Capital Markets in 1960

FINANCING through capital markets receded in 1960 from the unusually large volume in 1959, and interest rates declined until autumn. A shift in the Federal Government's budget position from substantial deficit to moderate surplus was a major factor in the changed climate in capital markets, but other demands for funds also fell off significantly.

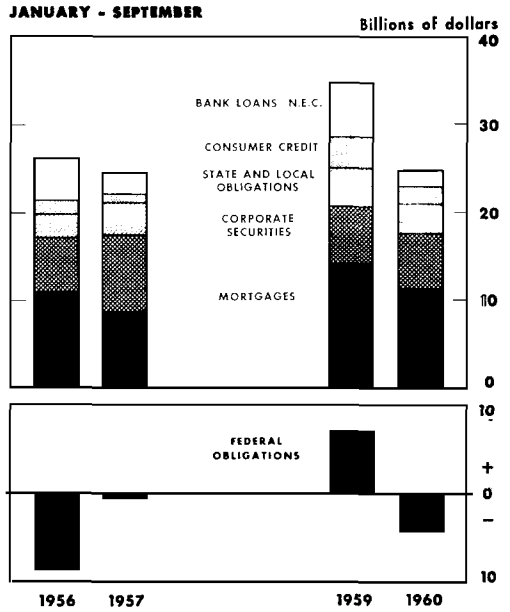
The net increase in both mortgage debt and State and local government obligations outstanding has been smaller than in 1959. Corporate security offerings have been a little larger than last year, primarily because sales and consumer finance companies have engaged in heavier long-term borrowing while relying less on short-term debt.

Savings institutions have supplied about the same volume of funds to the capital and credit markets in 1960 as in 1959. Consumers, however, have made fewer direct purchases of securities than the record volume last year, and corporations have reduced their holdings of Treasury securities in contrast with net purchases in 1959. The larger outflow of private capital from the United States in recent months has also tended to reduce the net supply of funds available in capital markets.

The decline in market interest rates that began early in 1960 was neither steady in time nor uniform among types of obligations. Market yields on long-term U. S. Government securities, which had risen sharply in late 1959, fell more from January through August than yields on corporate and municipal obligations. Yields on most types of securities reached lows for 1960 in the late summer, and then increased.

The rise in market yields in the autumn accompanied a heavy volume of corporate borrowing and an enlarged outflow of private funds to other countries. Expectations in this period about future interest rate movements were subject to divergent influences. Although market participants became increasingly doubtful about prospects for early resumption of economic expansion, the balance-of-payments problem and gold movements made them uncertain regarding the extent to which monetary conditions

NET CREDIT AND CAPITAL EXPANSION
JANUARY - SEPTEMBER



NOTE.—Flow-of-funds data; estimates for third quarter 1960 preliminary. Bank loans n.e.c. are mainly loans to business. Corporate securities include equity as well as debt issues of domestic corporations, foreign corporations, international institutions, and foreign governments sold in the United States.

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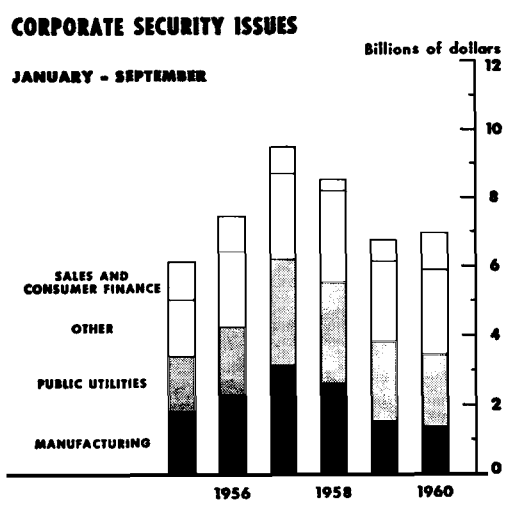
might ease further in response to the domestic economic situation. In December, however, some of the market uncertainties appeared to be dissipating, and yields began to decline again.

USES OF FUNDS

Corporate security issues have increased slightly this year, but new offerings of State and local government securities and new mortgage financing have been smaller than in 1959.

Corporate securities. Total requirements for funds by corporations have declined this year. As the volume of sales slackened over the year, both inventories and accounts receivable grew less than in 1959, and this more than offset the increase in plant and equipment expenditures. Total expansion in corporate assets in the January-September period was one-fifth less than in the corresponding period of last year, but about the same as in 1956 and 1957.

Corporate internal funds in the first three quarters of 1960 were generated at about the same high rate as in 1959. Lower corporate profits and larger dividend payments both contributed to a decline in retained earnings, but depreciation allowances continued to grow. With lower requirements for funds, and with internal funds about the same as last year, total external financing by corporations has declined. Expansion of short-term debt—including both bank loans and trade debt—was less than in the first nine months of 1959. Corporate security issues for new capital, though slightly larger than in January-September 1959, were smaller than in the first nine months of any other year since 1955.



NOTE.—Net proceeds for new capital as published by Securities and Exchange Commission except that estimates for sales and consumer finance companies are by Federal Reserve.

Corporate spending for plant and equipment turned down after mid-1960, as it had also in the autumn of 1957. The change in corporate spending and financing from 1959 to 1960 has been similar in a number of respects to the change from 1956 to 1957, but long-term financing has increased much less than in the earlier period. In both periods, plant and equipment outlays expanded, whereas accumulation of inventories and accounts receivable slowed. Similarly, the flow of internal funds changed little, while expansion of short-term bank and trade debt slackened.

From 1956 to 1957, however, the volume of corporate security issues increased substantially, while financing through reduction of cash and Government security holdings declined. Corporations reduced their liquid assets sharply in January-September 1956 but much less in the same period of 1957. In 1959, in contrast, they increased their liquid assets somewhat, but holdings of these assets were reduced substantially in the first nine months of this year. By the end of September 1960, the liquidity ratio of corporations—liquid assets divided

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by current liabilities—had declined to a level that was a little higher than in the summer of 1957 but lower than at any other time in the postwar period.

Although manufacturing companies had planned to expand their plant and equipment expenditures by about one-fifth from 1959 levels, they have financed the increase to a greater extent by drawing down liquid assets than by borrowing in security markets. Through September, new security issues were one-tenth below the volume a year earlier and the lowest for the first nine months of any year since 1950. The capital spending programs of electric, gas, and water utilities showed little change from 1959 to 1960. With the flow of internal funds higher, these companies borrowed less in the capital market in the first nine months of this year than in the same period of 1959.

In most other industries, issues for new capital were larger in the first nine months of 1960 than in the corresponding period of last year. Issues of sales and consumer finance companies were 70 per cent greater. An unusually large proportion of new issues by sales finance companies in recent months have been in the form of public offerings rather than private placements. While growth in their customer receivables in the January-September period was at about the same high rate as in 1959, these companies reduced bank debt this year.

Finance companies and other corporations issued a relatively heavy volume of new securities in the third quarter, at a time when spending plans for plant and equipment were being curtailed and uncertainties about the business outlook had increased. The sharp drop in corporate bond yields in the summer months, and fears of some corporate borrowers that this tendency might be reversed, may have contributed to the heavy volume of flotations in the third quarter. Offerings of corporate securities continued to be substantial in October and November. This led to market congestion at times and exerted upward pressure on interest rates.

Mortgages. New private construction activity in the first nine months of 1960 was slightly below the all-time record in the same period of last year. Housing starts were a fifth less than last year's advanced rate. Lower outlays for new residential building were not quite offset by larger nonresidential construction expenditures. In contrast, during the previous cyclical upswing, the dollar volume of total private construction activity had increased in 1956 and 1957 as rising spending for business and other construction more than offset the decline in residential building outlays.

Along with the decline in activity, new mortgage borrowing has been reduced this year. The amount of nonfarm mortgage recordings of $20,000 or less, chiefly on new and existing houses, was about a tenth lower than the record amount in the January-September period of last year. As a result of the smaller rise in new mortgage loans and the continued increase in repayments and retirements, the growth in outstanding mortgage debt has been about one-fifth less than in 1959, a year of record increase.

State and local obligations. New construction put in place by State and local governments in the January-September period this year was slightly less than in the same period of 1959. Part of this decline resulted from a decrease in highway construction financed by Federal grants-in-aid. Construction outlays for sewer and water and power systems and for educational facilities increased.

New bond sales by State and local govern-

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ments were slightly less this year than in the first three quarters of 1959, which in turn were less than the record amount in the same period of 1958. These governments sharply reduced their short-term financing from the large volume last year and retired a larger amount of outstanding debt. The growth in total State and local debt outstanding therefore has been only about three-fourths as great as in 1959.

Bond sales for the purpose of financing both school construction and highways have been larger in 1960 than in 1959, although below the record 1958 total. Borrowing to finance public power systems has been the principal type of financing to decline this year. Expenditures for construction of electric power facilities have increased, but they have been partly financed with the proceeds from several very large revenue bond issues sold in 1959.

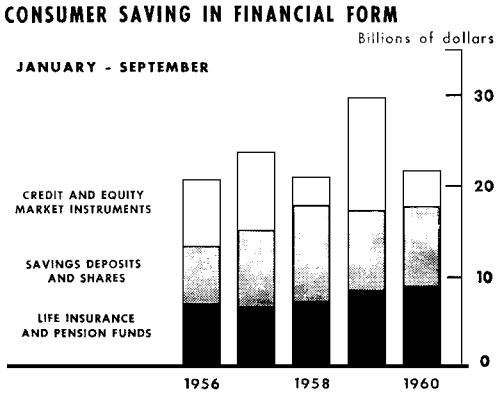
Sales of bonds by State and local governments were quite small in October and November, when interest rates were higher than in the late summer. Some State and local officials postponed financing in anticipation that interest costs would soon decline again. The backlog of State and local bonds authorized but unsold rose to a record level, as voters approved nearly all of the large dollar volume of bond proposals submitted in the November general election. Some of the large issues are expected to be sold gradually over a long period of years.

MAJOR SOURCES OF FUNDS

Funds supplied to the capital markets directly by consumers declined in 1960, as did those provided by major savings institutions, but this was partly offset by an increase in the net flow of credit supplied by commercial banks.

Consumers. In the first three quarters of 1960, consumers acquired fewer financial assets but also incurred a smaller volume of debt than a year earlier. The net increase in consumer credit was little more than half the previous year's expansion, and the net increase in residential mortgage debt was almost one-fifth less.

The composition of financial assets acquired by consumers has shifted markedly in recent years. In the 1955-57 period, marketable securities comprised about one-third of the net increase in consumer financial assets. After falling off in 1958, this ratio rose sharply in 1959, as interest rates advanced to new high levels for the postwar period and consumers purchased substantial amounts of U. S. Government obligations.



NOTE.—Flow-of-funds data; included are all categories under net acquisition of financial assets except demand deposits and currency, U. S. savings bonds, and net investment in unincorporated business. Estimates for third quarter 1960 preliminary.

In the first nine months of 1960, when interest rates on capital market instruments were generally declining, consumer net investment in marketable obligations again decreased—to about the same proportion as in 1958, as the chart shows. The largest decline was in net purchases of Government

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securities, but consumers also reduced their acquisitions of other securities.

In recent months, flows of funds into savings institutions apparently have accelerated. After having risen less in the first half of 1960 than in the same period of 1959, the total of time and savings deposits at commercial and mutual savings banks and shares at savings and loan associations increased more than twice as much in the third quarter as during the corresponding period a year earlier.

Savings deposits and shares. Deposit growth at mutual savings banks slackened in the first half of 1960, then picked up sharply in the third quarter. For the first nine months, however, deposit expansion was the smallest for any corresponding period since 1950.

The pattern of asset growth has changed little in 1960, with mortgage acquisitions predominating. Although corporate security holdings have risen somewhat this year, in contrast with 1959, the increase has been much less than in earlier years. Mutual savings banks also have reverted to net sales of Government securities after having made little change in such holdings in 1959.

Savings and loan associations experienced a record inflow of savings capital in the first nine months of 1960, 10 per cent more than in the same period of 1959. With demands for conventional residential mortgages less intense, associations have repaid $500 million to the Federal home loan banks and other lenders—about the same amount they had borrowed in the first nine months of 1959. Their mortgage holdings increased $5.3 billion in the first nine months of 1960, $600 million less than in the same period a year earlier. These associations also have invested considerably less in Government securities this year than in 1959.

Life insurance companies and pension funds. The net increase in assets of life insurance companies this year has been about the same as in 1959. The increase in policy loans, however, has been heavier than in 1959, thereby reducing the amount of funds available for purchase of capital market instruments. At the same time, these companies have reduced their Government security portfolios by more than they did last year.

The net increase in mortgage holdings by life insurance companies in the first nine months of 1960 was about one-fourth larger than in the corresponding period of 1959, though it remained considerably below the amounts of 1955 and 1956. On the other hand, the net volume of corporate securities acquired was about one-third less than in the same period of 1959, and less than in the corresponding period of any recent year.

The flow of saving to pension funds has continued its steady increase in 1960. These institutions have enlarged their holdings of corporate securities substantially more than in 1959.

Commercial bank credit. Commercial banks have contributed more to the flow of credit this year than in 1959, and this was accompanied by a much larger growth of time and savings deposits. Bank credit declined more than seasonally in the first half of 1960. In the third quarter, however, credit expansion was exceptionally large and took the form primarily of investment in U. S. Government securities. The shift by commercial banks from net sales of Government securities early in the year to large-scale purchases in the third quarter contributed to the accelerated decline in market interest rates in the summer months.

Bank holdings of other securities, mainly obligations of State and local governments,

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also increased in the third quarter, offsetting a decline in the first half of the year. For the nine-month period, mortgage loans increased only about one-third as much as in the same period of 1959.

INTEREST RATES AND MARKET DEVELOPMENTS

Yields on debt securities of all types declined in 1960 from the high levels prevailing early in the year, as shown in the chart. The reduction was most pronounced during the late spring and early summer. After August, market yields turned up and then fluctuated irregularly at levels above their late summer lows. During the autumn, expectations for a continuing reduction in long-term interest rates, based on growing indications of a slackening in economic activity, were counterbalanced by concern over the balance of payments and associated gold movements.

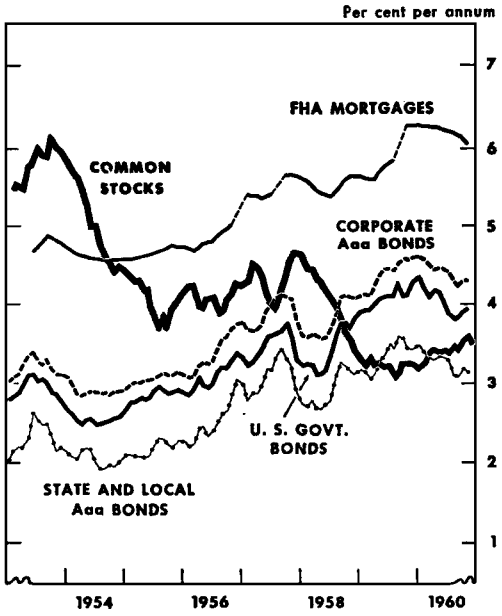
Between January and August, yields on long-term U. S. Government securities fell two-thirds of a percentage point—about the same as the reduction from the autumn of 1957 to mid-1958. On the other hand, yields on highest grade State and local government issues fell only half a point, and rates on outstanding corporate issues declined even less. This disparity of rate movements reflects in part the relatively high yields on U. S. Government bonds in late 1959 and the net reduction in outstanding Federal obligations in 1960. Since August, increases in yields on these securities have been larger than for most other securities.

The smaller flow of consumer saving directly into debt and equity securities this year represents for the most part smaller purchases of Federal obligations, but it may also be related to lessened enthusiasm for common stocks. Stock prices have moved irregularly throughout the year, but have declined on balance.

At a time of increasing uncertainty as to the market reception of stocks, corporations have relied less upon such issues as a method of raising new capital than in 1959. Sharp price declines have been recorded for stocks of companies in industries where profits usually respond to changes in levels of business activity; stocks of companies that have been little affected by postwar recessions have generally increased in price over the year.

As a result of irregular declines in common stock prices and a moderate increase in dividends, yields on equities have risen from little more than 3 per cent early in

SELECTED YIELDS



NOTE.—Monthly averages for (1) 500 common stocks (90 before mid-1957) from Standard and Poor's Corporation; (2) 30 corporate bonds rated Aaa from Moody's Investors Service; (3) 5 State and local government bonds rated Aaa from Moody's Investors Service; and (4) U. S. Government bonds maturing or callable in 10 years or more. For FHA mortgages, data are for last month of quarter through mid-1955 and monthly thereafter; data are Federal Reserve computations based on average prices reported by FHA (dashed lines indicate periods when averages were adjusting to changes in contractual interest rates and no data were available).

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1960 to about 3½ per cent in recent months. The excess of yields on highest grade corporate bonds over those available on common stock narrowed to less than one percentage point beginning in July, as compared with a peak of almost 1½ percentage points in late 1959.

The spread between interest rates on new corporate issues and yields available to buyers of outstanding long-term obligations of comparable quality also decreased through most of the year. Yields available on new issues, which had turned down late in 1959, continued to fall more rapidly than those on existing bonds, as is usual in a period of declining interest rates. By August, yields on new issues had fallen one-sixth—about twice as much as the decline in the return on highest grade outstanding bonds.

Yields on State and local obligations have declined more than those on outstanding corporate issues of similar quality. The timing of their movement, however, has differed. Rates for State and local issues reached a peak in September 1959, after rising less from mid-1958 than yields on corporate or Federal securities. As in the case of corporate bonds, the decline in yields was particularly marked in the summer of this year, but there was a subsequent reversal. More recently, with an unusually low volume of new State and local issues, market yields have again turned down, in contrast with corporate security yields.

Mortgage yields rose less between mid-1958 and late 1959 than did returns on most other obligations. Throughout 1960, these yields have shown a declining tendency. According to past experience, a tightening or easing in capital and credit markets is likely to be reflected in the mortgage market more in changed availability of funds than in a sharp rise or fall in interest costs.

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