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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 11, 1937

To Chairman Eccles

Subject:

From Woodlief Thomas

W.T.

In connection with your Treasury meeting.

CONFIDENTIAL

Cc. 25
May 11, 1937

CURRENT COMMENTS

Effect of increase in reserve requirements

During the week ending May 5 excess reserves of member banks declined by about $750,000,000 to a total of $890,000,000, reflecting the effect of the increase of requirements. Total reserve balances decreased about $50,000,000 owing chiefly to a rise of money in circulation. The excess reserves of leading New York City banks reached a low of $96,000,000 on May 6, but increased somewhat later in the week. Other classes of banks taken as a whole had substantial excess reserves after the increase in requirements.

Adjustments by member banks to the increased requirements were reflected in a further decrease in interbank balances and an increase in borrowings by reporting member banks. There was little change in total loans and investments. During the week ending May 5 balances due to other banks declined by $213,000,000 at reporting member banks, of which $118,000,000 was withdrawn from New York and $28,000,000 from Chicago banks. Reporting banks outside New York City and Chicago lost $67,000,000 of bankers' deposits and withdrew $162,000,000 of balances from their correspondents, thus increasing their reserve balances. Balances due to domestic banks by weekly reporting banks have declined by $400,000,000 in the last three weeks and by $800,000,000 since January. This has had the effect of substantially reducing required reserves at central reserve city banks and increasing them somewhat at other banks.

Loans to other banks increased last week by $28,000,000 in New York City and by $16,000,000 in other leading cities. Loans to brokers and dealers increased by $44,000,000 and commercial loans, which had remained practically unchanged during the last two weeks in April, increased by $14,000,000, most of which was in the Boston district. Loans on securities to customers also increased while holdings of acceptances and commercial paper declined.

Holdings of Government securities declined by $35,000,000 more at New York banks and by $11,000,000 at other reporting banks. Holdings of other securities were also reduced.

Notwithstanding the increase in reserve requirements, the open-market rate on 90-day bankers' acceptances, which had been 9/16 of 1 percent since March 23, was reduced to 1/2 of 1 percent on May 7. Other open-market rates and customer rates at New York banks continued unchanged.

Government security market

Treasury bond prices rose somewhat last week, and the average yield on the longer-term issues declined to 2.66 percent on Saturday, as compared with the low of 2.68 percent reached on the previous recovery on April 19, and with the April 1 high of 2.78 percent. The average yield on Treasury notes maturing in 3 to 5 years declined from 1.51 percent on Monday of last week to 1.48 percent on Friday and Saturday. This compares with the high of 1.70 percent reached on April 9.

This week's new issue of 9-month Treasury bills sold at an average discount of 0.72 percent, as compared with a yield of 0.74 percent for the previous week. The average yield on the September bills was 0.51 percent, compared with 0.53 percent last week.

Corporate bond market

Prices of corporate bonds rose on the average about 3/4 of a point last week. Higher grade bonds improved more than the lower grades, and the average yield on Aaa bonds on Monday of this week was 3.33 percent, in comparison with 3.41 a week earlier. Average yields on municipal bonds improved by about the same amount. The volume of bond trading on the New York Stock Exchange was unusually small last week.

New security issues last week totalled about $90,000,000, in comparison with $28,000,000 in the week ending May 1. About 3/4 of last week's total was in two issues, one for refunding by a telephone company and the other for the Federal Home Loan Banks. Both issues were conservatively priced and almost immediately went to a premium.

Stock market

During the week ending May 8 there was little activity in the stock market and the general level of stock prices showed little change. Daily turnover averaged about 770,000 shares. Prices on Saturday were slightly higher than a week ago.

A further increase of more than $25,000,000 during April in the borrowings by member firms as reported to the New York Stock Exchange indicates that the amount loaned by such firms to their customers, of which figures will not be available for about 10 days, probably increased further during April.

The price movement of British stocks in London was reversed after Friday, April 30, and a sharp advance during the week ending May 8 was about equal to the sharp decline of the preceding two weeks.

Foreign buying of American stocks

Foreigners became buyers of American stocks last week for the first time since early April. The buying was mainly for British account, with Netherlands and Switzerland also participating.

Gold and capital movements

Since April 28 the flow of gold to the United States has greatly diminished. Foreign selling of American securities reached a peak at the turn of the month, and the inflow of short-term funds, which was the chief factor in the April gold movement, appears to have declined considerably during the week now ending. The current gold movement of $20,000,000 to $25,000,000 a week is about the same as the average for February and March.

Shifts in Government securities by types of holders in 1937

The following table shows the changes between the end of 1936 and March 31, 1937, in the United States Government portfolios of the various holders:

CHANGES IN UNITED STATES TREASURY SECURITIES BY TYPES OF HOLDERS
December 31, 1936, to March 31, 1937
(In millions of dollars)

	Total	Bonds	Notes	Bills
All member banks	-780	-146	-502	-132
New York	-383	-126	-178	-80
Chicago	-252	-20	-72	*-161
Reserve city	-174	-2	-267	+95
Country	+29	**+2	+13	+14
United States Treasury	+153	+156	-3	--
Federal Reserve banks	--	+146	-122	-24
Reporting Government security dealers	-102	-70	-27	-5
All other holders (Open-market debt)	+732	+413	+149	*+161
Open-market debt outstanding ***	-22	+484	-506	--

* The decline in Chicago banks' holdings of bills and the increase in those of other holders is largely due to temporary tax-date shifts.
** Includes purchases of $15,000,000 of U. S. Savings bonds.
*** Excludes United States Savings bonds and Postal Savings bonds and various special accounts.

Member bank holdings.- Member banks decreased their holdings of Government securities by nearly $800,000,000 in the first quarter of 1937. Bond holdings decreased about $150,000,000, notes by $500,000,000, and bills by $130,000,000. Practically all the decline in bonds occurred at New York City banks. Of the total sales of $126,000,000 by New York banks, $107,000,000 consisted of bonds maturing after December 31, 1949.

The decline in bills is largely explained by the sale of bills by Chicago banks to their customers around April 1 which is the Illinois personal tax date. The New York banks also let bills run off, while reserve city banks increased their holdings of Treasury bills. The decline in notes may be largely accounted for by the decrease in Treasury notes outstanding, which occurred at the March financing date when the notes maturing in April were refunded into bonds, although it appears that banks, including Federal Reserve banks, sold notes from their portfolios. Country banks increased their holdings of each type of security but the amounts were insignificant.

Treasury holdings for trust accounts and Government agencies.--The Treasury purchased about $150,000,000 of Government bonds mostly in March during the break in the bond market.

Federal Reserve.-- While no net change occurred in the System's holdings in this period, $146,000,000 of bonds were purchased against net sales and maturities of $122,000,000 of notes and $24,000,000 of bills. The bulk of this increase in bonds occurred during the month of March.

Reporting dealers.--Dealers decreased their portfolios by $100,000,000, the majority consisting of bonds.

Other holders.--Other holders substantially increased their Government securities during the period. If we ignore the increase in bills which was largely due to temporary acquisitions by persons in Chicago seeking to avoid property taxes on deposits, the total increase was about $550,000,000, consisting of $400,000,000 of bonds and $150,-000,000 of notes. Life insurance companies were probably the heaviest purchasers in the outside market. During January and February the leading companies, whose assets total over $20,000,000,000, increased their Government security holdings by $177,000,000, and it is likely that they added further to their holdings during March. In addition to the figures shown in the table "other" holders also increased their holdings of United States Savings bonds by $175,000,000 in the quarter.

Changes since the end of March.--Since the end of March the New York banks have continued to liquidate Government securities. The total decline in the holdings of all types of Treasury issues for the leading New York banks between March 31 and May 5 amounted to about $140,000,000. As the New York banks probably purchased about $110,000,000 of the new Treasury bills issued during this period, it would appear that their holdings of Treasury bonds and notes declined by about $250,000,000. From April 7 to May 5 Chicago banks sold on balance $60,000,000 of Government securities. Little change occurred in the holdings of other weekly reporting banks. Federal Reserve banks, of course, purchased $96,000,000 of Government securities in this period.

Capital issues in April

The volume of new security issues in April was the smallest since February 1935, just preceding the revival in the capital markets. Total issues in April, as compiled by the Commercial and Financial Chronicle and excluding those of the United States Government, were $272,000,000. This compares with $382,000,000 in March and a monthly average of $520,000,000 for the year 1936.

The extent to which the offering of new securities has been curtailed in March and April is shown in the following table which gives, for all issues and for issues by domestic corporations classified as between new and refunding, the monthly average for the year 1936 and monthly figures beginning with December 1936.

(In millions of dollars)

	Total issues	Domestic Corporate		
		Total	New	Refunding
1936 monthly average	518	382	99	282
1936--December	726	625	218	408
1937--January	603	306	95	204
February	497	355	130	225
March	382	319	138	181
April	287	172	85	87

The greatly reduced volume of new security issues in March and April was preceded by an unusually large volume of corporate issues both for new and refunding purposes in December 1936 and by a large volume of other issues in January, chiefly municipal issues and foreign refunding issues. In February the total offered was not much different from the average for 1936, in part as a result of further foreign refunding issues.

New security offerings declined in March, chiefly as a result of a smaller volume of refunding issues from all sources. In April there was a further sharp decrease in new and refunding issues by domestic corporations.

The decline in issues offered by domestic corporations in April occurred entirely in offerings by public utilities. Despite a smaller volume of corporate issues for new capital purposes in April, the monthly averages for March and April and for the first four months of 1937 are larger than the 1936 average.

First quarter reports of corporation profits

Early reports for a limited number of leading industrial corporations show profits in the first quarter of 1937, about 50 percent larger than in the same period of 1936. Profits, which are figured without reserves for the Federal tax on undistributed earnings, were slightly lower than in the final quarter of the preceding year. This decline is attributed in part to seasonal factors and in part to labor difficulties, particularly in the automobile industry, and to increasing costs.

The increase in profits over the corresponding quarter of 1936 reflects further large increases in the profits of certain groups of corporations in the heavy industries, chiefly iron and steel, building materials, household supplies, railroad equipment, and machinery. Other lines in which there were important increases include manufacture of paper products, merchandising, and oil producing and refining. The automobile industry, which in the first quarter of 1937 was affected by serious strikes, showed no increase in profits as compared with the first quarter of 1936.

Early reports for first quarter earnings of class I railroads indicates continued improvement in this industry, although about ~~70~~ 30 percent of the mileage continued to be operated by trustees and receivers at the beginning of the year. It appears that class I railroads will show a small net income for the quarter as compared with a deficit in the first quarter of 1936. An increase of about 10 percent over the corresponding period of 1936 is indicated in the preliminary reports of earnings of public utility companies, reflecting in part a growth in gross income and in part some reduction in expenses as a result of interest saving from refunding operations.