February 1966

FEDERAL RESERVE BANK OF ST. LOUIS *Review*

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Volume 48 • Number 2

FEDERAL RESERVE BANK OF ST. LOUIS

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Is Total Demand Too High?

MONETARY, FISCAL, AND DEBT MANAGEMENT actions since mid-1965 have been stimulative to the economy. Production, employment, income, and sales have risen substantially, and since October price mark-ups have accelerated. Since movements in monetary and fiscal policy variables usually influence the economy with some lag, the full force of the recent policy mix may yet be felt.

When an economy is at less than full employment, economic expansion can stem from the use of idle resources as well as from increases in the labor force and capacity. However, when full employment is approximated, economic growth can come only from additions to resources.

Since early 1961 economic expansion has been made possible by utilization of idle resources, by additions to the labor force and capital stock, and by technological progress. In early 1966 unemployment and idle capacity are low, implying that unless resource growth accelerates the rate of growth of real output that took place from 1961 to 1965 may now be unsustainable.

Labor resources will probably increase less rapidly in 1966 than in 1965. The number of persons of working age (18 to 64 years) will increase at a somewhat slower rate than in 1965. In addition, the armed forces may be expanding, and college attendance, rising.

Given the state of the economy, the expansionary actions taken since mid-1965 may put a further strain on the economy. In

the near future any rapid increase in spending could be reflected more in price increases than in increased output of goods and services.

Financial Developments

Monetary actions have been very expansionary since mid-1965. Money supply growth accelerated from what was already a rapid rate of expansion. Bank reserves grew sharply, and bank credit expanded considerably.

The nation's money supply (demand deposits plus currency) has grown at a 7 per cent annual rate since June. This was the fastest rate of expansion for a seven-month period in thirteen years. Money increased at a 4 per cent rate from September 1962 to June 1965 and at a 1.5 per cent rate from 1953 to 1962.

Historically, sustained periods of strong monetary growth have been accompanied, with a lag, by a rise in spending.[1] Since the economy is now fairly taut, an exceptionally rapid increase in spending, which could follow recent monetary growth, might result more in price rises than in expansion of real output.

The increase in money in the past half year has been facilitated by an expansion in the volume of bank reserves. The growth of reserves that member banks have available to support private demand deposits, the largest component of the money supply, has been at an advanced 6 per cent annual rate since mid-1965. This recent rate compares with a 2.0 per cent rate from September 1962 to mid-1965 and a 1.3 per cent rate from 1951 to 1962. A major factor in the recent gain of reserves was net Federal Reserve purchases of Government securities.

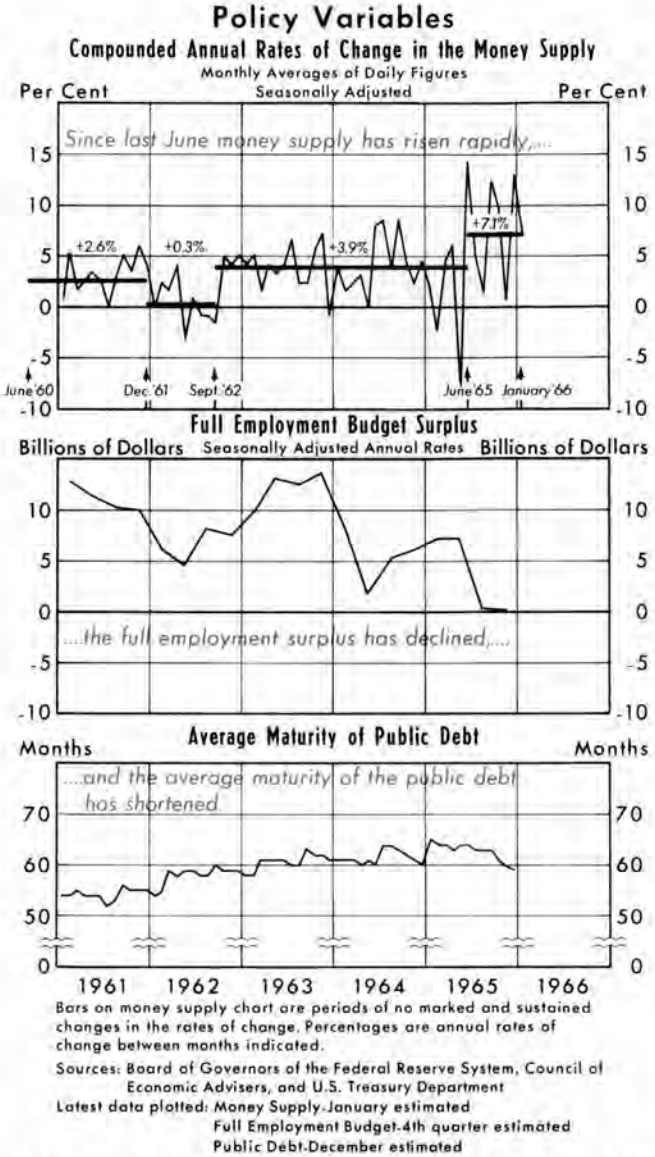
Banks have expanded their holdings of loans and investments at an estimated 10 per cent annual rate since last July. This is significantly greater than the 5.6 per cent annual rate of growth from 1953 to 1964.

The Fiscal Situation

The Government's spending and taxing actions in the last half of 1965 were the most stimulative in many years. Expansionary steps during 1965 included excise tax cuts, increased social security outlays, expanded domestic social welfare programs, and higher than anticipated outlays necessitated by the escalation of activity in Vietnam.

In 1966 rising Government expenditures may more than offset increased social security taxes, reinstated excise taxes on automobiles and telephone service,[2] and built-in increases in income tax receipts. The Government's fiscal actions are expected to provide a stronger stimulus to the economy in 1966 than in the latter half of 1965.

Fiscal actions are somewhat less flexible than monetary actions, which can be altered quickly. It is commonly thought that Government expenditures, especially those concerned with national defense, are not easily adapted to the goals of economic stabilization policy. Changes in tax rates are perhaps the primary way by which fiscal operations can be adjusted to the economic environment. However, since tax changes must be enacted by Congress, they may



Bars on money supply chart are periods of no marked and sustained changes in the rates of change. Percentages are annual rates of change between months indicated.

Sources: Board of Governors of the Federal Reserve System, Council of Economic Advisers, and U.S. Treasury Department

Latest data plotted: Money Supply-January estimated
Full Employment Budget-4th quarter estimated
Public Debt-December estimated

[1] See "Money Supply and Time Deposits, 1914-1964" in the September 1964 issue of this *Review*.

[2] If the President's recommendations are adopted, excise taxes on automobiles and telephone service reduced on January 1, 1966 will be reinstated. Excise tax cuts on admissions, automobile parts and accessories, documentary stamps, and other minor items will remain in effect.

be subject to a considerable "administrative" lag between need and execution.

Debt Management Policy

Change in the composition of the Federal debt has also tended to be stimulative since mid-1965 because newly issued debt has been relatively short term. Supposedly, the shorter the maturity of the public debt, the more expansionary its influence. This may be because short-term debt is more liquid than long-term debt, and the more liquid are people's assets, the more likely they are to spend. Shortening the debt also tends to lower long-term interest rates relative to short-term rates, making plant and equipment investment somewhat more attractive.

In recent months the Treasury has, in large measure, lost control of the maturity of the Federal debt because of the legal interest rate limit of 4.25 per cent payable on new Government bonds (i.e., securities 5 years or more to maturity). Since this rate is no longer competitive, Government borrowing has to be in the form of securities with short or intermediate maturities.

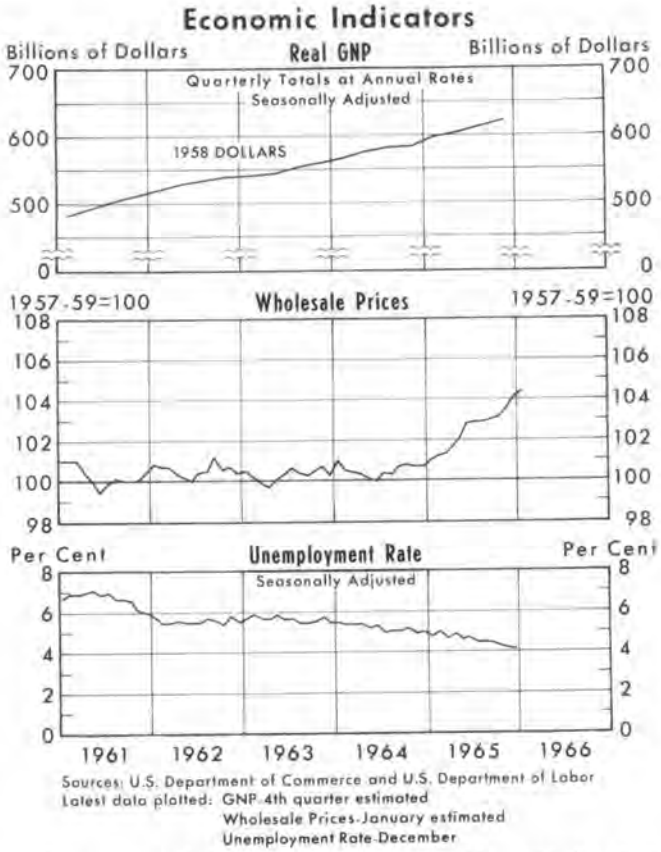
The legal interest ceiling has had an effect on the term structure of interest rates as well as on the maturity structure of the national debt. Yields on Treasury bills and intermediate-term Government securities have risen abnormally relative to yields on long-term Government bonds.

The Economic Setting

Since summer a broadly based rise in aggregate demand, encouraged by expansionary policy developments, has resulted in a large increase in output. While current dollar GNP rose at an 8 per cent annual rate from the second to the fourth quarter of 1965, real GNP rose at a 6 per cent rate. Total demand has been so great that resource markets have tightened and prices, including interest rates, have risen.

The jump in the nation's real output of goods and services at a 6 per cent annual rate from the second to the fourth quarter of 1965 compares with a 4.3 per cent rate from 1960 to 1964 and a 2.4 per cent rate from 1953 to 1960.

The strong increase in output was made possible in part by marked increases in employment. Payroll employment rose at a 5 per cent annual rate after mid-year compared with an average 1.8 per cent rate from 1960 to 1964. Total employment rose at a 3.5 per cent rate in the last half of 1965 compared with a 1.4 per cent rate from 1960 to 1964.



At year end the unemployment rate was 4.1 per cent, its lowest level in nearly a decade. Only 1.8 per cent of the married men in the labor force were jobless in December, a surprisingly low figure since it includes those who are changing jobs and seasonally unemployed, as well as some unemployables.

Tighter labor markets have encouraged wage increases, and labor costs per unit of output have risen slightly over the past year. Nevertheless, price per unit of output has risen faster than labor cost per unit in the past year, indicating that rising labor costs have not been the major cause of price rises.

Part of the strong increase in demand for goods and services since last summer has spilled over into price rises. The increase in U. S. wholesale prices during the last year and a half has been a marked departure from the unusual stability experienced from 1958 to mid-1964. Wholesale prices started to rise in mid-1964 and increased at a 2.4 per cent annual rate to September 1965. Since then these prices have risen at about a 4 per cent rate. The rise in the price indexes since mid-1964 has been broadly based and has been paced by sharp rises in the prices of sensitive industrial materials and of agricultural commodities.

Consumer prices have gone up at a 2.8 per cent annual rate since August compared with a 1.4 per cent rate of increase from 1953 to 1964.

(Continued on page 16)

Annual Report

Federal Reserve Bank of St. Louis

1965

THE FEDERAL RESERVE BANK OF ST. LOUIS conducts day-to-day operating and supervisory functions, as well as participating in the formulation of monetary policy. As a part of the Federal Reserve System it contributes to economic growth, a high level of employment, and a viable price level. Its policy actions and the economic information upon which they are based are frequently discussed in this *Review*. This article, however, focuses primarily on the operating aspects of the bank during 1965. Its operating and supervisory functions contribute to efficient commercial bank and Government financial operations in the Eighth Federal Reserve District.

Although the basic demand for Reserve Bank services reflects such factors as the area's population, income, and level of business and financial activity, the size and structure of the commercial banking system in the district is important in determining the volume of Reserve Bank activities. Some measures of the size and structure of commercial banking in the Eighth District and the nation since 1950 which have influenced the volume of operations at the Federal Reserve Bank of St. Louis are discussed in this article.

Structure of Eighth District Banking

As of June 30, 1965 there were 1,500 commercial banks, with combined assets of nearly $16 billion and deposits exceeding $14 billion, located in the Eighth Federal Reserve District. About 11 per cent of all commercial banks in the nation (7 per cent of all banking offices) are located in the district. However, reflecting their smaller average size, Eighth District banks hold only 4.4 per cent of the nation's bank assets and 4.5 per cent of all bank deposits.

Banking Offices

Eighth District banks in mid-1965 maintained 2,054 offices for conducting banking business (Table I). The total number of banking offices has increased substantially during the last 15 years, rising from 1,616 in 1950. The gain in banking offices reflects primarily the establishment of branches and additional offices rather than organization of new banks. The number of banks increased by only 30, from 1,470 in 1950 to 1,500 in 1965, while the number of branches and additional offices increased from 146 to 554.

The commercial banking system in the United States at mid-1965 comprised 13,791 banks maintaining a total of 28,938 banking offices. As in the Eighth District, the number of banking offices has increased rapidly in recent years, rising from 18,964 in 1950. Banking office gains in the nation resulted entirely from new branches and additional offices, as the number of banks declined from 14,121 in 1950 to 13,791 in 1965. The number of branches and additional offices more than tripled during the period, rising from 4,843 to 15,147.

Table I

COMMERCIAL BANKS AND BANKING OFFICES[1]

(December 31)

	Eighth District		United States	
	Banks	Banking Offices	Banks	Banking Offices
1950	1,470	1,616	14,121	18,964
1955	1,459	1,677	13,716	20,639
1960	1,476	1,826	13,472	23,955
1965 (June 30)	1,500	2,054	13,791	28,938

[1]Banking offices include banks, branches, and additional offices.

Ratio of Banking Offices to Population

The number of banking offices relative to population may be used as a rough approximation of the availability of banking services. In the Eighth District the number of banking offices per 100,000 persons was 16.3 in 1965, somewhat above the average of 14.8 for the nation (Table II).

Table II

RATIO OF BANKING OFFICES TO POPULATION

	Population (Thousands)		Banking Offices per 100,000 Persons[1]		
			Number		Change
	1950	1965	1950	1965	1950-65
Eighth District[2]	10,472	11,460[3]	15.1	16.3	8%
Arkansas	1,910	1,972	12.3	12.9	5
Illinois	1,319	1,361	19.9	20.6	4
Indiana	693	740	18.2	21.3	17
Kentucky	1,561	1,810	16.0	18.8	18
Mississippi	1,041	1,050	13.5	15.5	15
Missouri	2,970	3,341	14.9	14.4	— 3
Tennessee	978	1,186	13.0	15.6	20
United States	152,271	194,583	12.6	14.8	17

[1] Includes banks and branches. District data exclude "limited service" offices and are not precisely comparable with United States data.

[2] Includes all of Arkansas but only portions of the remaining states.

[3] Estimated by the Federal Reserve Bank of St. Louis, based on county population data prepared by state health departments or agricultural experiment stations.

The rapid growth of branches and other offices in the district and the nation in recent years has resulted in a faster rate of increase in total banking offices than in population. Banking offices per 100,000 people in the district increased 8 per cent from 1950 to 1965; in the nation there was a 17 per cent increase.

Prior to the agricultural recession of the 1920's and the general depression of the 1930's substantially more banking offices existed in the United States relative to population (Table III). With the advantage of hindsight it appears that there may have been more banks

Table III

BANKING OFFICES PER 100,000 PERSONS

	United States
1915	26.5
1920	28.5
1925	26.2
1930	21.7
1935	14.6
1940	13.5
1945	12.8
1950	12.6
1955	12.5
1960	13.4
1965	14.8

in the 1920's than were economical. Many failed and were not replaced. During the four years 1929-33 the number of offices declined almost 50 per cent. Economic expansion was slow during the rest of the 1930's, and relatively few banking offices were established. Also, entry into banking was hampered by rules designed to prevent abuses caused by an excessive number of banks. The war effort required most of the nation's resources in the first half of the 1940's, and the ratio of banking offices to population continued relatively low.

Since World War II economic conditions have provided a strong demand for new banks or new banking offices. The rate of increase in banking offices, however, did not exceed that of population until about 1955. The number of banking offices is now almost as large as at the peak in 1920 but is far less in relation to population. A lower banking office-population ratio may be appropriate; first, there may have been an uneconomically large number of offices in the 1920's, and second, increased urbanization and improved transportation may have decreased the economical number of banking offices in relation to population.

The banking office-population ratio varies considerably within the Eighth District. In 1965 there were 12.9 offices per 100,000 people in Arkansas compared with 21.3 in Indiana. Since 1950 the ratio of offices to population has increased rapidly in the district portions of the branch banking states of Indiana, Kentucky, Tennessee, and Mississippi but has remained relatively stable in the nonbranching states of Arkansas, Illinois, and Missouri.

Several factors may be of importance in explaining variation in the banking office-population ratio. Included are variations in state banking laws and population density. State laws pertaining to branch banking apparently exert a strong influence, since those states which permit branching have had greater banking office-population ratio gains than have unit bank states. Urban areas have lower banking office-population ratios than rural areas. For example, there are 5.3 banking offices per 100,000 people in the St. Louis Metropolitan Area compared with 21.8 offices per 100,000 people in the rest of the district portion of Missouri. While rates of population and economic growth, differences in attitudes of state regulatory agencies in granting bank charters, and other factors are important in influencing the ratio of banking offices to population, the extent of their impact is more difficult to assess.

Bank Deposits

Total deposits at commercial banks in both the district and the nation increased throughout the 1950's,

and since 1960 the growth has accelerated. Deposits at Eighth District banks rose from $6.7 billion in mid-1950 to $14.1 billion on June 30, 1965, an average annual rate of 5.1 per cent (Table IV). During this period deposits in the nation grew at an average rate of 5.3 per cent. Since 1960 total deposits in the district have risen 7.7 per cent annually compared with 8.3 per cent for the nation.

The growth of time and savings deposits has proceeded much faster than the growth of demand deposits. From 1950 to 1965 time and savings deposits at district banks rose from $1.4 billion to $5.6 billion, an annual rate of 9.9 per cent. Since 1960 such deposits have risen at an annual rate of 16.4 per cent. Time deposits in the nation increased somewhat less rapidly, rising at a 9.1 per cent annual rate during the whole 1950-65 period and at a 14.9 per cent rate since 1960. The substantial growth in time and savings accounts is the result of increased aggressiveness by commercial banks in seeking funds to meet a rising demand for credit. Reflecting this increased competition for funds were more liberal interest rates paid by banks. Banks have also developed additional sources of funds by issuing unsecured notes, subordinated debentures, and an increasing variety of certificates of deposit.

Demand deposits at district banks rose from $5.4 billion in 1950 to $8.5 billion on June 30, 1965, an average annual increase of 3.1 per cent. In the nation such deposits rose from $106.5 billion to $173.2 billion, a gain of 3.3 per cent annually. Since 1960 such deposits in the district have increased at a 3.6 per cent rate compared with 4.3 per cent in the nation.

Total bank deposits per capita increased at an annual rate of 3.5 per cent in the Eighth District from 1950 to 1964 compared with 2.9 per cent in the nation (Table V). Per capita demand deposits in the district and nation rose at annual rates of 1.5 per cent and 0.4 per cent, respectively, while per capita time and savings deposits rose at rates of 8.9 per cent and 6.0 per cent.

The higher rate of increase in district per capita deposits has reduced the disparity between the district and the national averages. Total deposits per capita in the district rose from 62 per cent of the national average in 1950 to 67 per cent in 1964. Per capita demand deposits rose from 73 per cent to 84 per cent, and time deposits, from 34 per cent to 50 per cent.

Although the district has made sizable gains in per capita deposits relative to the nation, a considerable

Table IV

SELECTED ASSET AND LIABILITY ITEMS OF COMMERCIAL BANKS

(June 30)

Amount

(Billions)

	1950		1955		1960		1965	
	District	U.S.	District	U.S.	District	U.S.	District	U.S.
Total deposits	$6.7	$143.8	$8.3	$181.5	$ 9.7	$209.0	$14.1	$311.6
Demand	5.4	106.5	6.5	131.5	7.1	139.9	8.5	173.2
Time[1]	1.4	37.3	1.8	50.0	2.6	69.1	5.6	138.4
Loans	2.2	44.8	3.3	75.2	4.8	114.8	7.9	187.9
U. S. Government securities	2.9	65.8	3.0	63.3	2.9	54.2	3.2	56.8
Other securities	0.5	11.2	0.7	16.8	1.0	19.9	2.0	42.2
Total capital accounts	0.5	11.4	0.7	14.9	1.0	20.3	1.4	29.2
Total assets	7.2	156.9	9.1	199.3	10.8	237.0	15.7	353.5

Average Annual Rates of Change

	1950-55		1955-60		1960-65		1950-65	
	District	U.S.	District	U.S.	District	U.S.	District	U.S.
Total deposits	4.4%	4.8%	3.1%	2.8%	7.7%	8.3%	5.1%	5.3%
Demand	4.0	4.3	1.7	1.2	3.6	4.3	3.1	3.3
Time[1]	6.2	6.0	7.4	6.7	16.4	14.9	9.9	9.1
Loans	8.8	10.9	7.5	8.8	10.7	10.4	9.0	10.1
U. S. Government securities	0.6	— 0.8	—0.6	—3.1	1.9	1.0	0.6	— 1.0
Other securities	7.7	8.4	5.3	3.4	15.4	16.3	9.4	9.2
Total capital accounts	7.1	5.5	6.6	6.3	7.5	7.8	7.0	6.5
Total assets	4.7	4.9	3.5	3.5	8.7	8.4	5.3	5.6

[1]Includes both time and savings deposits.

Table V

DEPOSITS PER CAPITA

	Demand Deposits[1]			Time Deposits[1]			Total Deposits[2]		
	1950	1964	Annual Rate of Increase	1950	1964	Annual Rate of Increase	1950	1964	Annual Rate of Increase
Eighth District[3]	$437	$536	1.5%	$123	$407	8.9%	$ 712	$1,158	3.5%
Arkansas	310	432	2.4	51	295	13.4	443	867	4.9
Illinois	399	522	1.9	186	473	6.9	743	1,246	3.8
Indiana	372	484	1.9	200	407	5.2	672	1,072	3.4
Kentucky	455	548	1.3	72	258	9.5	689	1,013	2.8
Mississippi	231	299	1.9	33	216	14.4	317	601	4.7
Missouri	611	698	1.0	180	532	8.0	1,001	1,498	2.9
Tennessee	443	490	0.7	126	560	11.2	805	1,342	3.7
United States	598	635	0.4	361	818	6.0	1,151	1,727	2.9

[1]Excluding government and interbank deposits.
[2]Including government and interbank deposits.
[3]Includes all of Arkansas but only portions of the remaining states.

gap still remains. Both demand and time deposits per capita are below the national average. It is generally believed that demand deposits are desired as a convenient means for settling day-to-day transactions and as a means of storing wealth. If this is the case, the per capita level is likely to be related to both per capita income and wealth in a community. Per capita income in the Eighth District is below the United States average but, like demand deposits, is increasing at a somewhat higher rate than in the nation. Per capita time and savings deposits, in addition to their relationship to income and wealth, are perhaps associated with the convenience and competitive features of banking versus other savings-type institutions. Banks in the Eighth District may be less competitive in this respect than in the nation, due both to the structure of district banking and to legal restrictions. Four district states limit the rates paid on time and savings deposits.

Bank Credit

Loans at Eighth District banks increased from $2.2 billion in 1950 to $7.9 billion in 1965, an average annual rate of 9.0 per cent. During this period bank loans in the nation rose at an annual rate of 10.1 per cent. Since commercial banks have been increasing their loans faster than deposits, the loans-to-deposits ratio rose from 32.4 per cent in 1950 to 56.3 per cent in 1965. In the nation this ratio rose even faster, from 31.1 per cent to 60.3 per cent.

A decline in the holdings of U. S. Government securities relative to total bank assets has been a major complement to the increase of the loans-to-deposits ratio. While the amount of such securities held by district banks has remained about unchanged since 1950, Government securities have declined from 40 per cent of total assets to 20 per cent. In the nation, Government securities declined from 42 per cent to 16 per cent of total bank assets.

In contrast to Government securities, the relative importance of "other" securities (mostly obligations of state and local governments) in bank asset structure has been increasing. Such securities held by district banks increased from $0.5 billion in 1950 to $2.0 billion in 1965, an annual rate of 9.4 per cent. Between mid-1960 and mid-1965 district bank holdings of these securities more than doubled. Relative to total assets, these other securities increased from 7.1 per cent in 1950 to 12.6 per cent in 1965. A similar growth in such securities has occurred at commercial banks in the nation, with holdings increasing at an average annual rate of 9.2 per cent during the 1950-65 period. Such securities increased from 7.1 per cent of assets to 11.9 per cent.

Bank Capital

Total capital accounts of commercial banks in the Eighth District rose from $0.5 billion in 1950 to $1.4 billion in 1965, an average annual increase of 7.0 per cent. Bank capital has increased at a greater rate than some other important banking variables over this period. The 7.0 per cent annual rate of growth in bank capital compares with an annual increase of 5.1 per cent in total deposits, 5.8 per cent in bank credit, and 5.3 per cent in total assets. As a consequence, the capital-to-assets ratio of district banks rose from 6.9 per cent to 8.8 per cent during the period.

In the nation total bank capital rose from $11.4 billion in 1950 to $29.2 billion in 1965, an average annual increase of 6.5 per cent. The capital-to-assets ratio rose from 7.3 per cent to 8.2 per cent.

Bank capital relative to deposit liabilities has increased since 1950 in both the district and nation. Capital accounts at district banks rose from 7.4 per cent of deposits in 1950 to 9.8 per cent in 1965 (Table VI). In the nation capital relative to deposits rose from 7.9 per cent to 9.4 per cent. All of the rise in the ratio of capital to deposits occurred in the 1950-60 period; since 1960 this ratio has been about unchanged.

Table VI

BANK CAPITAL AS A PER CENT OF DEPOSITS AND RISK ASSETS

	1950	1955	1960	1965
	Per Cent of Deposits			
Eighth District	7.4	8.4	9.9	9.8
United States	7.9	8.2	9.7	9.4
	Per Cent of Risk Assets[1]			
Eighth District	18.0	16.8	16.6	13.7
United States	19.7	15.7	14.5	12.3

[1]Total assets less cash assets and U. S. Government securities.

Relative to certain risk assets, bank capital has declined, both from 1950 to 1960 and since 1960. Capital relative to all assets less cash assets and U. S. Government securities declined from 18.0 per cent in 1950 to 13.7 per cent in 1965 at district banks. Most of this decline has occurred since 1960. Similarly, the capital-to-risk assets ratio in the nation declined from 19.7 per cent in 1950 to 12.3 per cent in 1965.

These data do not necessarily indicate that commercial banks are becoming more risky or that coverage for loan and security losses has declined. Many bank loans are guaranteed by agencies of the United States Government, which in effect makes the risk equivalent to that of Government bonds. Also, foreclosures and forced sales are at a very low rate compared with some historical periods. Furthermore, most banks maintain a sizable bad debt reserve which is deducted from loans and not reflected in the capital account.

Concentration in District Banking

Another important aspect of the banking structure in the district is the degree of concentration of banking activity. Other factors equal, it is generally assumed that a greater concentration of banking activity indicates less competition. To determine the level of concentration in the Eighth District, all insured banks were divided by volume of total deposits into 10 groups, each containing an equal number of banks. This array of groups revealed that the 10 per cent containing the largest banks in the district accounted for nearly 60 per cent of total deposits of all banks on June 30, 1965, whereas the 10 per cent containing the smallest banks held less than 1 per cent of total deposits (Table VII).

Table VII

DISTRIBUTION OF DEPOSITS BY BANK SIZE

Eighth District

Size Groups[1]	1950	1955	1960	1965
Top 10 per cent	63.15	64.03	60.88	59.69
2nd 10 per cent	11.27	11.14	11.69	12.11
3rd 10 per cent	7.01	6.87	7.40	7.61
4th 10 per cent	5.20	5.06	5.59	5.76
5th 10 per cent	4.03	3.85	4.34	4.45
6th 10 per cent	3.08	2.95	3.31	3.46
7th 10 per cent	2.35	2.26	2.55	2.64
8th 10 per cent	1.83	1.76	1.93	2.00
9th 10 per cent	1.31	1.30	1.42	1.44
10th 10 per cent	0.77	0.78	0.89	0.84
Total	100.00	100.00	100.00	100.00

[1]All insured banks grouped by total deposits. Each group in 1950 contained 141.9 banks; in 1955, 142.4 banks; in 1960, 145.2 banks; and in 1965, 148.3 banks.

Since 1950 the percentage of total deposits held by the various groups of banks has changed somewhat. From 1950 to 1955 the share held by the group of largest banks rose slightly, from 63.15 per cent of all deposits to 64.03 per cent, while the share of each other group, except the smallest size group, declined. Since 1955 this trend has been reversed; total deposits of the group of largest banks declined from 64.03 per cent in mid-1955 to 59.69 per cent on June 30, 1965.

The diminution since 1955 in the percentage of total deposits held by the group of largest banks has permitted a small increase in the relative share of all other groups. Thus, it appears that, based on total deposits, the banking industry in the Eighth District since 1955 has become less, rather than more, concentrated. However, in a particular state or city the situation may be considerably different than in the district as a whole.

The trends in relative amounts of most other variables held by banks in the various groups are similar to the trend in total deposits. The proportion of total assets, time deposits, loans, and Government securities all declined for the group of largest banks and increased for all other groups. An exception to this generalization was the trend in total capital accounts. The proportion of capital in the first and the sixth through tenth groups increased slightly between 1950 and 1965, while the second through fifth groups showed declines.

Clifton B. Luttrell
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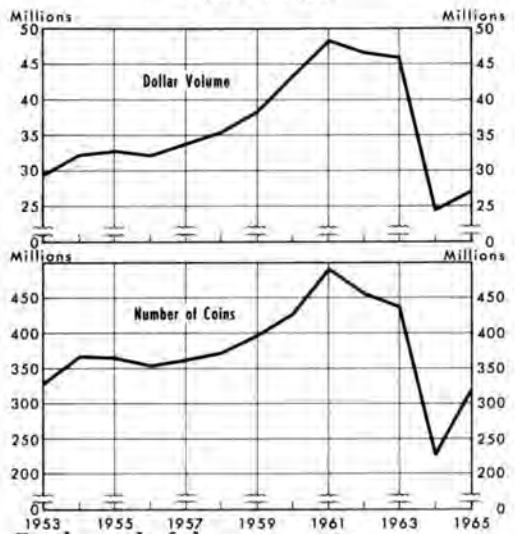
Operations

at the Federal Reserve Bank of St. Louis

Money Handling

Operations in the Money Department of the bank[1] rose rapidly in 1965, primarily as a result of increased coin counting. Following three successive years of coin shortage, supplies began to gain on demand in 1965. By the end of the year most requests for coin, with the exception of half dollars, could be filled on schedule. During the shortage member banks seldom had excess coin to return to the Federal Reserve, and counting operations declined drastically. In 1965, however, coin counting rose to 318 million pieces from 227 million in 1964, a gain of 40 per cent. The dollar value rose from $24.5 million to $27.0 million, an increase of 10 per cent. This, however, was still substantially below the 1961 peak when 490 million pieces valued at $48.3 million were counted.

Coin Counted



Introduction of a nonsilver quarter in early November contributed to increased supplies of coin. The new quarter is a three-layer coin with outer faces of the same alloy as is used for the five cent piece—75 per cent copper and 25 per cent nickel. These cupronickel faces are bonded to a core of pure copper. Nonsilver dimes, scheduled to go into circulation in early 1966, will be made of the same materials and in the same manner. Later in the year half dollars of reduced silver content will be introduced. They will be faced with layers of 80 per cent silver and 20 per cent copper, bonded to a core of 79 per cent copper and 21 per cent silver, giving them an overall 40 per cent silver content. All of the new coins have the same designs and are of the same size as their silver counterparts; however, the dime and quarter are 9.3 per cent lighter and the half dollar is 8 per cent lighter. The traditional dimes, quarters, and half dollars, all containing 90 per cent silver, are to remain in circulation with the new coins.

Currency counting at the Federal Reserve Bank of St. Louis rose to 219 million pieces in 1965 from 201 million pieces in 1964, an increase of 9.0 per cent. The dollar value rose to $1.4 billion, an increase of 9.4 per cent. Currency counting has shown little net change

Table VIII

VOLUME OF OPERATIONS[1]

	Dollar Amount (Millions)		
	1960	1964	1965
Coin counted	43.3	24.5	27.0
Currency counted	1,186.0	1,300.2	1,421.9
Checks handled[2]	68,537	91,837	102,900
Noncash collection items	391.1	466.7	566.2
Transfers of funds	61,434	94,453	109,066
U. S. Savings Bonds handled[3]	685.9	615.5	624.3
Other Government securities handled[3]	10,933.3	16,015.5	16,282.6
U. S. Government coupons paid	123.1	144.9	136.6
Loans to member banks—daily average outstanding	17.4	5.8	15.3
	Number (Millions)		
	1960	1964	1965
Coin counted	426.6	226.8	317.5
Currency counted	201.4	201,2	218.8
Checks handled[2]	170.7	226.1	244.6
Noncash collection items	.560	.528	.587
Transfers of funds	.152	.188	.200
U. S. Savings Bonds handled[3]	7.534	8.155	8.784
Other Government securities handled[3]	.457	.554	.564
U. S. Government coupons paid	.872	.791	.733

[1] Including the Little Rock, Louisville, and Memphis branches.

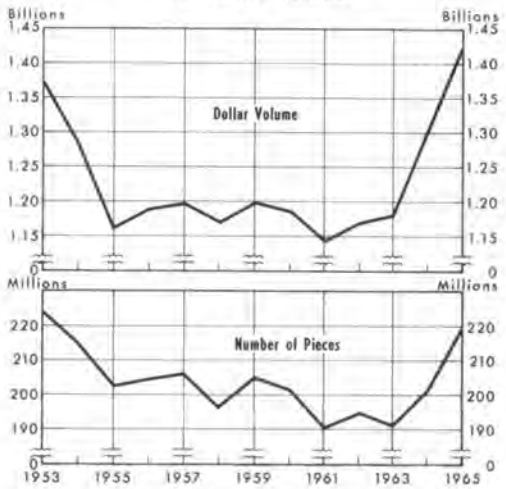
[1] Total for the St. Louis office and the Louisville, Memphis, and Little Rock branches.

[2] Excludes Government checks and money orders.

[3] Issued, exchanged, and redeemed.

since the early 1950's. Both dollar value and number of pieces declined from 1953 to 1961 but recovered the loss by 1965.

Currency Counted



The amount of coin and currency in circulation in the country has risen rapidly since 1960. Coin in circulation has risen at a rate of 9.4 per cent in the last five years compared with a 4.5 per cent annual rate during the 1945-60 period (Table IX). Currency in circulation rose at an average annual rate of 3.9 per cent from 1960 to 1965 after increasing at a 1.0 per cent rate from 1945 to 1960.

Coin and currency counting at the Federal Reserve Bank is related to the volume in circulation. In turn, the volume in circulation is associated with the amount of transactions paid for by coin and currency. An individual has the choice of holding money either in the form of coin and currency or demand deposits. Since 1950 the amount of coin and currency held has totaled about 30 per cent of the amount of demand deposits. Coin has increased somewhat relative to demand deposits, while currency has declined slightly.

Table IX

COIN AND CURRENCY IN CIRCULATION

June 30
(Millions)

	1940	1945	1950	1955	1960	1965
Total in circulation[1]	$7,848	$26,746	$27,156	$30,229	$32,065	$39,720
Total coin	599	1,205	1,496	1,858	2,338	3,662
Total currency	7,250	25,542	25,662	28,372	29,727	36,059
Currency denominations:						
$1	546	981	1,307	1,226	1,440	1,752
$2	35	73	61	72	84	116
$5	1,015	2,215	1,966	2,061	2,141	2,447
$10	1,791	6,515	5,891	6,471	6,604	7,489
$20	1,599	8,193	8,363	9,625	10,363	12,723
$50 and above	2,264	7,565	8,344	8,917	9,095	11,532

[1]Outside the Treasury and Federal Reserve Banks.

Relative to personal income, coin and currency in circulation rose rapidly during World War II but has declined fairly steadily since the early postwar years. From 10.0 per cent of personal income in 1940 the volume of coin and currency in circulation rose to 15.6 per cent in 1945 but has since declined to 7.6 per cent (Table X). All the relative coin and currency decline has occurred in the currency component, which dropped from 14.9 per cent of personal income in 1945 to 6.9 per cent in 1965. Coin totaled about 0.7 per cent of personal income in 1945, the same as in 1965.

Table X

COIN AND CURRENCY IN CIRCULATION
AS A PER CENT OF PERSONAL INCOME

	Coin	Currency	Coin and Currency
1940	0.8%	9.2%	10.0%
1945	0.7	14.9	15.6
1950	0.6	11.3	11.9
1955	0.6	9.1	9.7
1960	0.6	7.4	8.0
1965	0.7	6.9	7.6

Check Collections

Progress toward automated check collection continued during 1965. A third computer for check handling was installed at the St. Louis office in September. Plans for automation were made and computer equipment ordered for delivery to the Memphis and Little Rock branches. Target dates for delivery are mid-1966 for Memphis and early 1967 for Little Rock. Such equipment at the branches will be used for numerous other operations in addition to check collections.

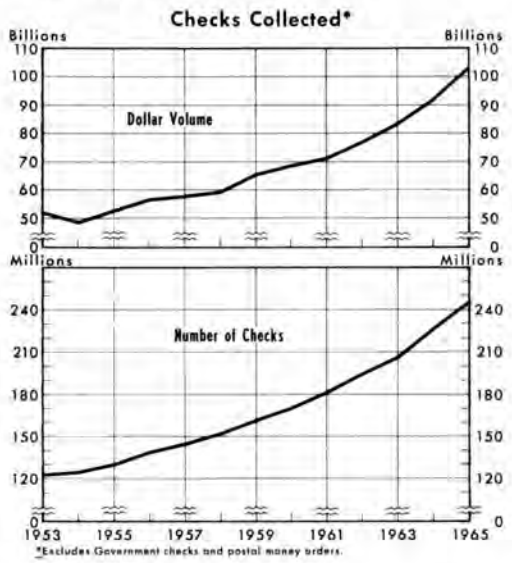
About 83 per cent of all checks received at the St. Louis office in recent months were sorted through electronic check processing equipment. This compares with about two-thirds of all checks similarly processed a year earlier. At the Louisville branch, automated in mid-1964, about 90 per cent of all checks received in recent months were sorted through electronic equipment. This compares with about 70 per cent a year earlier.

The Federal Reserve Bank of St. Louis may receive checks from each of the 483 member banks[2] in the Eighth District, other Federal Reserve Banks and

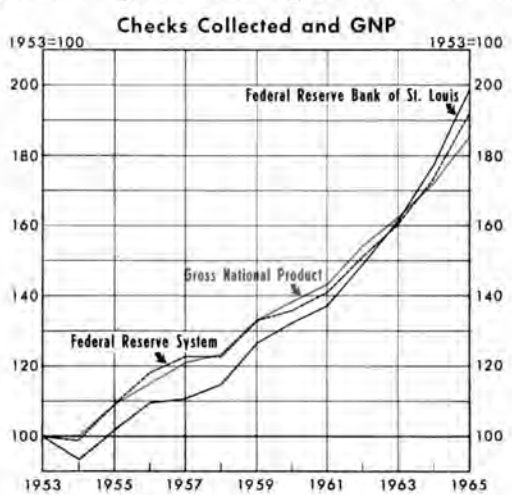
[2]Number as of December 31, 1965.

their direct-sending member banks, and Government agencies. Checks are sent to member banks and nonmember par-remitting banks in the Eighth District and to other Federal Reserve Banks for collection.

The number of checks cleared through the Federal Reserve Bank of St. Louis, including the branches, rose from 226.1 million in 1964 to 244.6 million in 1965. The dollar volume of these collections rose from $91.8 billion in 1964 to $102.9 billion in 1965.



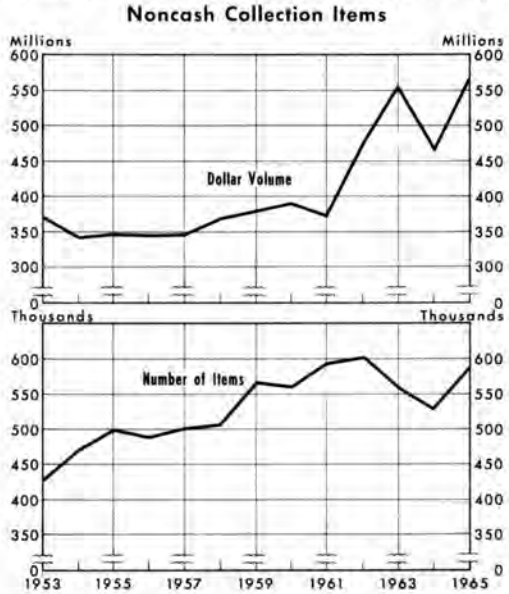
The growth in check collections at this bank and in the Federal Reserve System has generally paralleled the growth in gross national product. Since 1953 the



dollar value of checks collected at the Federal Reserve Bank of St. Louis increased at an annual rate of 5.9 per cent, while such collections in the System rose at a 5.6 per cent rate, and GNP rose at a 5.3 per cent rate. From 1964 to 1965 checks collected at the Federal Reserve Bank of St. Louis rose 12.0 per cent and in the System rose 10.6 per cent compared with a 7.5 per cent increase in GNP.

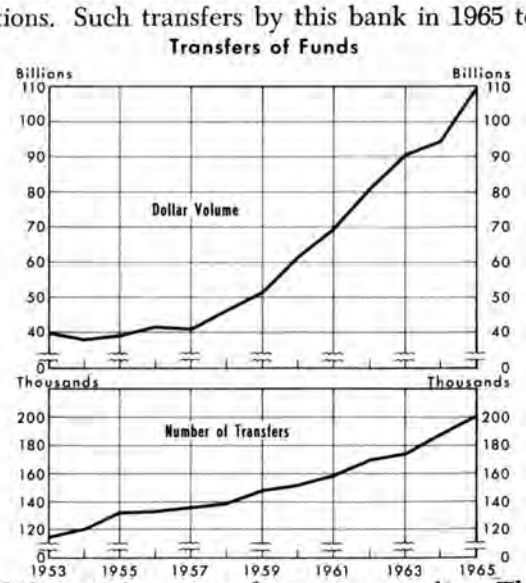
Noncash Collections

In addition to maintaining facilities for check collection, Federal Reserve Banks handle numerous other items for collection. Included are drafts, promissory notes, bonds and bond coupons, and various other documents. The combined dollar value of these noncash collections was up 21.3 per cent in 1965 from 1964, while the number of items was up 11.2 per cent.



Transfers of Funds

Transfers of funds are largely movements of member bank balances between Federal Reserve Banks, which for the most part result from Federal funds transactions, check collection settlement, and transfers in connection with transactions in U. S. Treasury obligations. Such transfers by this bank in 1965 totaled



200,000, up 6.4 per cent from a year earlier. The dollar value of transfers, totaling $109 billion, was up 15.5 per cent.

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Rebsamen & East, Inc.
Little Rock, Arkansas

Deputy Chairman of the Board

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H. LEE COOPER, President, Ohio Valley National Bank of Henderson, Henderson, Kentucky

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HARRY E. ROGIER, President, The First National Bank of Vandalia, Vandalia, Illinois

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Con T. Welch, President, Citizens Bank, Savannah, Tennessee

James S. Williams, Plant Manager, American Greetings Corporation, Osceola, Arkansas

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Benjamin B. Monaghan, *Cashier*

Paul I. Black, Jr., *Assistant Cashier*

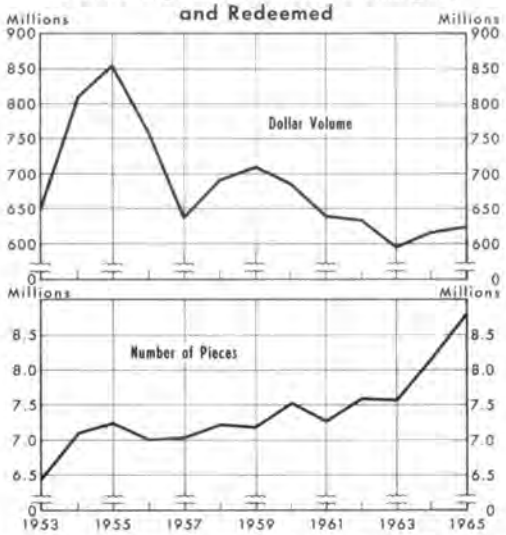
Joseph P. Garbarini, *Assistant Cashier*

Fiscal Agency Operations

To facilitate orderly Government financial transactions in all parts of the country, the Reserve Banks act as fiscal agents of the United States Government. They carry the principal checking accounts of the Government, issue and redeem Government securities, administer the Treasury tax and loan deposit accounts at commercial banks, and perform various other Government financial duties.

The Federal Reserve Bank of St. Louis issued, exchanged, and redeemed 8.8 million United States Savings Bonds in 1965 compared with 8.2 million in 1964. The dollar value of such bonds was up 1.4 per cent from a year earlier.

U.S. Savings Bonds Issued, Exchanged, and Redeemed

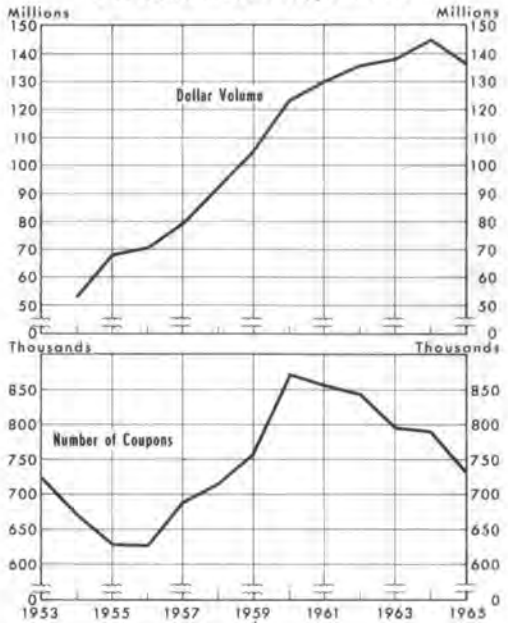


Other Government securities issued, serviced, or retired in 1965 totaled 564,000, valued at $16.3 billion.

Other Government Securities Issued, Serviced, and Retired

This was an increase of 1.8 per cent in number and 1.7 per cent in dollar value from 1964. Government coupons paid were down 7.3 per cent in number and 5.7 per cent in dollar value.

U.S. Government Coupons Paid



The Discount Rate and Lending Operations

The interest rate charged on loans to member banks (commonly called the discount rate) was raised from 4 to 4½ per cent in December 1965.[3] This increase, which followed rising market rates, was the highest rate charged on such loans since early 1929. The current uptrend in the discount rate began in mid-1963 with an increase from 3 to 3½ per cent. The rate was increased to 4 per cent in late 1964.

Discount Rate
Federal Reserve Bank of St. Louis

Federal Reserve credit is generally extended on a short-term basis to a member bank to enable it to adjust its asset position when necessary because of developments such as a sudden withdrawal of deposits or seasonal requirements for credit beyond those which can reasonably be met by use of the bank's own resources. Federal Reserve credit is also available for

[3]The rate charged under Sections 13 and 13a of the Federal Reserve Act on advances secured by U. S. Government securities and discounts of and advances secured by eligible paper.

longer periods when necessary to assist member banks in meeting unusual situations resulting from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks.

Lending operations at the Federal Reserve Bank of St. Louis during 1965 approached the average of the 1954-60 period, following four years at relatively low levels. Average daily outstandings to member banks in the Eighth District in 1965 were $15.3 million, up from $5.8 million in 1964. In comparison, average daily borrowings were about $17 million for the seven years 1954-60.

Functional Cost Analysis

The Federal Reserve Bank of St. Louis, in cooperation with other Reserve Banks, in 1965 instituted a functional cost analysis program as a service to member banks in assessing their operations. This program is designed to provide participating banks a detailed breakdown of income and expenses by various functions. It also provides a comparative measure of each participating bank's performance with the average experience of a group of banks of similar functional size.

Member banks provide the Reserve Bank with income and expense data, certain item counts, and asset and liability averages for the year. The data is computer processed and each of the participating banks is given a report in which costs and income are allocated among the functions of loans and investments, demand deposits, time deposits, safekeeping, and trust department. The loan function is further broken into installment, real estate, and others, and the demand deposits function, into regular and special checking accounts.

The program is provided without charge to member banks and is strictly on a voluntary basis for those banks which have expressed a desire to participate.

Statements

of the Federal Reserve Bank of St. Louis

Net earnings, before payments to the United States Treasury, rose to $47.2 million in 1965, up 13.5 per cent from 1964. Dividends to member bank stockholders, limited by law to 6 per cent of paid-in capital, were up 5.3 per cent. Payments to the Treasury (interest on Federal Reserve notes) of $44.9 million, were less than a year earlier, when the remainder of current earnings, after dividends, was augmented by a $16.3 million withdrawal from surplus.

Table XI

COMPARATIVE PROFIT AND LOSS STATEMENT

(Thousands)

	1965	1964
Total earnings	$58,246	$52,073
Net expenses	11,053	10,488
Net earnings	$47,193	$41,585
Net additions (+) or deductions (—)	+ 39	+ 27
Net earnings before payments to U. S. Treasury	$47,232	$41,612
Distribution of net earnings:		
Dividends	$ 1,110	$ 1,054
Interest on Federal Reserve notes	44,935	56,863
Transferred to surplus	1,187	—16,305
Total	$47,232	$41,612

Table XII

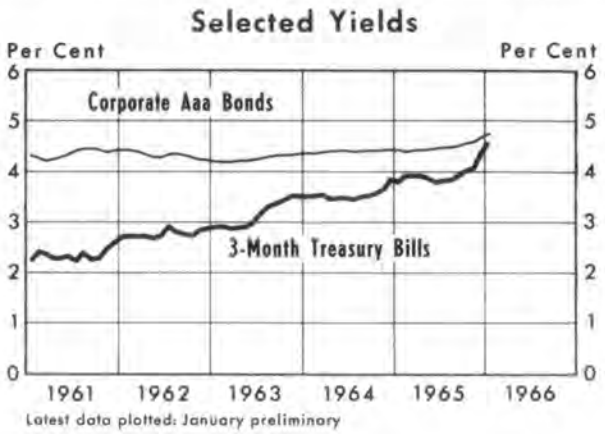
COMPARATIVE STATEMENT OF CONDITION

(Thousands)

Assets	December 31, 1965	December 31, 1964
Gold certificate reserves	$ 527,575	$ 636,030
Federal Reserve notes of other banks	42,029	32,033
Other cash	7,128	6,401
Discounts and advances	1,394	1,220
U. S. Government securities	1,546,710	1,436,374
Uncollected items	412,676	409,868
Other assets	40,003	26,543
Total assets	$2,577,515	$2,548,469
Liabilities and Capital Accounts		
Federal Reserve notes (net)	$1,450,866	$1,409,903
Deposits:		
Member banks—reserve accounts	690,741	694,156
U. S. Treasurer—general account	55,282	56,288
Other	14,589	11,497
Deferred availability cash items	320,883	318,377
Other liabilities and accrued dividends	6,894	22,362
Total capital accounts	38,260	35,886
Total liabilities and capital accounts	$2,577,515	$2,548,469

Is Total Demand Too High? —*(Continued from page 3)*

The vigorous buying in the U. S. economy has also put upward pressure on interest rates. With an optimistic outlook and with production nearing capacity,



business plant and equipment expenditures have increased rapidly. These increased expenditures have caused corporations to turn increasingly to outside sources for investment funds. State and local governments have continued to borrow heavily in long-term capital markets. Federal budget developments have recently increased the Government's demand for funds. These rising credit demands have put pressure on banks and capital markets, and higher interest rates have resulted despite a large volume of saving and the rapid monetary expansion.

Conclusion

Sharp rises in money and bank reserves, a decrease in the full employment budget surplus, and a reduction in the average maturity of the public debt have helped to amplify a strong rise in economic activity which began early in 1961. These increasingly stimulative actions have occurred since last June, even though the economy is nearing capacity.

Output cannot be expected to grow so rapidly as when there were large pools of unused resources. Further growth in output must spring primarily from additions to resources.

Since fiscal policy cannot always be quickly changed to suit the needs of stabilization, and since debt management policy has become less flexible because of the legal interest rate ceiling on Government bonds, a large part of the burden of maintaining balanced growth appears to rest currently on monetary policy.