leveled off as professional participants attempted to trim rather large inventories. The average issuing rates at the last two weekly auctions were about unchanged. For the month as a whole, Treasury bill rates declined by 15 to 70 basis points.

The market for Treasury coupon securities rallied sharply early in May in response to the smaller than anticipated size of the May refunding operation and the manageable size of each of the individual offerings. Yields declined prior to the refunding operation, as investor

Table I

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

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

Factors	Changes in daily averages— week ended				Net changes
	May 7	May 14	May 21	May 28	
"Market" factors					
Member bank required reserves	+ 370	+ 401	— 114	+ 596	+1,253
Operating transactions (subtotal)	—1,095	+ 189	— 383	— 66	—1,355
Federal Reserve float	— 26	— 14	+ 421	— 397	— 16
Treasury operations*	—1,045	+ 562	+ 478	+ 480	+ 475
Gold and foreign account	+ 47	— 45	+ 19	+ 78	+ 99
Currency outside banks	— 160	— 545	— 923	+ 21	—1,607
Other Federal Reserve liabilities and capital	+ 89	+ 230	— 378	— 249	— 308
Total "market" factors	— 725	+ 590	— 497	+ 530	— 102
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 967	— 905	+1,155	— 522	+ 695
Outright holdings:					
Treasury securities	+ 483	+ 526	+ 45	+ 250	+1,304
Bankers' acceptances	+ 19	+ 24	+ 27	— 2	+ 68
Federal agency obligations	— 27	—	—	— 20	— 47
Repurchase agreements:					
Treasury securities	— 8	— 972	+1,015	— 436	— 401
Bankers' acceptances	+ 234	— 162	— 43	— 147	— 118
Federal agency obligations	+ 266	— 321	+ 111	— 167	— 111
Member bank borrowings	— 208	— 15	+ 104	— 38	— 157
Seasonal borrowings†	+ 4	— 2	—	+ 2	+ 4
Other Federal Reserve assets‡	+ 143	— 77	— 654	+ 106	— 482
Total	+ 902	— 997	+ 604	— 454	+ 55
Excess reserves‡	+ 177	— 407	+ 107	+ 76	— 47

	Daily average levels				Monthly averages§
Member bank:					
Total reserves, including vault cash‡	35,319	34,511	34,732	34,212	34,693
Required reserves	34,934	34,533	34,647	34,051	34,541
Excess reserves	385	— 22	85	161	152
Total borrowings	33	18	122	84	64
Seasonal borrowings†	10	8	8	10	9
Nonborrowed reserves	35,286	34,493	34,610	34,128	34,629
Net carry-over, excess or deficit (—)‖	94	240	81	11	107

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 May 28, 1975.
‖ Not reflected in data above.

demand strengthened and Government securities dealers bought Treasury securities rather aggressively, in some cases to cover short positions in maturities of over five years. While a cautious view emerged as the bidding for the $5 billion of refunding issues began, the three auctions, which raised $1.2 billion in new cash, drew a good response. In the refunding, $2.75 billion of 3¼-year notes was auctioned on Tuesday, May 6, at an average yield of 7.70 percent, and a coupon of 7⅝ percent subsequently was placed on the issue. The next day, $1.5 billion of seven-year notes was sold with an average yield of 8 percent. At the final sale, $750 million of thirty-year bonds was auctioned at an average yield of 8.30 percent, and an 8¼ percent coupon was established on the issue. These issues moved to a premium in trading on a "when-issued" basis, and an auction of $2 billion of two-year notes attracted strong interest the next week. The two-year notes were sold at an average yield of 6.86 percent. Late in the month, however, the market developed a cautious stance in reaction to the potential for strengthening credit demands implied by the sharp rise in new orders for durable goods in April. Also, some participants began to revise expectations of further Federal Reserve easing. The auction of $1.5 billion of seventeen-month notes on May 22 did not attract as much interest as expected, and the average issuing yield was 6.54 percent. For the month as a whole, yields on intermediate-term issues moved 30 to 70 basis points lower, while yields on longer term issues dropped by about 15 to 45 basis points.

Yields on Federal agency issues declined in May, reflecting the generally light new cash needs of the agencies as well as the improvement in the Government securities market. Sentiment was bolstered early in the month by the announcement that the FHLB planned to redeem nearly $1.3 billion of debt maturing late in May. Overall, demands in this market during May were relatively light. At midmonth, two Farm Credit Administration agencies sold $1.3 billion of short-term securities which raised only $12 million in new cash. In particular, the Banks for Cooperatives sold $428.3 million of six-month bonds priced to yield 5.80 percent, and the Federal Intermediate Credit Banks sold nine-month bonds priced to yield 6.15 percent. These rates were 35 and 45 basis points lower, respectively, than on comparable issues marketed in April. On May 20, the Government National Mortgage Association auctioned $275.7 million of modified pass-through securities which were priced to yield 8.55 percent on a corporate-bond-equivalent basis. Two days later the Federal National Mortgage Association priced three issues to refund $750 million of securities and raise $600 million of new money: $400 million of three-year debentures priced to yield 7.45 percent, $650 million of 4½-year debentures priced to yield 7¾ percent, and $300 million of 8½-year debentures priced to yield 8 percent. These issues sold quickly.

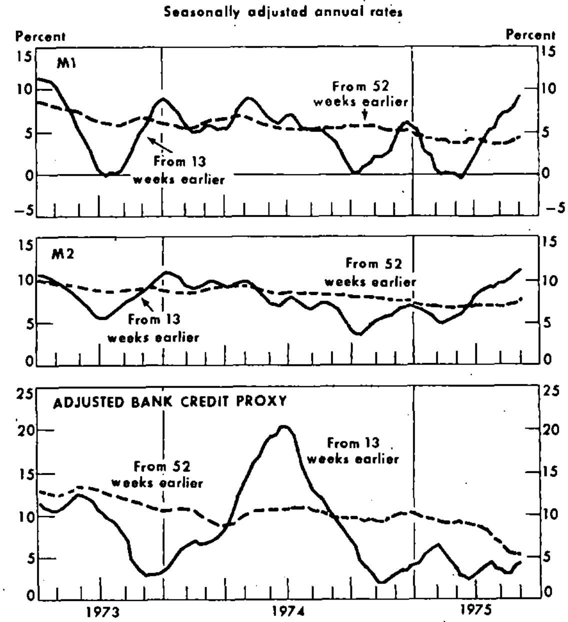
THE OTHER SECURITIES MARKETS

The corporate bond market, which had been marked by a cautious and uncertain climate as April drew to a close, rebounded sharply during the first half of May, and yields on new issues declined from the highs reached in April. Subsequently, the calendar became heavy and the market sagged under the weight of the new offerings, resulting in the postponement of at least one large offering at the month end. The municipal market also improved modestly early in May but the improvement was

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 May 28, 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.

restrained, in part because banks continued to find tax-exempt income relatively unattractive. The Bond Buyer index of twenty municipal bond yields declined early in May and then rose to 7.09 percent on May 29, the highest rate since last December.

The degree of improvement in the corporate bond market was highlighted by the yields attached to several industrial offerings. Early in May, Texaco Incorporated brought to market a $300 million issue of thirty-year Aaa-rated debentures which were priced to yield 8.95 percent. Texaco had postponed this issue in early April, when the issue had been expected to be sold with a yield of about 9¼ percent. The rally extended to the middle of the month, and an offering of $250 million of thirty-year Aaa-rated debentures by Shell Oil Company was priced to yield 8.82 percent. These gains were shared by lower rated and shorter maturity issues as well. Also at midmonth, Aluminum Company of America sold a $150 million issue of 25-year A-rated debentures priced to yield 9.45 percent; early in April, comparable securities were sold with yields in the 10 to 10¼ percent range. In addition, Revlon, Incorporated, marketed $100 million of A-rated ten-year notes which were priced to yield 8.45 percent, down from the highs of about 9 percent reached in early April.

The new issue market for common and preferred stocks received some renewed attention in May, especially from utilities. The rebound in the stock market in general and the improved financial outlook for some of these companies have prompted them to reduce their dependence on debt capital and to improve their equity positions. According to preliminary estimates, new common and preferred stock financing amounted to roughly $900 million in May, in contrast to the monthly average of about $500 million in 1974. In other equity market activity, American Telephone & Telegraph Company received over $160 million when approximately 3.1 million warrants were exercised before their expiration on May 15.

The municipal bond market was buffeted by New York City's need to raise a total of about $1 billion in the May-June period. At midmonth the city announced and then subsequently canceled a planned sale of $280 million of short- and long-term securities after consulting with prospective underwriters. During the last week of the month, New York State made an advance payment of $200 million to the city to help meet payments that were due at the end of May.

The largest municipal offering of May, a $140 million issue of Commonwealth of Pennsylvania bonds, sold well early in the month. The securities, rated A-1 by Moody's and Aa by Standard & Poor's, were reoffered to yield from 4 percent in 1975 to 7.15 percent in 1992-94. In an improving atmosphere, the State of Michigan successfully sold a $100 million issue rated Aa by Moody's and Aaa by Standard & Poor's. The bonds were reoffered to yield from 4.5 percent in 1978 to 5.85 percent in 1987, rates that were slightly below those on an Aaa-rated issue sold late in April and 25 to 35 basis points below an Aa-rated issue sold at the end of April. The May calendar became heavier as the month progressed, and several issues sold slowly late in the month. The State of Maryland sold $89.2 million of Aaa-rated bonds originally priced to yield between 4.4 percent in 1978 and 5.9 percent in 1990, but price concessions were necessary to move the bonds out of dealers' inventories. During the month the Blue List of dealers' advertised inventories rose by $152 million to finish May at $614 million.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—May 1975			
	May 5	May 12	May 19	May 23
Three-month	5.356	5.182	5.115	5.206
Six-month	5.724	5.481	5.412	5.469
	Monthly auction dates—March-May 1975			
	March 5	April 2	April 30	May 28
Fifty-two weeks	5.637	6.475	6.400	5.803

* 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.