Things Have Changed

Economic activity and financial conditions have changed in the last few months. The year 1967 began with the economy's slowing down in contrast with its unsustainable rapid pace of early 1966.

The gross national product figures underscore the slower economic expansion. After having increased in first quarter 1966 at an annual rate of 9.5 percent, measured in current dollars, the rates slowed to 6.2 percent in the second quarter and 7.1 percent in the third. In the final quarter, the rate of increase picked up to 7.4 percent.

However, when account is taken of price increases, the final quarter rate amounted to only 4.4 percent, compared with 5.9 percent in the first quarter computed on the same basis.

The failure of consumers to increase their spending, especially for durable goods, is part of the reason for the slowdown. Automobile sales in 1966 totaled 8.8 million units, considerably below the record of 9.3 million units sold in 1965. The number would have been even lower had not foreign car sales been strong. Moreover, plans to buy new automobiles deteriorated. With sales below anticipated levels, inventories of new cars became excessive. Declining sales and rising inventories in turn caused downward adjustments in production. Most auto makers announced further cuts in January.

A slower rate of business-fixed investment expansion also contributed to the slackened growth of GNP. Until recently, business spending for new plant and equipment provided a substantial lift to the economy. However, the rate of gain has eased up. Moreover, a survey of plans for new plant and equipment spending through the second quarter 1967 indicates that the stimulus from this source is continuing to weaken. Predicted gains for this year are less than half as large as those of previous years. New orders for machinery were vigorous in July, but have taken a definite downturn since then. That spending for commercial and industrial construction may also decrease is suggested by the weakening in contracting for such projects in recent months.

With consumer buying of durable goods failing to expand and a slowing in the growth of business capital investment, the decline in home building began to have a much greater impact on the nation's total output in the last half of 1966. Private housing starts had begun to decline in early 1964, even though at that time mortgage rates were relatively low and the Federal Reserve's policy

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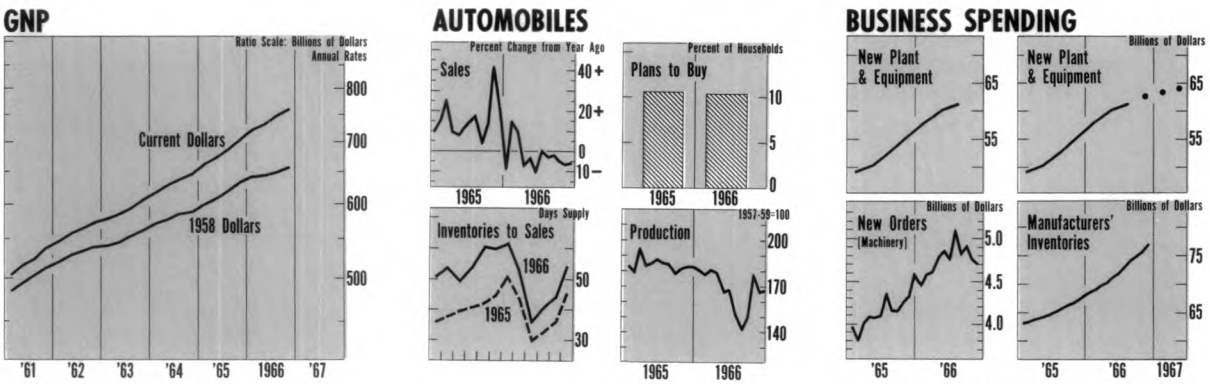
1966 Changes in GNP

Seas. Adj. Annual Rates	Quarters I	II	III	IV
Current Dollars		Billions of Dollars		
Personal Consumption Expenditures	10.4	4.5	9.8	4.5
Durable Goods	2.3	− 3.2	3.1	− 0.1
Nondurable Goods	4.9	3.7	6.2	0.6
Services	3.2	4.0	4.1	4.1
Gross Private Domestic Investment	2.6	4.0	− 3.5	3.0
Residential Construction	1.0	− 0.6	− 3.2	− 2.9
Business—Fixed Investment	4.1	0.6	− 1.1	− 1.5
Change in Business Inventories	− 1.5	3.4	− 2.4	4.5
Government Purchases of Goods and Services	3.8	4.0	7.2	5.7
Federal	2.1	2.1	5.0	3.5
Defense	2.1	2.5	4.9	3.5
Other	0.1	− 0.5	0.1	0
State and Local	1.7	1.9	2.2	2.2
Gross National Product	16.8	11.1	13.0	13.8
Constant 1958 Dollars	9.3	3.0	6.4	7.1
		Percent Change		
GNP Current Dollars	9.5	6.2	7.1	7.4
GNP Constant Dollars	5.9	1.9	4.0	4.4

had not become restrictive. Furthermore, intense demands for business and consumer credit had not diverted funds from home building and raised interest rates. Thus, when mortgage yields began to advance in 1966, the decline in housing starts accelerated. In final quarter 1966 net private domestic investment in residential construction at a seasonally adjusted annual rate of $21.9 billion was $4.1 billion lower than in the third quarter and fell $6.7 billion below the first-quarter level.

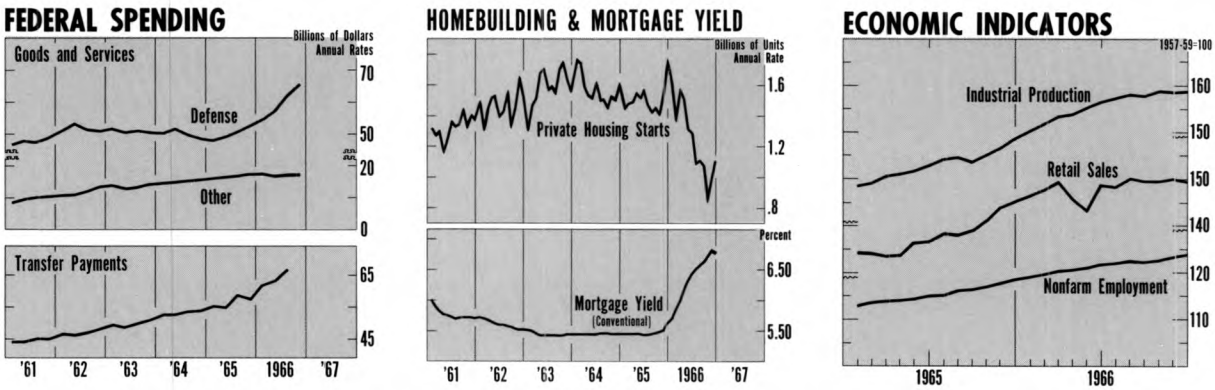
With reduced sales, manufacturing inventories expanded at an accelerated clip in the latter half of 1966. The accumulation of stocks led some manufacturers to curtail operations, and industrial production leveled off. Nevertheless, in fourth quarter 1966 business inventories increased $14.4 billion on a seasonally adjusted annual basis. The inventory component was responsible for about one-third of the growth of GNP in dollar terms between the third and fourth quarters.

Although the private economy had slowed by the end of 1966, government spending was still rising. The purchases of goods and services by both Federal and state and local governments in the last quarter was at a seasonally adjusted annual rate of $161.9 billion, compared with $145 billion in the first quarter. Although the rate of increase in defense spending slackened late in the year, rising Federal transfer payments, such



NOTE: Dotted lines represent plans through second quarter 1967.

The rapid expansion in the nation's output, measured by GNP, slowed during the latter part of 1966, especially when measured in 1958 dollars of constant purchasing power. Part of the reason was a slowdown in automobile sales, resulting in rising inventories and production cuts. A tapering off in business spending also added to the decline.



Although Federal spending continued to expand because of higher costs for defense and transfer payments in connection with social security and other purposes, the increase was offset in part by a cut in residential construction. Toward the end of 1966, industrial production and nonfarm employment grew at reduced rates, and retail sales were sluggish.

as increased Social Security benefits and Medicare, continued to be an expansive force in the economy.

Slowdown in Credit Growth

The slowdown in the private economy has had its counterpart in the credit field. The extraordinarily high rate of increase in total bank loans that characterized the first part of 1966 seems to have disappeared. Total loans at all commercial banks on August 31, 1966, stood 14.4 percent higher than at the end of 1965 after seasonal influences were considered. From August through the end of 1966, however, loans changed little. On the other hand, the flow of corporate security financing remained substantial.

The slackening in bank lending resulted in part from reduced credit demands, especially for consumer loans. Some of the slower growth reflected the decline in new car sales. The lessening in loan demand also contributed to the sharply reduced rate of expansion in business loans. The factors that had sparked some of the previous business loan demand—borrowing in anticipation of actual needs and an acceleration in corporate tax payments—were of diminishing force in late 1966. Reduced deposit growth further induced banks to curb their business lending. Real estate loans also faltered, although commercial banks did not neglect this field entirely.

Part of the slowing in the extension of bank credit may have reflected the delayed reaction to the more restrictive Federal Reserve policy. Although this policy was first publicly signaled by the Federal Reserve Banks' increasing their discount rates in mid-December 1965, seasonally adjusted member bank reserves continued to expand in the first half of 1966. Nevertheless, the System was taking policy steps restricting credit ex-

A reduction in credit expansion occurred during the latter part of 1966. A smaller loan demand resulting from the decline in automobile sales and business spending explains part of the slowdown in bank lending, but a more restrictive lending policy induced by a growing loan-deposit ratio and reduced deposit growth also contributed.

pansion during the first three quarters of the year. Through its open market operations a smaller volume of funds was being supplied in relation to the financial requirements of a booming economy than was demanded, and more of the growth in reserves was coming from member banks' borrowing at the discount window. The System raised reserve requirements on certain types of time deposits and made it increasingly difficult for banks to compete for time deposits. Moreover, discount officers at the Reserve Banks scrutinized applications for loans by member banks more carefully.

The accumulative results of these and other developments peaked last summer when seasonally adjusted bank reserves actually started to decline. The decisive turn in policy caused the seasonally adjusted money supply, demand deposits and currency, to drop from $171.1 to $169.2 billion between June and November 1966. Time deposits increased during the first half of 1966 as banks, eager to serve an almost insatiable demand for loans, offered higher interest rates for time money. By mid-1966, however, the inflow of time deposits began to taper off.

Some of the diminishing loan growth may also have resulted from restrictive lending policies of some banks. With deposit expansion tapering off and loan demand expanding rapidly, many banks found their liquidity seriously reduced.

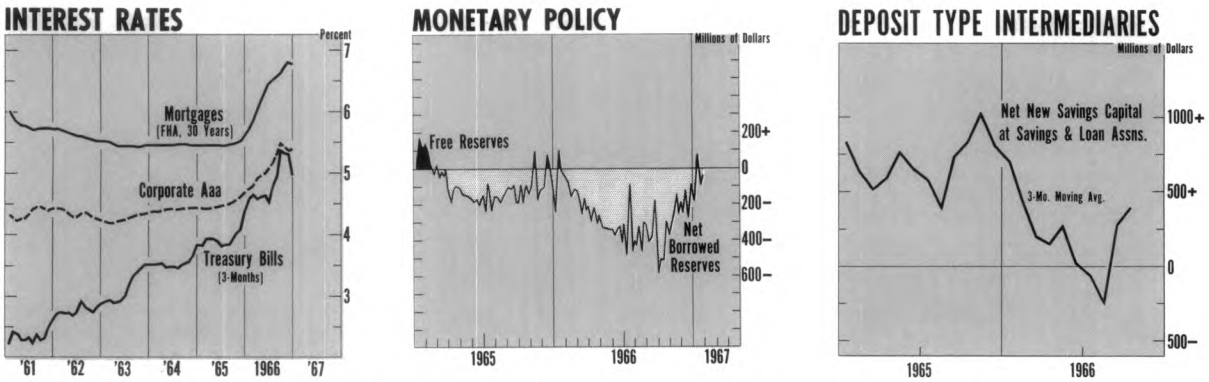
Nevertheless, the behavior of interest rates suggests that, despite the influence of monetary policy and the lending policies of banks, some of the slowing in bank credit expansion during the last half of 1966 must be traced to the change in the economic environment and forces not related to credit availability. At first the softening in rates was confined chiefly to the money and capital markets. The three-month Treasury bill that was yielding 5.5 percent in September 1966 had declined to 4.6 percent by late January. And yields of other government, corporate, and municipal securities also decreased. At banks reporting interest rates charged on new business loans the average rate was unchanged from September to December 1966. Toward the end of January major banks cut the prime rate charged to business borrowers.

Intermission or Overture?

How quickly the economic environment can change has been well demonstrated during the past two years. Turning from a steadily advancing economy with increasing productivity, ample unused resources, and stable prices, the economy took on some of the elements of an overheated boom toward the end of 1965. Some of the strains were reduced by late 1966. Economic conditions can change again quickly.

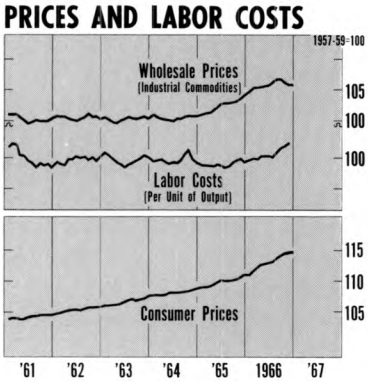
The general shape of monetary policy has always been dictated by economic and credit conditions. Thus, recognition of the changed environment led to the adoption of a more restrictive policy in late 1965. Currently, the tendency for member banks to reduce their indebtedness and a softening of interest rates suggests that monetary policy is less restrictive.

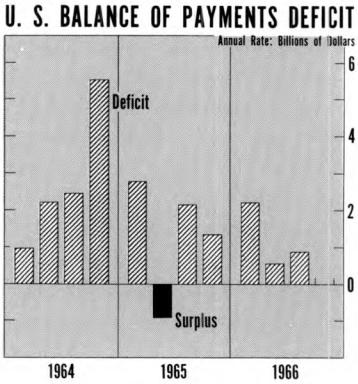
It is seldom clear at the moment what direction the economy is taking. Only some time after an event occurs does it become evident whether or not an economic mix such as at present is merely a pause or intermission prior to a re-



With credit demands weaker, interest rates in the capital and money markets began to turn downward in 1966. Lessening pressure on banks resulted in the gradually improved net borrowed reserves position. The flow of funds to deposit type intermediaries also turned upward. Marked improvement was evident for savings and loan associations.

That demand pressures have slackened is visible in the behavior of wholesale prices for industrial commodities. Labor costs per unit of output, however, continue to rise. Fourth quarter figures are expected to raise the 1966 balance-of-payments deficit over 1965's. The deficit picture would have been even worse had it not been for an inflow of funds attracted by higher interest rates, a situation that can be reversed quickly.





sumption of a pattern of the immediate past or the overture to a complete change in direction.

Some of the elements of the stresses and strains preceding the present slowdown remain. The nation is still faced with heavy defense spending. As for prices, inflationary elements are not completely absent; for example, labor costs per unit of output in manufacturing were rising in the final months of 1966. With unemployment at 3.8 percent in December, manpower utilization has not slackened a great deal. The degree of fiscal restraint that will prevail in 1967 is yet unknown. With a changing interest rate structure, the balance-of-payments deficit may become more troublesome.

Whether the current slowdown turns out to be an intermission or an overture may well shape the course of future monetary policy.

SOURCES FOR DATA USED IN CHARTS:

Automobiles (Sales, Plans to Buy, Inventories to Sales, Production):* R. L. Polk and Company, U. S. Department of Commerce, Board of Governors of the Federal Reserve System.

Credit (Total Bank Loans, Corporate Security Financing):* Board of Governors of the Federal Reserve System, Securities and Exchange Commission.

Deposit Type Intermediaries: Federal Home Loan Bank Board.

Economic Indicators:* Board of Governors of the Federal Reserve System, U. S. Department of Commerce, U. S. Department of Labor.

Federal Spending (GNP Account), U. S. Balance of Payments Deficit* (liquidity basis), Gross National Product*, Business Spending*:* U. S. Department of Commerce.

Homebuilding and Mortgage Yield (Private Housing Starts, Mortgage Yield):* Bureau of Census, Federal Housing Administration.

Interest Rates: Federal Housing Administration, Board of Governors of the Federal Reserve System, Treasury Department.

Monetary Policy, Money Supply and Time Deposits (Money Supply, Time Deposits*, Negotiable CD's). Bank Lending and Liquidity (Consumer Loans*, Business Loans*, Real Estate Loans*, Loan-Deposit Ratio):* Board of Governors of the Federal Reserve System.

Prices and Labor Costs (Wholesale Prices, Labor Costs, Consumer Prices):* U. S. Department of Labor, U. S. Department of Commerce, Board of Governors of the Federal Reserve System.

*Seasonally adjusted.

The Research Staff of the Federal Reserve Bank of Atlanta was responsible for this article.

Bank Announcements

On January 1, three nonmember banks began to remit at par for checks drawn on them when received from the Federal Reserve Bank. They are **The Bank of Loganville,** Loganville, Georgia; **The Bulloch County Bank,** Statesboro, Georgia; and **The Bank of Zebulon,** Zebulon, Georgia.

The First National Bank of Wayne County, Jesup, Georgia, a conversion of the par-remitting **Wayne State Bank,** opened for business as a member bank on January 3. Officers include R. W. Woodruff, president; J. C. Hodges and S. C. Harper, vice presidents; and Bert Hires, cashier. Capital totals $400,000; surplus and other capital funds, $292,884.

On the same date, January 3, the **Central Progressive Bank of Amite,** Amite, Louisiana, a newly organized nonmember bank, opened and began to remit at par. Homer McLeod is president; Philip A. Roth, Jr., executive vice president and cashier; and F. A. Sheffield, vice president. Capital amounts to $250,000, and surplus and other capital funds, $250,000.

The **Security National Bank,** Smyrna, Georgia, a new member bank, opened on January 30 and began to remit at par. Officers include Sam D. Reeves, president; Luther M. Ezell, Jr., executive vice president; and Roy V. Price, cashier. Capital is $240,000, and surplus and other capital funds, $360,000.