Easing in Credit Availability at Banks

Deposit inflows to, and the availability of credit from, commercial banks improved progressively during 1970 as a result of the cumulative effects of the general easing in monetary policy, of bank regulatory changes, and of the broad decline in market rates of interest. Because inflows of deposit funds were strong and loan demands were relatively weak, banks reduced sharply their reliance on nondeposit sources of funds after midyear and restored severely depleted liquidity positions. In light of these developments, banks by the end of 1970 were in a considerably better position to meet the credit needs of an expanding economy.

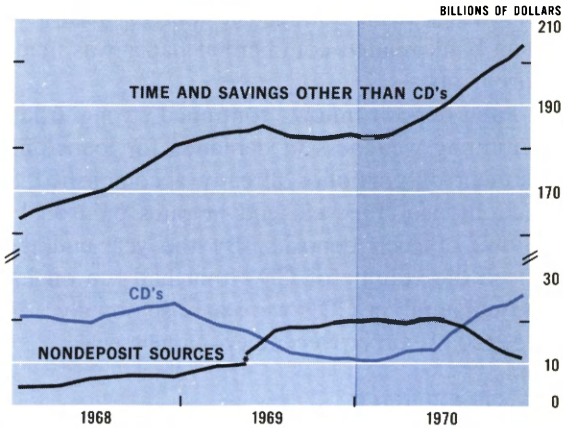
SOURCES OF FUNDS

Total deposits at banks rose sharply in 1970, in contrast to the decline during 1969 when monetary policy was quite restrictive. While demand deposits resumed their growth as market rates of interest declined and the public sought increased liquidity, the bulk of the increase in inflows at banks was attributable to the sharp rise in time and savings deposits.

Time and savings deposits other than large-denomination CD's—principally consumer-type time and savings deposits—grew rapidly after the first quarter of 1970. Banks generally raised the interest rates offered on these deposits shortly after the Board acted in January to liberalize ceiling rates under Regulation Q. Other authorities raised interest rate ceilings for savings and loan associations and mutual savings banks at the same time, and all three types of depositary institutions subsequently experienced increased rates of deposit inflow.

Growth in total time deposits surged after midyear when banks became able to compete aggressively for large CD's. Even though ceiling rates on large CD's had been raised in January, along with rates on other time and savings deposits, banks could sell only limited volumes of CD's because interest rates on competing money

10. INTEREST-BEARING SOURCES OF BANK FUNDS



Seasonally adjusted monthly averages of daily figures for all commercial banks. Time and savings deposits other than CD's exclude both those due to domestic commercial banks and the U.S. Govt. and balances accumulated for repayment of personal loans. Nondeposit sources include borrowings from foreign branches and * beginning June 1969, bank-related commercial paper, loan repurchase agreements, and borrowings from foreign banks and branches in U.S. territories and possessions.

market instruments remained significantly above the rates that banks were permitted to offer. Following the suspension of the Regulation Q ceilings on large 30- to 89-day CD's in late June, banks quickly raised their offering rates on short-term CD's to competitive levels.

As a result banks were able to increase their outstanding CD's by $4.9 billion during the month of July alone. There are indications that part of these CD's were acquired by investors who did not want to roll over their commercial paper in the wake of the substantial deterioration of confidence in such paper following the announced insolvency of a major railroad. In addition to CD inflows, banks during the summer used the Federal Reserve discount facility to meet unusual loan demands from customers who were unable to refund maturing issues in the commercial paper market.

But even after the pressures associated with the commercial paper crisis subsided, banks continued to issue large CD's in volume. They used a sizable portion of these inflows to restructure their liabilities, with particular emphasis on repaying higher-cost Euro-dollar borrowings and bank-related commercial paper. Many banks had relied

heavily on such funds during 1969 and early 1970 to supplement the funds they acquired through normal deposit channels. Repayments of borrowings from nondeposit sources were accelerated in September, when bank-related commercial paper was made subject to reserve requirements.

Total deposit inflows continued strong in late 1970. In view of the continuing weakness in demands for loans and the substantial readjustment of portfolios already accomplished, banks made sharp reductions near the year-end in rates paid on large CD's to moderate inflows of such deposits. By the year-end they had more than replaced the volume of CD's that had run off in 1969 and early 1970, and outstanding CD's were at a seasonally adjusted monthly average of $26.0 billion in December—a new peak.

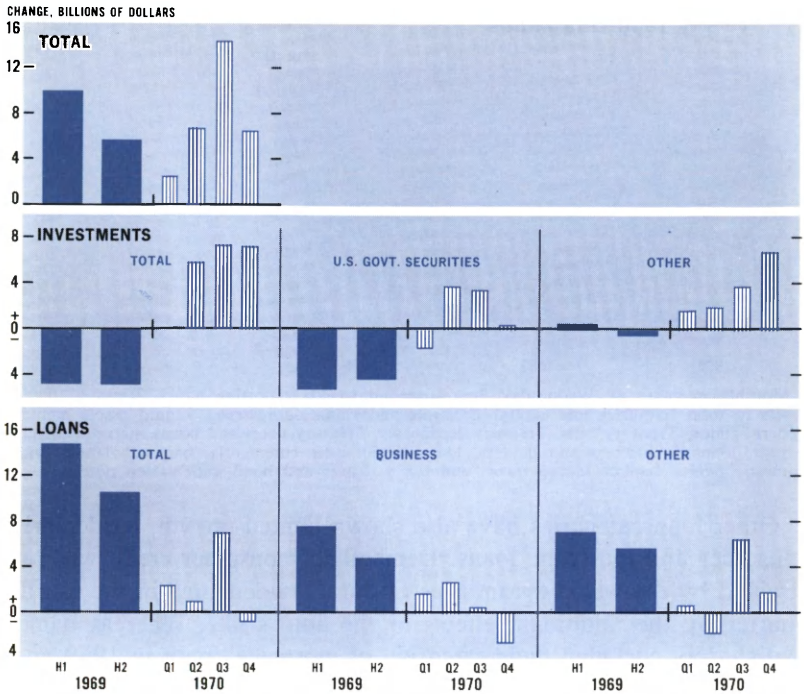
BANK CREDIT

Bank credit developments in 1970 and early 1971 have reflected principally the marked increase in fund availability and the lessening of loan demands. Total loans and investments at all commercial banks, including loans sold to bank affiliates or subsidiaries, increased by $30 billion in 1970, or nearly twice the increase over the preceding year. A substantial portion of this growth represented bank acquisitions of securities, which had registered a considerable decline in 1969.

Participating heavily in U.S. Treasury financing operations, banks acquired a net of more than $7 billion, seasonally adjusted, of U.S. Government securities during the middle two quarters of 1970. And throughout the year they increased sharply the rate of acquisition of other securities—principally State and local government obligations—after having maintained their holdings of such securities virtually unchanged in 1969. In large measure, banks concentrated on acquiring shorter-term investments so as to restore their depleted liquidity positions. The large rise in liquid assets along with concerted efforts to reduce reliance on borrowed funds resulted in an appreciable improvement in over-all bank liquidity and contributed significantly to banks' willingness to extend a larger volume of loans.

Although the substantial rebuilding of liquidity was in large part desired, it also reflected the general weakness in demand for loans. Total loans at all commercial banks, including loans held by affiliates

11. BANK CREDIT, 1969-70

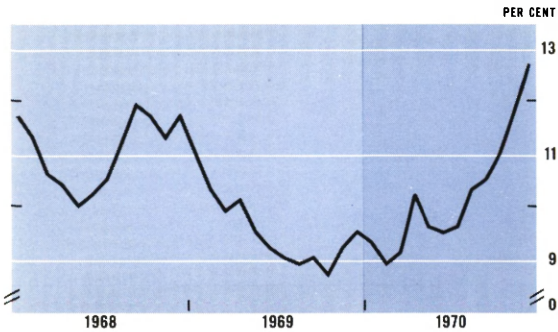


Seasonally adjusted data for all commercial banks. Beginning June 1969, loan items have been adjusted to include loans sold to bank affiliates, subsidiaries, holding companies, and foreign branches.

and subsidiaries, grew slowly in the first half of 1970, then rose by $7 billion in the third quarter. During the latter period banks extended a large volume of credit to securities dealers as well as to finance companies and other borrowers experiencing difficulty in the commerical paper market. But in the fourth quarter loans at commercial banks declined on a seasonally adjusted basis.

The reduction in loans at banks in the fall reflected the general weakness in economic activity and the associated decline in credit requirements, together with the effects of the auto strike in the fourth quarter. In addition, banks have experienced substantial business loan repayments out of the proceeds of capital market financings as corporations placed considerable emphasis on lengthening their debt structure and improving liquidity positions.

12. LIQUIDITY RATIO
Weekly reporting banks



Monthly averages of Wednesday figures for all weekly reporting banks. Ratio of liquid assets to total liabilities less capital accounts and valuation reserves. Liquid assets include Federal funds, Treasury bills, Treasury certificates, Treasury notes and bonds maturing within 1 year, loans to brokers and dealers, loans to domestic commercial banks, balances with domestic banks, bankers acceptances, and tax warrants and bond anticipation notes.

Other loan categories have also shown limited growth, particularly consumer and mortgage loans. Demand for consumer credit was restrained by the weakness in sales of durable goods and in the fourth quarter by the additional effects of the auto strike. Whereas banks had sharply curtailed their extension of mortgage credit in 1969 and early 1970, when their fund inflows were constrained, since the autumn they have indicated an increased willingness to extend mortgage credit. The increase in mortgage loan portfolios did not pick up appreciably until late in the year, but this appears to reflect the long lags between mortgage commitments and the actual takedown of funds.

These changes in bank asset positions were an important factor in the decline in the prime rate of interest from 8½ per cent in early 1970 to 6 per cent in January 1971. Other loan terms and conditions also have been eased, and banks are now more willing to undertake loan commitments that they would not have made earlier, including extensions of term loans to business. However, with concern over the quality of loan portfolios heightened by the well-publicized difficulties of several major firms, banks reportedly are continuing to emphasize quality standards. □