Capital Markets in 1959

DEMANDS FOR CREDIT AND CAPITAL were large throughout 1959. In addition to record peacetime borrowing by the Federal Government, private financing reached a new peak, one-third above 1958 and one-tenth above the previous peak in 1955.

Increases in borrowing last year were primarily in short- and intermediate-term debt. Consumer financing of durable goods purchases and business borrowing for working capital needs rose sharply. Moreover, Federal Government borrowing was almost entirely through short- and intermediate-term issues, as the statutory ceiling on interest rates on new Treasury bond issues prevented the Government from competing effectively for long-term funds. Federal bond financing in 1959 was only one-seventh as large as in 1958.

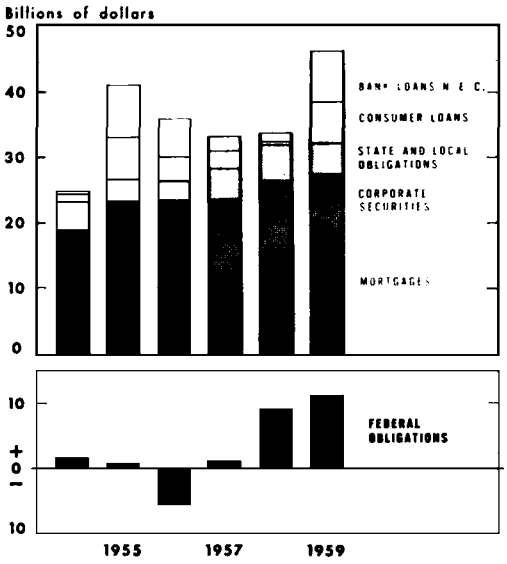
Private long-term financing increased only slightly. A rise in mortgage borrowing was largely offset by a decline in security financing by domestic corporations and foreign borrowers. Also, expansion in State and local government debt was somewhat smaller than the record growth in the preceding year.

Interest rates rose further in 1959, reaching new postwar highs. Sharpest increases were in short-term rates, reflecting the exceptionally large demands for short-term credit. Despite contraction in total long-term financing, bond and mortgage yields also advanced.

The increase in long-term borrowing costs reflected in part a decline in the flow of savings to institutions that customarily supply the bulk of long-term funds to capital markets. Growth in time and savings deposits at commercial and mutual savings banks was much smaller last year than in 1958. The decline in savings flows to banks more than offset the rise in flows to savings and loan associations and pension funds; saving through life insurance companies was little changed. Expansion in short-term lending and tighter reserve positions also limited the supply of commercial bank funds available for longer term investment.

Rising interest rates, however, attracted an increased volume of consumer and busi-

CREDIT AND CAPITAL EXPANSION



NOTE.—Flow of funds data; for description see BULLETIN for August 1959, p. 828 ff. Estimates for 1959 preliminary. Bank loans n.e.c. are mainly loans to business. Federal obligations include nonguaranteed debt of Government-sponsored enterprises. Corporate securities include issues of foreign corporations, international institutions, and foreign governments sold in the United States as well as issues of domestic corporations.

ness savings directly into mortgage and security markets. Investment in credit and equity market instruments by consumers and by foreign investors expanded greatly, and nonfinancial corporations made unusually large additions to their holdings of short-term marketable U. S. Government securities.

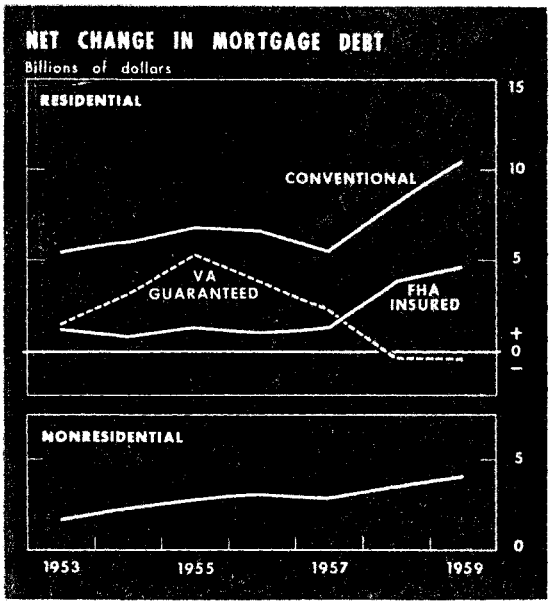
MORTGAGES

Real estate mortgage markets were under increasing pressure in 1959 as construction outlays reached new highs. Expansion in outstanding real estate mortgage debt, approximating $19 billion for the year, exceeded the previous record in 1955 by about one-sixth.

The accelerated rise in residential mortgage lending last year reflected in part increases in forward lending commitments by private financial institutions during the recession and recovery period of 1958 and early 1959. The volume of new loans, which had increased sharply in the second half of 1958, rose further over the first half of 1959 and, on a seasonally adjusted basis, reached a peak level in June.

Yields on alternative investments continued to rise more than those on mortgages, however, tending to divert a larger share of new investment funds into other capital markets. About midyear the volume of outstanding mortgage commitments began to decline, as did housing starts. Loan closings, based partly on earlier commitments, nevertheless continued in large volume.

Most of the increase in outstanding residential mortgages last year was in conventionally financed debt, as the accompanying chart shows. The record rise in conventional lending reflected in part a substantial increase in funds obtained by savings and loan associations, which lend primarily on conventional terms.



NOTE.—Federal Reserve estimates based on data from Federal and private agencies.

Mortgage debt insured by the Federal Housing Administration also increased more than in any other year. Part of the rise represented credit extended by the Federal National Mortgage Association through purchases in the secondary market and through takedowns of commitments made under special assistance programs. The decline in home mortgage debt guaranteed by the Veterans Administration in 1959 was slight, as it had been in 1958.

Real estate borrowing costs rose substantially last year. Average yields on conventional home mortgages advanced to above 6 per cent by autumn, and the maximum permissible contract rates on both VA-guaranteed and FHA-insured home mortgages were raised during the year. Even with higher permissible contract rates, Federally underwritten mortgages continue to be traded at discounts and effective yields currently are above 6 per cent.

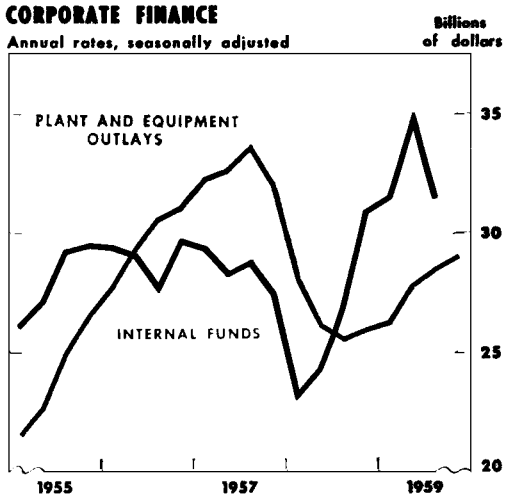
CORPORATE SECURITIES

In contrast with the record expansion in mortgage debt, the volume of corporate security financing declined last year. Corporate security issues for new capital totaled $9.2 billion, one-seventh smaller than in 1958 and one-fourth below the record volume in 1957. With interest rates higher, security offerings in the United States by international institutions, and foreign corporations and governments also declined.

Corporations depended less on external long-term financing last year primarily because of expansion in internal funds. Profits increased more than outlays for plant and equipment from recession lows in 1958 and depreciation allowances continued to grow. Until the steel strike temporarily reduced earnings, the surplus of internal funds over outlays for plant and equipment increased appreciably, as the chart shows. Moreover, funds needed for increased financing of customers and for build-up of inventories were obtained largely through short-term borrowing.

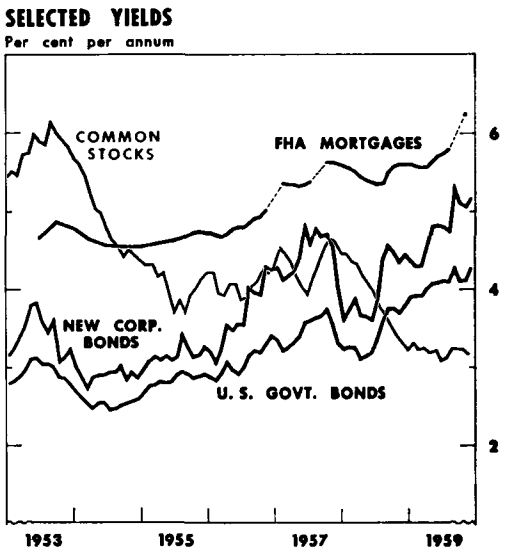
Contraction in capital market financing occurred in most major industries last year. Manufacturing companies sold the smallest volume of issues for new capital since 1954. Flotations by public utilities declined about one-sixth and issues by communication companies were only half as large as in the preceding year. Long-term borrowing by consumer finance companies increased substantially, however, reflecting the sharp rise in consumer credit.

The decline in corporate security flotations last year was entirely in publicly offered debt issues. Private placements of bonds and notes increased moderately and sales of stock rose considerably. Stock issues accounted for one-fourth of all corporate security offerings in 1959, the largest proportion since 1956. Sales of common stock were much larger than in the preceding year, while offerings of preferred stocks declined somewhat.



NOTE.—Department of Commerce and Securities and Exchange Commission data. Internal funds comprise (1) corporate profits after deducting income tax liabilities and dividend payments and (2) depreciation allowances. Plant and equipment outlays adjusted by Federal Reserve to exclude those of noncorporate business. Outlays for fourth quarter 1959 as anticipated by business.

Despite expansion in the supply of equity securities, common stock prices continued to rise until early August. After declining somewhat at that time, prices fluctuated within a narrow range for several months, rising toward the year-end to levels only slightly below the August peak. With dividends increasing moderately, average yields on common stocks remained slightly above 3 per cent throughout the year, as can be seen on the chart on the following page. Stock yields have been below yields available on alternative investments, including U. S. Government securities and high-grade corporate bonds, for an exceptionally long period.



NOTE.—Monthly averages for (1) 500 common stocks (90 before mid-1957) from Standard and Poor's Corporation; (2) new corporate long-term bonds, estimated yields from First National City Bank of New York, adjusted to a Aaa basis (figures reflect changes in quality, industrial composition, maturity, and type of offering); and (3) U. S. Government bonds maturing or callable in 10 years or more. For FHA mortgages, data are for last month of quarter mid-1953 through mid-1955 and monthly thereafter; data are Federal Reserve computations from average prices reported by FHA (dashed lines indicate periods when averages were adjusting to changes in contractual interest rates and no data were available). Latest figures shown, December, except for FHA mortgages (November).

U. S. GOVERNMENT SECURITIES

Cash payments to the public by the Federal Government in calendar year 1959 exceeded cash receipts by $8 billion, a somewhat larger deficit than in 1958. Tax receipts rose with expanding economic activity, but payments to the public rose even more rapidly. Moreover, redemptions of savings bonds exceeded new purchases by a much wider margin than in 1958, and financing needs of Government-sponsored enterprises rose. As a result, the Federal Government found it necessary to raise more than $11 billion on balance through sale of marketable securities in 1959, one-fourth more than in the preceding year.

Almost all of the Treasury's financing last year was in short- and intermediate-term issues. Early in the year a small amount of long-term bonds was sold for cash. As interest rates rose generally, the 4¼ per cent statutory ceiling on Treasury bond coupon rates precluded further resort to long-term financing. Intermediate-term issues were sold in August and again in October and November at rates of around 5 per cent, and the remainder of the loan funds needed by the Treasury was obtained through sales of bills and certificates with relatively short maturities. The passage of time and the preponderance of short-term financing last year shortened considerably the average maturity of the public debt.

STATE AND LOCAL GOVERNMENTS

New bond sales by State and local governments in 1959 were only slightly below the record volume in 1958. Short-term financing also declined, while retirement of outstanding debt increased. As a result, growth in State and local debt was about one-eighth smaller than in 1958.

A larger than usual proportion of the new issues in 1959 represented financing of revenue producing facilities such as electric power and water systems. Borrowing to finance school and highway construction declined, the latter decline reflecting in part the increase in Federal Government grants for highway building.

MAJOR SOURCES OF FUNDS

Most of the funds flowing to capital markets in postwar years have been channeled through major financial institutions such as banks, savings and loan associations, insurance companies, and pension funds. In

periods of rapid expansion in economic activity, savings inflows to these institutions have not increased commensurately with demands for funds, and in some instances have even contracted. Under these conditions interest rates have tended to rise, thereby attracting an increased volume of direct investment in financial markets by individuals and other savers.

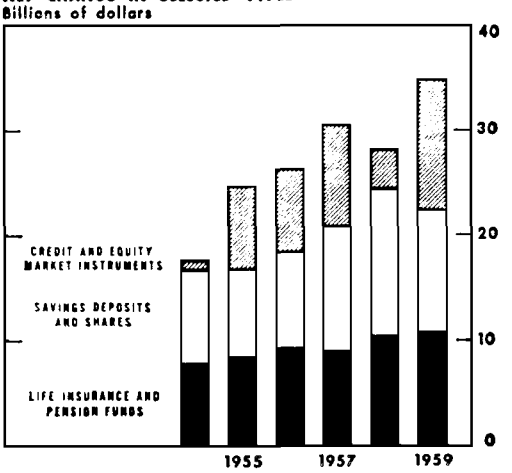
In 1959, as in 1955, inflows to institutions did not keep pace with rising demands for funds. In each year interest rates rose, and direct financial investment by consumers, nonfinancial businesses, and foreigners expanded substantially.

Consumers and businesses. Consumer purchases of mortgages and securities rose sharply in 1959. This expansion of investment in capital market instruments was greater than the decline in consumer saving through financial institutions, as can be seen on the chart.

The largest increase was in consumer purchases of marketable obligations of the United States Government. Available data indicate that consumers purchased a very large volume of marketable Government securities in 1959, in contrast with net sales in the preceding year. Consumer investment in State and local government obligations and in mortgages also increased last year, more than offsetting a decline in their acquisitions of corporate bonds and stocks.

Holdings of Government securities by nonfinancial corporations also increased in 1959. During the first half of the year, profits and short-term borrowing rose more rapidly than current needs for funds, and corporations added to their liquid assets at a time of year when they usually draw down such reserves.

CONSUMER SAVINGS
NET CHANGE IN SELECTED TYPES
Billions of dollars



NOTE.—Flow of funds data; for description see BULLETIN for August 1959. Credit and equity market instruments include corporate and foreign bonds and stocks, State and local obligations, Federal obligations except savings bonds, and mortgages. Savings deposits and shares comprise time and savings deposits at commercial banks, deposits at mutual savings banks, savings shares at savings and loan associations and credit unions, and postal savings. Life insurance and pension funds comprise life insurance, fraternal orders, self-administered corporate pension funds, and Federal and State and local government pension funds. Estimates for 1959 preliminary.

Corporations increased these liquid asset reserves further after midyear, in part reflecting temporary investment of funds which became available as steel inventories were reduced. For the year as a whole, the increase in corporate holdings of U. S. Government securities was the largest for any year in the postwar period.

Life insurance companies. Inflows of savings to life insurance companies changed little last year. To augment funds available for investment in capital markets, insurance companies drew down their holdings of cash and U. S. Government securities, as they have in most postwar years other than 1958. Reductions in these liquid asset holdings were small, however, compared with earlier years.

The pattern of insurance company investment in 1959 was about the same as in 1958. A somewhat larger amount of funds was invested in mortgages and State and local government securities last year and a somewhat smaller volume in corporate securities.

Larger acquisitions of mortgages reflected mainly earlier increases in forward lending commitments. In early 1958, when mortgage yields exceeded those on alternative investments by a wide margin, insurance companies increased their commitments for mortgage loans. Despite a narrowing in the yield spread in the latter part of 1958 and in 1959, they continued to increase mortgage commitments as business demands for external long-term financing continued at reduced levels. Insurance company commitments for forward lending stopped rising after midyear, but mortgage acquisitions under earlier commitments continued in large volume.

Insurance company investment in State and local government obligations in 1959 was as large as in 1954, the previous peak year for such investment. In both 1954 and 1959 a large proportion of the new issues sold by State and local governments was in revenue bonds, which customarily offer higher yields than do general obligation issues. Recent revision in laws affecting insurance company income tax liabilities was probably an additional factor encouraging increased investment in tax-exempt securities last year.

Mutual savings banks. Deposits at mutual savings banks increased by $1.3 billion in 1959, after adjustment to exclude the effects of consolidation of a large mutual savings bank with a commercial bank at the beginning of the year. The increase was less than half that of the preceding year, and the smallest since 1951. Slower growth in deposits reflected the higher yields available last year on alternative uses of savings as market rates on both short- and long-term investments rose much more rapidly than did rates of interest paid on savings deposits.

Mutual savings banks responded to the decline in savings inflows by reducing holdings of corporate securities and by making further reductions in their holdings of U. S. Government securities. These portfolio adjustments permitted them to acquire almost as large a volume of mortgages as they had in 1958.

The pattern of savings bank investment in 1959 was similar to that in 1955, another year of rapid economic expansion. In both years amounts invested in mortgages were substantially larger than the increases in deposits, and funds needed to finance mortgage acquisitions were obtained largely by sales of U. S. Government and corporate securities.

Savings and loan associations. In contrast with the decline in savings inflows at commercial and mutual savings banks, share capital of savings and loan associations increased at a record rate in 1959, about one-tenth greater than the previous peak rate in 1958. Also, associations reduced their cash balances, and increased their borrowing more than in any other year. At the end of December outstanding advances by the Federal Home Loan Banks to member associations were at an all-time high of $2.1 billion.

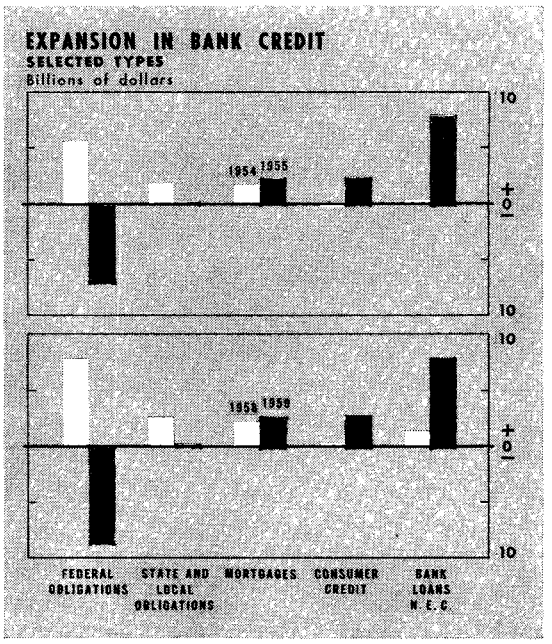
Almost all of the funds available to associations for investment last year were channeled to mortgage markets. Expansion in mortgage holdings reached a record of nearly $7.5 billion, one-third more than in 1958 and two-fifths more than in 1955.

Holdings of U. S. Government securities were also increased.

Commercial banks. Time and savings deposits at commercial banks increased by an estimated $1.5 billion in 1959, after adjustment to remove the effects of bank structure changes. This compares with a rise of $5.6 billion in 1957 and $7.0 billion in 1958. In the first half of the year deposits increased much less rapidly than in the corresponding period of 1958, and after mid-year deposits declined, in contrast with a further rise in the preceding year.

Demand deposits other than U. S. Government and interbank balances increased only slightly in 1959, following an exceptionally rapid expansion in the preceding year. The small rise in the public's holdings of bank deposits in 1959 was accompanied by an increase in the turnover of deposits and by a large rise in their holdings of other liquid assets, particularly short-term Government securities.

Reflecting the smaller inflow of savings and tighter reserve positions, along with larger demands for short-term bank credit, commercial banks reduced their holdings of Federal obligations by about $8.5 billion, somewhat more than these holdings had been increased in the preceding year. Also, net purchases of State and local government securities which had been exceptionally large in 1958 were very small in 1959. Commercial bank lending on real estate, however, rose somewhat more rapidly than in 1958.



NOTE.—Flow of funds data for all commercial banks; for description see BULLETIN for August 1959. Federal obligations include nonguaranteed debt of Government-sponsored enterprises. Data for 1959 are preliminary estimates adjusted to eliminate effect of bank structure changes.

As the chart shows, the pattern of changes in bank loans and investments last year closely resembled the pattern in 1955, also a year of recovery and renewed expansion. In both years, reserve positions tightened as credit demands rose sharply, and banks obtained funds for lending to private sectors by reducing their holdings of U. S. Government securities and curtailing their lending to State and local governments. In both years, mortgage lending increased moderately, while other loans to consumers and businesses increased sharply.