Chapter 3

Economic Policies in 1958

VARIOUS MEASURES undertaken by Government helped overcome the contractive forces in our economy in 1957–58. Some of these measures were initiated specifically to help reverse the decline and to promote a higher level of business activity. Others were designed to mitigate the special hardships experienced by individuals and families through loss of employment. Still others were called for by considerations entirely independent of economic conditions, but they nevertheless had the effect of stimulating economic activity. After the recovery started, policies were directed to helping achieve a high and sustainable rate of economic growth with stable prices.

A review of these actions and an appraisal of how they influenced the year's economic developments are important as guides for Government and for private individuals and groups in meeting future problems of economic stabilization with balanced and constructive policies.

Policies During the Contraction

Money and Credit

During the past 18 months, monetary and credit policy was directed successively to moderating the rate of credit expansion, helping to reverse economic contraction, and encouraging a steady and balanced recovery and growth.

Demands for capital and credit were heavy in the months preceding the 1957 downturn. Plant and equipment expenditures were at an all-time high, and expanding inventories required financing. Because the cash and liquidity position of businesses was relatively strained, funds to help finance investment programs and working capital needs were necessarily sought in large volume from outside sources. But because the Federal Reserve System confined the reserves supplied to member banks at its own initiative to amounts consistent only with seasonal swings in activity, bank credit was less readily available than in 1956. Businesses did obtain additional credit from commercial banks, but the increase was much smaller than in 1956, and more reliance for funds had to be placed on the capital markets. Securities offered by corporations increased to a new high volume, and the offerings of State and local governments approached record amounts. Meanwhile, the flow of funds into life insurance companies, savings and loan associations, and mutual savings banks slackened. Although larger

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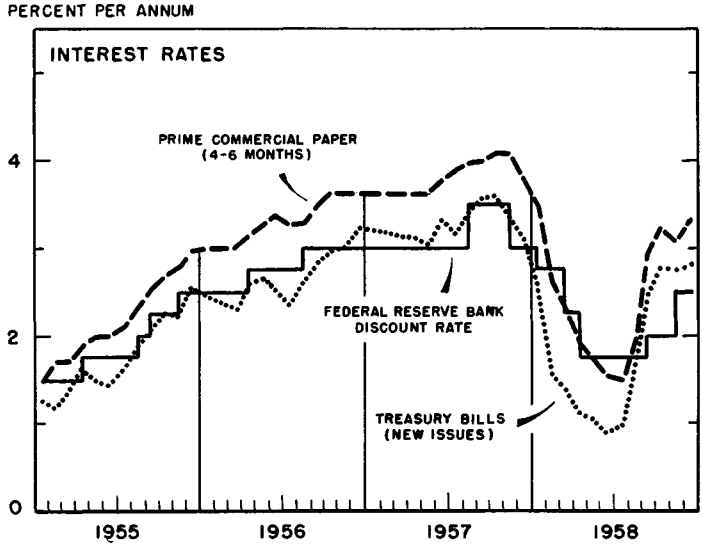
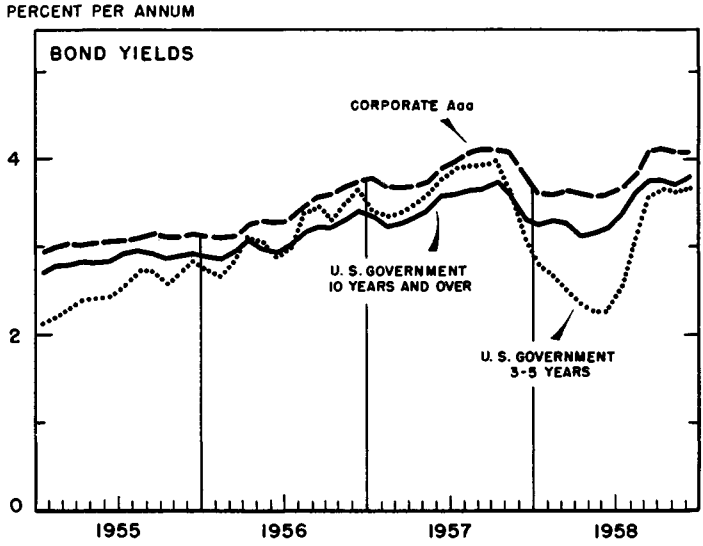
CHART 12

Interest Rates and Bond Yields

Short-term interest rates continued to decline until mid-1958, then rose sharply until October.



Long-term interest rates declined slightly early in the year, but rose rapidly from midyear until October.



SOURCES: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, MOODY'S INVESTORS SERVICE, AND TREASURY DEPARTMENT.

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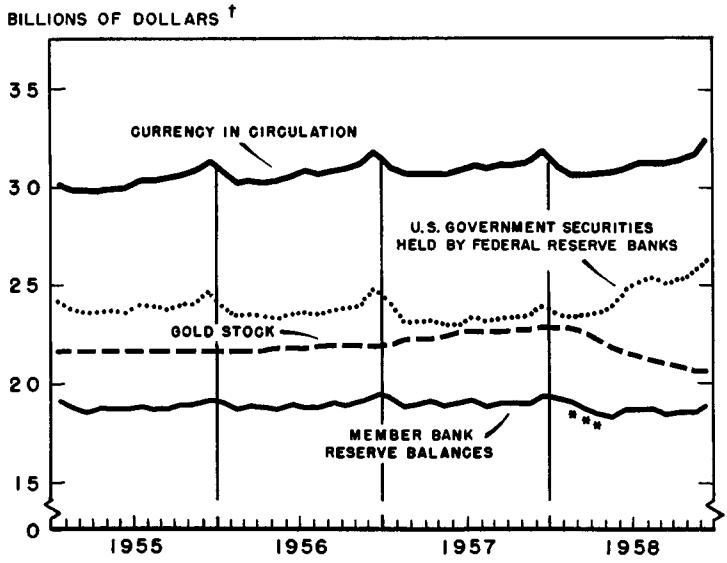
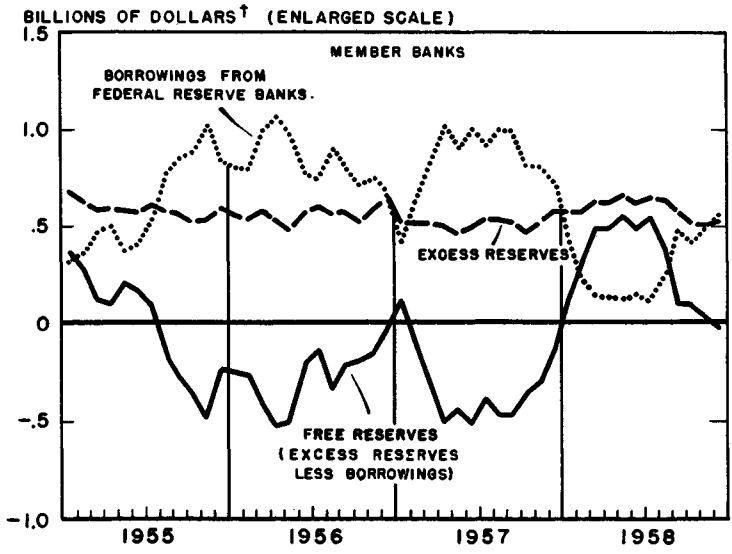
CHART 13

Member Bank Reserves

In 1958 the rise in Federal Reserve holdings of U. S. Government securities offset the effect of gold outflow on bank reserves.



Free reserves increased sharply early in 1958 and declined after midyear.



† AVERAGES OF DAILY FIGURES.
* CHANGE IN RESERVE REQUIREMENTS.
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

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amounts of savings were supplied from other sources, notably from the increasing volume of time deposits in commercial banks, the rising tide of financial demands in the capital markets helped bring about progressively higher interest rates and bond yields. The peak of credit and capital costs came in the fall of 1957, when interest rates generally reached the highest levels since the early 1930's (Chart 12).

By the end of September, there were indications that the demand by business concerns for bank credit was slackening; and the flow of funds into home financing fell as the ceiling interest rates on federally underwritten mortgages became increasingly out of line with yields available on investments not subject to such controls. In the second half of October, the Federal Reserve authorities began to ease slightly the reserve position of member banks through open market operations in United States Government securities. This was followed in mid-November by a reduction in the discount rate from 3½ percent to 3 percent, signaling a decisive change in policy. Subsequently, the Federal Reserve authorities eased reserve positions still more by open market purchases of Government securities and released some $1.5 billion of bank reserves by lowering reserve requirements. In a series of steps over five months beginning in mid-November, the discount rate was reduced to 1¾ percent. By March 1958, the reserve position of banks had eased markedly. Member bank borrowings from the Federal Reserve Banks were nearly $1 billion below those of September 1957, and net free reserves (excess reserves less borrowings) had increased to $500 million. This reserve position of member banks remained virtually unchanged until July 1958 (Chart 13). Monetary policy was, moreover, sufficiently expansionary to offset the impact on bank reserves of a gold outflow of $1.4 billion, which took place in the first six months of the year.

These steps produced emphatic reactions in financial markets. The improved reserve position of commercial banks enabled them to add nearly $10 billion in loans and investments to their assets in the first half of 1958. This took the form largely of additions to their holdings of United States Government securities, which increased $6.0 billion by midyear, but their holdings of State and local securities also increased significantly. The demand for bank credit from most other borrowers was not heavy, and other forms of credit increased only a little or declined. As a result, the ratio of United States Government securities to loans in bank portfolios increased.

Because the major part of this increase in bank assets was reflected in an expansion of $5.7 billion of time deposits, the volume of demand deposits and currency, which is the economy's active money supply, increased by only $2.2 billion, on a seasonally adjusted basis (Chart 14). Without posing potentially inflationary threats, this timely expansion of the money supply helped to improve the liquidity position of the economy generally.

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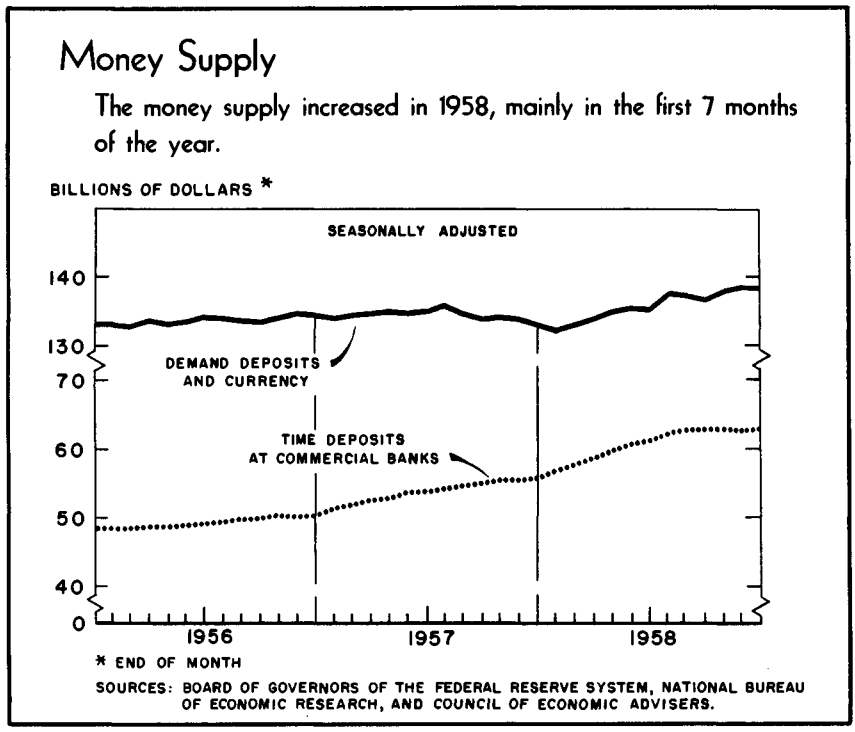
CHART 14



Borrowing costs and investment yields in capital and credit markets reacted quickly to these developments. Short-term interest rates fell sharply. The rate on 91-day Treasury bills dropped significantly below 1 percent by May, and the rate on prime commercial paper was reduced to as low as 1½ percent in June. In the market for longer-term funds, the yield on outstanding long-term United States Government issues fell to a low of 3.05 percent in April, a decline of 19 percent from the October 1957 high. By the time the economy was turning from recession to recovery, the yield on high-grade corporate bonds had fallen 14 percent below its 1957 high, and the yield on high-grade municipal securities almost 19 percent. Prices of FHA-insured and VA-guaranteed home mortgages in secondary markets had risen significantly by midyear, and there was a rapid improvement in the availability of mortgage investment funds throughout the country.

Housing and Home Financing

Nowhere in the economy was the stimulative effect of the easing of credit conditions more clearly visible than in residential building. Evidences of underlying strength in this area, in which activity had been declining more or less steadily for two years, were apparent as early as mid-1957. Low vacancy rates, a somewhat quickened tempo of sales, and a reduction in

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the number of unsold houses held by builders suggested a firming of demand. In numerous communities, the elimination of rent controls had created conditions more favorable to the construction of apartment projects; and significant progress had been made, through the provision of needed community facilities, in removing deficiencies that were impeding the construction of single-family homes. In August 1957, minimum downpayment requirements on FHA-insured loans were reduced by administrative order, issued under the authority granted by the Housing Act of that year. And the increase in residential construction costs, which had been particularly rapid during 1955 and a good part of 1956, halted.

In this favorable environment, an increase in the flow of private funds into the home mortgage market served rather quickly to initiate an upturn in prospective residential building activity. Indeed, the reaction was so marked that it was necessary in January 1958 to request authority from the Congress to use additional funds to meet the costs of processing an unexpectedly large volume of applications for FHA loan insurance (Chart 15).

Numerous administrative actions were taken to spur building activity. In December 1957, more than $175 million was released for purchases of mortgages by the Federal National Mortgage Association (FNMA) and to assist urban renewal. Early in January 1958, the rule requiring that closing costs on FHA-insured loans be paid in cash—a rule which had been imposed in 1955 as a check on the excessive use of credit—was rescinded. In February, a new program was launched by the Federal Home Loan Bank Board to make loans available on a five-year basis to member associations, supplementing its shorter-term loan program. In March, adjustments were made in allowable discounts on VA loans, another $200 million was released to the FNMA for the purchase of mortgages under its special assistance programs, and the Housing and Home Finance Agency was directed by the President to expedite construction on approved and planned projects for college housing, urban renewal, and public housing. Early in April, minimum downpayment requirements on VA-guaranteed loans were reduced. In the same month, several additional steps were taken under authority granted by the newly approved housing legislation. Adjustments were made in the interest rate on military housing to expedite the flow of private funds into this type of investment; minimum downpayment requirements were reduced on FHA-insured loans; the interest rate on VA-guaranteed loans was adjusted upward to the maximum permitted under the law, in order to draw additional funds into this type of investment; discount controls, which had previously tended to block the flow of funds into FHA-insured and VA-guaranteed loans, were removed; and $325 million was released by the President for purchases by the FNMA of mortgages on properties in urban renewal areas and on housing for elderly persons and for military personnel. Funds were made available in April, May, July,

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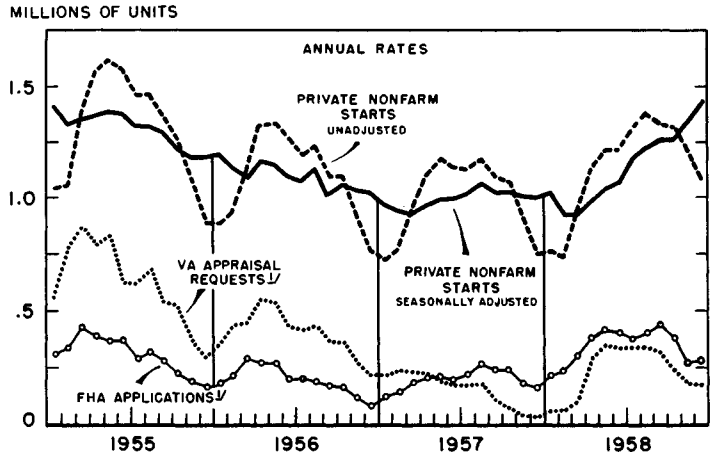
and August, under the FNMA special assistance program created by the April housing legislation for the purchase of mortgages ranging in amount up to $13,500. At that time, the law required that qualifying mortgages be purchased at par. Since this assured financing of projects at costs below the price of funds obtainable from private sources, and because the law authorized the issuance of advance commitments, builders turned at once to the Federal Government. By the middle of September, virtually all of the $1 billion authorized by this legislation had been committed to be paid out as mortgages were delivered.

As already indicated, evidence of an imminent upturn in home building was visible even before the end of 1957, but the increase naturally lagged by some months behind the improvement in financial conditions. A small increase in housing starts began in March 1958, when the seasonally adjusted annual rate rose slightly above the 915,000 reached in February. By December 1958, starts of new homes had reached a rate of 1,430,000. The volume of new residential construction expenditures also increased, but somewhat later than the rise in housing starts. Although other types of construction activity continued at a high level, it was residential building that supplied the major impetus from the construction field to general economic recovery.

CHART 15

Housing Starts and Requests for Federal Underwriting

Private housing starts rose sharply after March 1958. Applications for FHA and VA financing increased before midyear, then declined.



1/ FOR NEW HOME CONSTRUCTION.
SOURCES: DEPARTMENT OF LABOR, FEDERAL HOUSING ADMINISTRATION (FHA), AND VETERANS ADMINISTRATION (VA).

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Unemployment Insurance Benefits

The primary objective of our Federal-State system of unemployment insurance is directly to aid those experiencing involuntary loss of employment. However, by sustaining the aggregate purchasing power of consumers at a level higher than would otherwise prevail, these payments contribute significantly to the stabilization of the whole economy.

In both these respects, benefit payments were materially helpful during the 1957–58 recession. Payments rose moderately in the third quarter of 1957 and very sharply in the fourth quarter and after the turn of the year, as unemployment mounted. From July 1957 to April 1958, they directly offset about one-third of the decline in wage and salary disbursements and, because they are not taxable, their effect in maintaining disposable personal income was even greater.

The contraction of job opportunities meant that unemployment was extended for many workers beyond normal lengths and beyond the period of benefit rights under basic laws. As a result, the number of persons exhausting their benefits rose from 82,000 per month in September 1957 to a peak of 285,000 in July 1958.

Legislation was requested in March 1958 to lengthen temporarily the period of entitlement to unemployment benefits, and a bill was enacted in June. States participating in this temporary program, or otherwise extending the duration of benefits, accounted for 70 percent of covered employment. The number of unemployed persons eligible for its benefits reached a maximum of 658,000 in late August 1958. Extra benefits amounted to about $390 million during the year.

Defense Procurement

The Economic Report of January 1958 noted that the economy was beginning to feel the impact of an increase in defense expenditures. In the January 1958 Budget Message, $39.6 billion of new obligational authority was requested for the military functions of the Department of Defense, and budget expenditures of $40.3 billion were contemplated for the fiscal year 1959. The latter figure was $1.4 billion higher than the expenditures estimated for fiscal 1958. Much of this increase resulted from higher planned expenditures for military research and development programs, additional military construction, and a contingency reserve for the acceleration of weapons development. In line with national security policy, a supplemental appropriation request of close to $1.3 billion was made on January 7, 1958, as an advance on the program for the fiscal year 1959; and in April, close to $1.5 billion of additional funds were requested for the fiscal year 1959.

The acceleration of defense procurement under the amounts appropriated in the calendar year 1958 and prior years was soon evident in the awarding

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of contracts for major items. In the third quarter of 1957, gross obligations for major procurement and production in the Department of Defense military functions amounted to $2.2 billion. They rose to nearly $3.9 billion in the fourth quarter of 1957, and reached $4.7 billion and $6.1 billion in the first and second quarters of 1958, respectively.

Because changes in the backlog of unfilled orders permit the rate of current production to follow a more even course than would be dictated by the flow of new orders alone, this acceleration in defense contracting was not accompanied by a corresponding increase of output in the affected industries. However, the rise in defense contracting in the first half of 1958 did result in an expansion of defense production, and through its effect on the inventory policies of defense contractors had a significantly stimulative effect on the economy.

Civil Procurement and Construction

Steps taken to accelerate needed Government procurement and construction in nondefense programs also had a helpful, though necessarily limited, effect. Early in March, accelerated procurement of needed equipment and supplies was authorized, and instructions were issued to agencies calling for the placement of as many planned orders as possible under available authorizations. Stress was placed on the desirability of giving these orders, insofar as possible, to firms in areas of substantial labor surplus.

Legislation was requested in March and enacted in April to make available for immediate use one-half of the amounts requested for the purchase of supplies and equipment in the fiscal year 1959. The General Services Administration, the Veterans Administration, and other civilian agencies ordered substantial quantities of supplies under this plan, and the Post Office Department placed orders for new trucks earlier than had been scheduled. A program for accelerating the repair and modernization of Federal buildings was also put into operation in March, and congressional assent to requests for supplemental appropriations made it possible to continue an accelerated rate of activity on Federal water projects already under way.

Acceleration of Grants-in-Aid and Tax Refunds

Allocations to State and local bodies under various Federal grant programs, including aid for the construction of hospitals, medical research facilities, and airports, were accelerated during March and April so that contracts might be negotiated for projects that could be started immediately.

Special efforts were made by the Internal Revenue Service in 1958 to speed up the payment of refunds to those who had overpaid their 1957 income taxes. Refunds distributed in the first five months of the year exceeded those of the same period of 1957 by $700 million.

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Federal-Aid Highway Program

In order to maintain construction of the Interstate Highway System on schedule, legislation was requested to permit larger allocations to the States than would have been possible under the original provisions of the law. Such legislation was enacted in April, and allotments were promptly made. During the following six months, contracts were negotiated by the States for the construction of Federal-aid highways to cost $3 billion, 80 percent more than the amount obligated during the corresponding period of 1957 (Table 3). During this same six-month period, Federal payments to the States exceeded $1¼ billion. This, also, was more than 80 percent greater than the amounts paid during the same months a year earlier.

TABLE 3.—*Obligations and payments on Federal-aid highway programs, 1957–58*

[Millions of dollars]

Period	New obligations for highway construction [1]			Federal payments to States		
	Total	Interstate program	Other programs [2]	Total	Interstate program	Other programs [2]
1957: First quarter	781	418	364	214	82	132
Second quarter	896	410	486	235	64	171
Third quarter	803	405	398	362	120	242
Fourth quarter	1,174	833	341	423	173	250
1958: First quarter	770	386	385	269	129	140
Second quarter	1,378	598	780	410	251	159
Third quarter	1,399	737	662	643	365	278
Fourth quarter [3]	1,266	650	615	886	509	377

[1] Includes Federal and State matching funds.
[2] Includes primary, secondary, and urban extension highways.
[3] Preliminary estimates by Council of Economic Advisers.
NOTE.—Detail will not necessarily add to totals because of rounding.
Source: Department of Commerce (except as noted).

Federal Credit Programs

Steps to help counter the recession were taken in a number of Federal credit programs outside the housing field. Loan approvals by the Small Business Administration during the first half of 1958 amounted to about $122 million, $33 million more than in the corresponding period of 1957. The Export-Import Bank contributed even more heavily to the increased volume of Federal lending activity. Its contribution through loan authorizations toward the financing of domestic economic activity is estimated to have been more than $250 million larger in the first half of 1958 than in the corresponding period of 1957.

Federal Fiscal Operations

Not all Federal actions taken to help counteract recession are reflected in Federal budget accounts. Many involved no additional budget outlays at all and, where the placement of contracts and orders was involved, some part of the impact on the economy came at an earlier date than would be suggested by their eventual reflection in the budget as expenditures. Even so, significant interactions between economic developments and Government fiscal operations are revealed in the Federal budget.

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In the fiscal year 1958, Federal expenditures were $2.5 billion higher than in the fiscal year 1957—the twelve-month period which preceded the 1957 downturn (Table 4). This increase was due in part to actions taken specifically to help counter the recession but in part also to actions which, though taken for other reasons, had an expansive effect on the economy. Directly and indirectly, increases in Federal expenditures resulted in an

TABLE 4.—*Federal budget receipts and expenditures, fiscal years 1957–60*

[Billions of dollars]

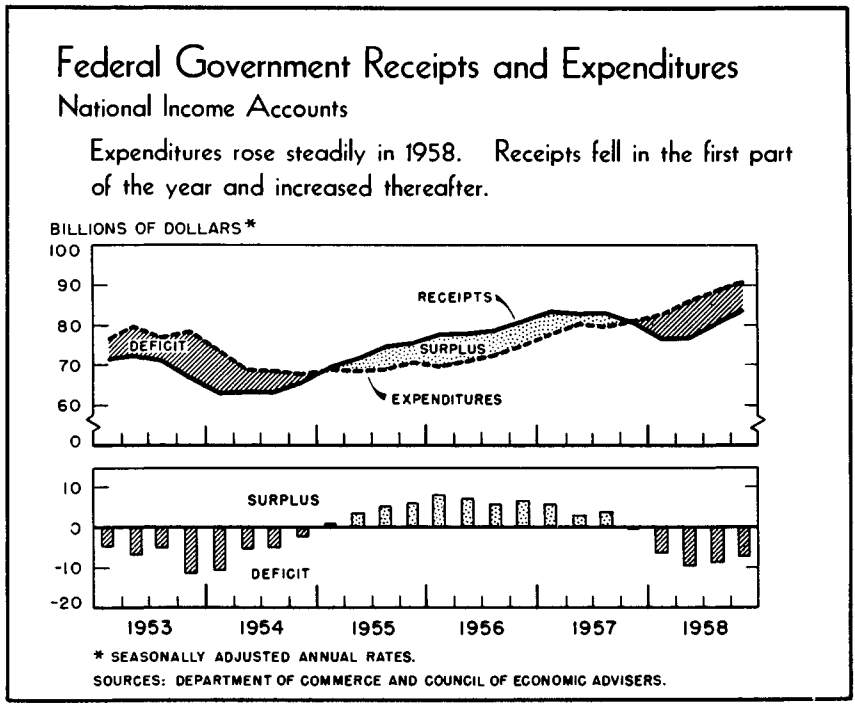
Fiscal year	Receipts	Expenditures	Surplus or deficit (−)
1957	71.0	69.4	1.6
1958	69.1	71.9	−2.8
1959 [1]	68.0	80.9	−12.9
1960 [1]	77.1	77.0	.1

[1] Estimate.

Sources: Treasury Department and Bureau of the Budget.

additional demand for output at a time when private demand had slackened. Furthermore, a small part of the impact of the recession on economic activity in general was lessened by a decline in personal income tax payments. Because of the structure of our tax system, the decline in personal income after taxes was less than the decline in income before taxes.

CHART 16



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The effect of changes in the Federal Government's fiscal operations can be followed more closely in our national income accounts. Total receipts and payments as registered in these accounts are larger, and differ from those in the budget, mainly because of the inclusion of trust fund operations, the exclusion of intra-governmental transactions, and the timing of transactions on a basis more closely related to their economic effects.

These accounts show that in the third quarter of 1957 the Federal Government was withdrawing more funds from the economy through receipts than it was putting in through disbursements. Aggregate receipts at the seasonally adjusted annual rate of $83.3 billion exceeded disbursements by $3.4 billion. By the first quarter of 1958, on the other hand, receipts fell short of disbursements by an annual amount of $6.6 billion; in this quarter, therefore, the Federal Government's combined fiscal operations were, on balance, exerting a stimulative effect on the economy. This turnabout of $10 billion—nearly three-fourths of which was reflected in the decline in receipts—had a greater impact on the economy than did fiscal operations in either of the two other postwar contractions (Chart 16).

Policies After the Upturn

With production, employment, and income moving upward in the second quarter of 1958, the economic policies of Government became concerned increasingly with keeping the recovery on a sound basis and promoting a sustainable, long-term expansion.

Credit and capital markets responded quickly to the rapidly strengthening confidence that a firm recovery was under way. The large financing requirements of the Treasury also influenced financial markets. The upturn in interest rates, which reflected these changed views and conditions, was accentuated by the liquidation, beginning in June, of large speculative holdings of United States Government securities. Interest rates subsequently stabilized, however, and the liquidation appears not to have had any continuing effect on capital costs. To the greatest extent possible, the large-scale Treasury financing that was essential in these months was carried out in ways designed to minimize inflationary consequences and yet not to hamper the recovery and expansion of the economy by putting undue pressure on long-term capital markets.

The events of 1958 presented an unusual variety of problems in the management of the public debt. During the year, an increase of $8 billion in the public debt had to be financed, and $53.2 billion of maturing marketable issues (exclusive of bills) needed refinancing. At the same time, the reduced pressure of private demand for credit made it practicable to undertake a lengthening of the average maturity of the Federal debt. In the first six months of the year, $19.6 billion of intermediate and long-term securities were issued, which resulted in a significant increase in the average length of the outstanding marketable debt. But after July, heavier than expected subscriptions to the June exchange bond and the later rapid decline in bond

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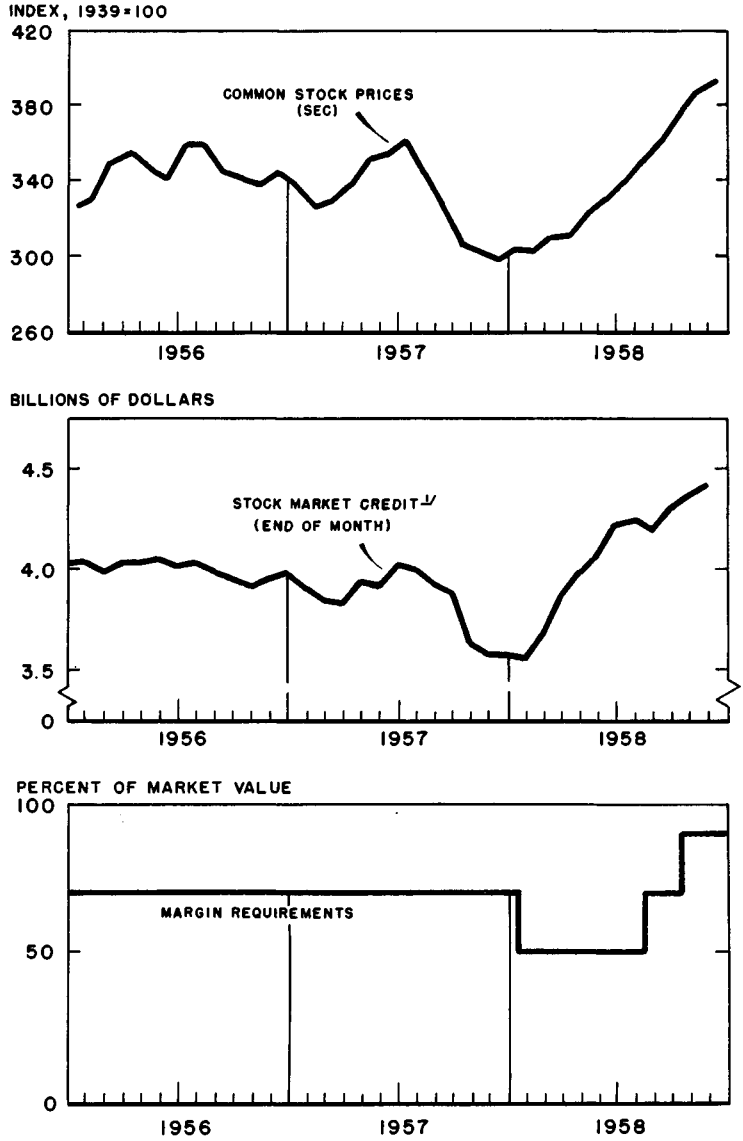
CHART 17

Stock Prices and Credit

Stock prices rose to a record level in 1958.



1/ CUSTOMERS' NET DEBIT BALANCES AND BANK LOANS TO OTHERS THAN BROKERS AND DEALERS. EXCLUDES U. S. GOVERNMENT SECURITIES.

SOURCES: SECURITIES AND EXCHANGE COMMISSION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, AND NEW YORK STOCK EXCHANGE.

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prices caused the Treasury to repurchase a quantity of its newly issued securities. During the latter part of July, the Federal Reserve suspended temporarily its policy of confining open market operations to short-term securities. For the remainder of 1958, the Treasury confined its borrowings to maturities not in excess of 2½ years.

It was evident by the end of the year that the Treasury's vast and difficult financing operation was being satisfactorily concluded. By December 31, most of the Treasury's prospective new money requirements for the current fiscal year had already been met. The Federal debt increased $6.6 billion during the second half of the year, but only about $2 billion of additional United States Government securities had been absorbed by the banking system. The expansion of the money supply, measured in terms of demand deposits and currency in circulation, had been limited to about $3 billion, or 2 percent, in the second half of the year. Most of the remainder of the Treasury's borrowing needs during this half-year were met from nonfinancial corporations and other short-term investors, rather than from longer-term holders of securities.

As business conditions improved, monetary and credit policy was shifted, with a view to limiting the expansion of bank credit to a sustainable pace. The increased restraint on bank reserves was marked by the sharp rise in member bank borrowings that began in August. Discount rates were raised to 2 percent in August and to 2½ percent in October, as short-term money rates moved upward. Margin requirements on new stock purchases were raised from 50 percent to 70 percent in August and to 90 percent in October, to prevent the excessive use of credit in stock market transactions, equity prices having risen in the meantime to record levels (Chart 17).

The response of interest rates to the recovery of the economy and the shift in monetary policy was rapid. Within the short space of four months, a rise in short-term borrowing costs wiped out much of the previous reduction, long-term capital costs returned to the levels they had reached in the late summer and early fall of 1957, and funds became more costly and somewhat less readily available in the mortgage market. By the close of the year, capital and credit markets had moved a considerable distance toward the conditions prevailing 18 to 24 months earlier.

Federal receipts and disbursements also reflected the economic and financial developments of the recovery period. The aggregate of the Federal Government's disbursements, as registered in national income accounts, rose from a seasonally adjusted annual rate of $82.8 billion in the first quarter of 1958 to $90.6 billion in the final quarter. Meanwhile, Federal receipts of all types, which had declined under the impact of recession to an annual rate of $76.1 billion by the first quarter of 1958, rose to a rate of $83.4 billion in the fourth quarter.

The gap between the Federal Government's disbursements and receipts narrowed, from a rate of $9.9 billion in the second quarter of the year to $7.2 billion as the year ended, as the fiscal operations of Government, which

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had tended earlier in the year to cushion the contraction, moved in the direction of restoring a balance between outlays and receipts and thereby countering potentially inflationary tendencies. This direction of change in the fiscal operations of Government is favorable to sustainable economic growth and improvement. Its beneficial effects would be extended by enactment of the financial plan presented to the Congress in the 1960 budget.

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