

National Economic Trends



Commercial Paper: A Colossal Market

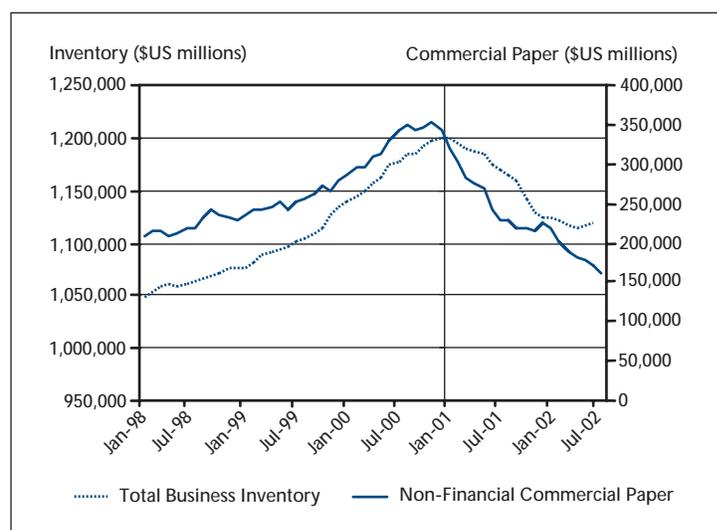
The nightly financial market news wrap-up tells investors where major stock market indices and benchmark government bonds stand. The financial news, however, rarely touches on private-issue money markets—the commercial paper market in particular—despite the important role they play in the healthy functioning of the economy. Commercial paper is unsecured short-term corporate debt, and I make a couple of points here about the commercial paper market to highlight its importance.

First, I examine the relative contribution of commercial paper outstanding to the total market value of firms, which includes the values of their debt and equity. At the end of 2000, the total equity value of domestic companies listed on the New York Stock Exchange was \$11.5 trillion with corresponding equity values for NASDAQ, Tokyo, and London of \$3.6 trillion, \$3.2 trillion, and \$2.6 trillion, respectively. At the same time, there was \$1.615 trillion of commercial paper outstanding. During 2000, the New York Stock Exchange experienced record trading volume with an average of \$43.9 billion per day. By comparison, using the historical weighted average of time to maturity for the commercial paper market (about 42 days), the average daily turnover in commercial paper is \$38.5 billion. So, using size and volume, we see the contribution of the commercial paper market to the value of firms and the transfer of that value.

Second, size alone does not convey how important the commercial paper market is to business activity. Commercial paper—with common terms to maturity of 7, 15, 30, 60, and 90 days—is a vital source of funding for day-to-day business operations. The purpose of this short-term corporate debt is to fund working capital (accounts receivable and inventory) so that businesses can provide the goods and services desired by consumers.

One example of the link between business activity and the commercial paper market is the relationship between non-financial commercial paper outstanding and total business inventory. From January 1998 through January 2001 there was a roughly \$150 billion increase in inventories accompanied by a roughly \$150 billion increase in non-financial commercial paper outstanding; from January 2001 through June 2002 there was a decrease in inventory of about \$100 billion and a similar decrease in commercial paper outstanding. The correlation in monthly changes in inventory and outstanding commercial paper is 0.49, which suggests a strong positive relationship between inventory and outstanding commercial paper. This relationship exists because the commercial paper market provides important funds that allow businesses to manage inventories and to adjust to unanticipated changes in inventories. The flexibility provided by the commercial paper market allows businesses to react adeptly to economic trends, which enhances their cash flows and, ultimately, their profitability.

—Drew B. Winters



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