The Money and Bond Markets in March

Interest rates in the money and bond markets were about unchanged on balance over March. During the first week of the month, a temporary rise in the Federal funds rate led market participants to believe that the Federal Reserve was moving toward a less accommodative policy stance. In response to this, nearly all short-term and other interest rates increased abruptly. These increases were reversed in trading over the remainder of the month, as market participants decided that their apprehensions were unwarranted. The short-term markets were also bolstered by the uncommon absence of net new issues of Treasury bills in the regular weekly auctions, as nearly all new cash raised by the Treasury during March was obtained in longer term issues.

The pattern of long-term interest rate movements was similar to the one followed by short-term rates. The improvement in market sentiment as the month progressed generated good investor demand, and substantial new financing in the Treasury coupon, corporate, and tax-exempt markets was readily accomplished. New issues and trading in the secondary market also appear to have benefited from the report that price increases in February had been modest. In addition, prices of state and local obligations, which had lagged behind during the rally in other sectors, adjusted upward. Reports of progress in resolving the financial problems of certain New York State agencies contributed to the more optimistic outlook.

Preliminary estimates indicate that the narrowly defined money stock (M_1) continued to rise moderately in March. A deceleration in the growth of consumer-type time and savings deposits, however, reduced the rapid expansion of the broadly defined money stock (M_2). Another decline in large negotiable certificates of deposit (CDs) held the bank credit proxy to a small increase.

THE MONEY MARKET AND THE MONETARY AGGREGATES

Although the Federal funds rate increased sharply during the first week of March, it soon began to recede to about the levels that have prevailed since shortly after the start of the year. The effective rate on Federal funds averaged 4.84 percent during the month, compared with a 4.77 percent average for February (see Chart I). After rising at the beginning of the month, rates on most money market instruments declined to levels near those prevailing at the end of the previous month. At the end of March, yields on 90- to 119-day dealer-placed commercial paper were 5⅛ percent, unchanged from the level at the end of February. Rates on 90-day bankers' acceptances fell by 5 basis points over the month to 5.10 percent. Large negotiable CDs maturing in ninety days traded in the secondary market at 5.23 percent at the end of the period, an increase of 3 basis points over the month. Member bank borrowings from the Federal Reserve fluctuated around frictional levels (see Table I), as the discount rate remained above the rate on Federal funds.

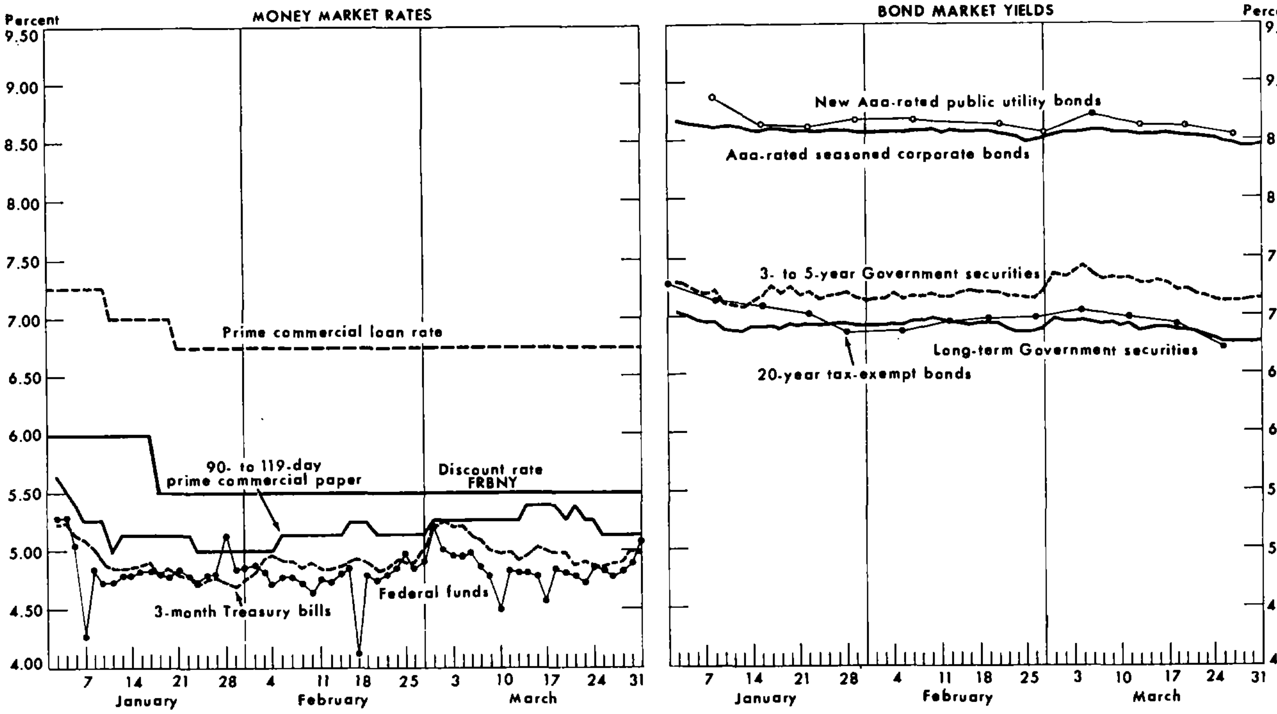
Business demand for bank loans continued to exhibit the weakness which has been characteristic throughout the current recovery. Over the five statement weeks ended March 31, commercial and industrial loans at large commercial banks fell by $1,676 million. For comparable periods in the preceding two years, these loans showed an average increase of about $4 billion. The demand for business loans has also been unusually sluggish relative to the early stages of past business upturns. In February, business loans at all commercial banks (seasonally adjusted and including loans sold to affiliates) were about 2 percent below their level in April 1975, about the beginning of the economic recovery. At the same stage of the previous four recoveries, these loans exceeded levels at their respective troughs by a range of 2½ to 5 percent. The unusually long lag in the response of loans to the current economic upswing is accounted for, in part, by more rapid advances in corporate liquidity and slower growth in inventories (which are usually financed by bank loans) than has been experienced in other recoveries.

Preliminary data indicate that the faster growth in M_1 that began in February continued during March. Over the four weeks ended March 24, M_1—private demand deposits plus currency outside commercial banks—advanced at a seasonally adjusted annual rate of 5.3 percent from its

Chart I

SELECTED INTEREST RATES

January-March 1976



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.

level over the previous four weeks, bringing growth over the four weeks ended fifty-two weeks earlier to 4.9 percent (see Chart II). As a consequence of sharp decelerations in time and savings deposits in March, however, growth in M_2—M_1 plus these deposits—was somewhat more modest than in recent months. Compared with its average level in the previous four weeks, M_2 in the first four weeks of March grew at an 8.5 percent rate. This brought the growth rate from the four weeks ended fifty-two weeks earlier to 9.3 percent. After a moderate increase in February, the bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—resumed its recent lackluster performance and rose by only 0.3 percent above its level over the previous four-week period, as large negotiable CDs continued to decline sharply in response to the weak demand for bank loans.

THE GOVERNMENT SECURITIES MARKET

Interest rates on United States Treasury bills during March were little changed from February, although they sustained a sharp increase at the beginning of March before gradually returning to earlier levels. According to market observers, the initial increases represented a sharp reaction to the temporary rise in the Federal funds rate

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MARCH 1976

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

Factors	Changes in daily averages—week ended					Net changes
	March 3	March 10	March 17	March 24	March 31	
"Market" factors						
Member bank required reserves	+ 93	+ 396	— 235	+ 80	— 384	— 50
Operating transactions (subtotal)	+466	+3,239	— 165	—3,894	+1,493	+1,139
Federal Reserve float	—816	+ 477	— 144	— 375	— 411	—1,269
Treasury operations*	+995	+2,743	+1,196	—2,929	+1,274	+3,279
Gold and foreign account	— 34	+ 24	+ 26	— 5	+ 21	+ 32
Currency outside banks	+383	— 306	— 880	— 585	+ 600	— 788
Other Federal Reserve liabilities and capital	— 63	+ 301	— 366	+ 2	+ 10	— 116
Total "market" factors	+559	+3,635	— 400	—3,814	+1,109	+1,089
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	— 93	—4,051	+ 427	+3,543	—1,002	—1,176
Outright holdings:						
Treasury securities	+334	—2,090	+1,203	+1,093	— 492	+ 48
Bankers' acceptances	— 25	— 36	— 20	— 56	— 14	— 151
Federal agency obligations	+254	+ 42	—	—	—	+ 296
Repurchase agreements:						
Treasury securities	—767	—1,502	— 646	+2,090	— 577	—1,402
Bankers' acceptances	+138	— 379	— 101	+ 191	+ 98	— 53
Federal agency obligations	— 27	— 86	— 9	+ 225	— 17	+ 86
Member bank borrowings	— 64	— 37	— 6	+ 36	— 40	— 111
Seasonal borrowings†	— 2	—	—	—	+ 2	—
Other Federal Reserve assets‡	+122	+ 151	+ 115	+ 154	+ 188	+ 730
Total	— 36	—3,937	+ 537	+3,732	— 855	— 559
Excess reserves‡§	+523	— 302	+ 137	— 82	+ 254	+ 530

	Daily average levels					Monthly averages‖
Member bank:						
Total reserves, including vault cash‡§	34,094	33,396	33,768	33,606	34,244	33,822
Required reserves	33,677	33,281	33,516	33,436	33,820	33,546
Excess reserves§	417	115	252	170	424	276
Total borrowings	84	47	41	77	37	57
Seasonal borrowings†	8	8	8	8	10	8
Nonborrowed reserves	34,010	33,349	33,727	33,529	34,207	33,764
Net carry-over, excess or deficit (—)¶	— 26	175	9	6	67	46

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.
§ Adjusted to include waivers of penalties for reserve deficiencies in accordance with the Regulation D change effective November 19, 1975.
‖ Average for five weeks ended March 31, 1976.
¶ Not reflected in data above.

early in the month. As a consequence, 52-week bills were sold in the regular auction on March 3 at an average yield of 6.01 percent, 44 basis points higher than rates obtained at the auction four weeks earlier (see Table II). After upward rate pressures in the money market disappeared, however, the average yield on 52-week bills auctioned at the end of the month fell to 5.78 percent. At the last regular auction in March of three- and six-month bills, average yields were 4.93 percent and 5.33 percent, respectively, up 6 and 12 basis points from average yields on February 23. For the first month in a year and a half, little new cash was raised by the Treasury in these short-term issues. Rates on most bill issues ended March unchanged to 20 basis points below levels at the end of the previous month.

Yields on Treasury coupon issues ended March slightly below those prevailing at the end of February, as the market was bolstered by the announcement of a low inflation rate in February. The Treasury continued efforts during March to meet its cash needs for the first half of 1976 by offering a variety of new coupon issues. On March 5, $2 billion of new cash was obtained by the auction of four-year notes at a 7.54 percent average rate. On March 18, $3 billion of two-year notes was sold to raise $700 million in new cash at an average yield of 6.76 percent. An additional $2.5 billion of 58½-month notes was sold to raise new cash on March 24 at an average return of 7.38 percent. These securities were well received. Many market observers expect the reliance placed by the Treasury on longer term issues in March to continue throughout 1976, since the average maturity of the debt declined substantially in 1975 and since the Congress has increased the volume of long-term Treasury bonds exempt from a 4¼ percent interest ceiling and has extended the allowable maturity of note issues (which are not subject to a rate ceiling) from seven to ten years.

Rates in the market for Federal agency securities were little changed in generally light trading and remained quite close to those on Treasury issues. Early in the month, the Government National Mortgage Association (GNMA) auctioned two issues to raise $300 million of new money. The yield on $200 million of 7¼ percent and $100 million of 7½ percent thirty-year modified pass-through securities was 8.47 percent. Later in March, GNMA borrowed additional funds by auctioning $239.3 million of 7¼ percent and 7½ percent modified pass-through securities priced to yield 8.23 percent. The Farm Credit Banks sold $1,613.6 million of new bonds to replace $1,196.5 million of bonds maturing April 1 and to raise $417.1 million of new cash. This financing was composed of $499.6 million of six-month Banks for Cooperatives bonds yielding 5.80 percent,

$753.5 million of nine-month Federal Intermediate Credit Banks (FICB) bonds yielding 6.1 percent, and $360.5 million of ten-year FICB bonds returning 7.95 percent. The Federal National Mortgage Association offered $400 million of four-year debentures and $300 million of 9½-year debentures toward the end of the month. These securities were enthusiastically received at yields of 7.375 percent and 7.9 percent, respectively, and immediately traded at premiums in the resale market.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—March 1976				
	March 1	March 8	March 15	March 22	March 29
Three-month	5.258	5.060	4.981	4.890	4.929
Six-month	5.724	5.487	5.459	5.283	5.327
	Monthly auction dates—January-March 1976				
	January 7	February 4	March 3	March 31	
Fifty-two weeks	5.578	5.572	6.010	5.781	

* 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

Yields on corporate bonds ended March about unchanged from the end of February. Early in the month, interest rate expectations and additions to the schedule of new financing precipitated an increase in rates on seasoned corporate issues. The market improved, however, in trading activity during the remainder of the month, as it became evident that a tighter monetary policy had not emerged, as a period of less new issue activity approached, and as inflation in February appeared quite modest despite continued strength in the economic recovery. Yields on tax-exempt bonds declined, on balance, following reports of progress toward resolution of New York State's short-term financing needs.

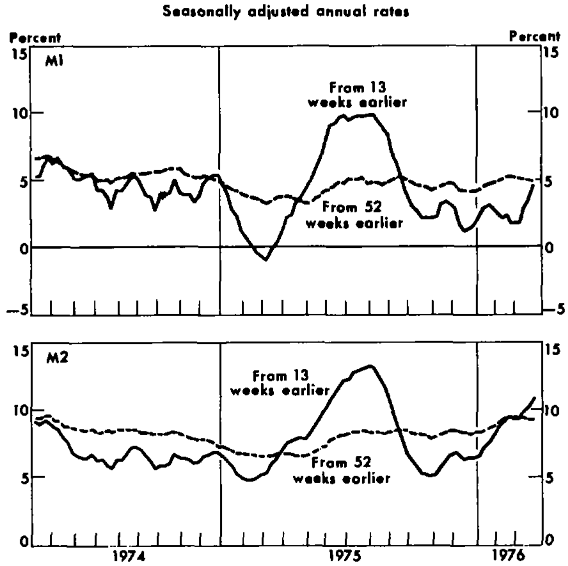
While new borrowing through corporate debt was very substantial during March, investors appeared willing to acquire longer term issues—albeit at somewhat higher yields than had been required in February. A return of 8.70 percent was available on $200 million of thirty-year Aa-rated industrial debentures, 25 basis points higher than a similar issue in February. In sales of Aaa-rated debentures, $300 million of forty-year telephone debt provided an 8.56 percent return and $300 million of thirty-year industrial obligations yielded 8.57 percent. These yields were about 25 basis points above issues distributed a month earlier.

Though the volume of tax-exempt financing was also heavy in March, yields on most issues trading in the secondary market declined somewhat. In the largest general obligation issue on record, Massachusetts sold $535 million of 25-year bonds rated A-1 by Moody's and AA by Standard & Poor's. The yield provided by these bonds was 9 percent, and the underwriting was oversubscribed. California offered $100 million of Aaa-rated serial bonds at yields from 3.4 percent in 1978 to 5.7 percent in 2002. These aggressively priced bonds met with considerable sales resistance. Other sizable offerings included Penn-

Chart II

GROWTH OF SELECTED MONEY STOCK MEASURES

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 24, 1976.

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.

Source: Board of Governors of the Federal Reserve System.

sylvania's $110 million of bonds, with yields ranging from 3.25 percent in 1976 to 7.05 percent in 1995, and Connecticut's $100 million issue priced to yield 3.8 percent in 1977 to 6.75 percent in 1996. Both issues were also rated A-1/AA and were well received. The tax-exempt market was buoyed during March by reports of progress in New York State's efforts to assemble a $2.6 billion package to allow four state construction finance agencies to avert a potential default in March and to finish their ongoing construction projects over the next thirty months. In particular, this development contributed to the strong performance of Municipal Assistance Corporation issues during the month. The Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds fell 29 basis points to 6.69 percent. The Blue List of dealers' advertised inventories rose by $47 million to close the month at $749 million.