Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 24, 1937

To Chairman Eccles

Subject:

From Woodlief Thomas

W. T.

In connection with your Treasury meeting.

CONFIDENTIAL

Cc. 27
May 24, 1937

CURRENT COMMENTS

Member bank reserves

In the week ending May 19 member bank excess reserves declined by $30,000,000 to a total of $910,000,000. Excess reserves of leading New York City banks increased to about $200,000,000 and those of Chicago banks to more than $60,000,000, while other member banks lost reserves in the week. No important change in total excess reserves is anticipated in the current statement week ending May 26.

Last week there was a small further withdrawal of bankers' balances from central reserve city banks, and one New York City bank temporarily increased its borrowings in the market. Loans and investments of New York and Chicago banks showed little change.

Government security prices

Treasury bond prices rose on Monday of last week, declined slowly through Thursday, and recovered on Friday and Saturday to the Monday level. The average yield on bonds callable after eight years was 2.66 percent on Saturday, compared with 2.67 percent on Saturday of the previous week. The average yield on 3- to 5-year Treasury notes reached a low for the month of 1.46 percent on Friday and Saturday, which compares with 1.49 percent on April 30.

Corporate bond market

The general trend of corporate bond prices was upward last week. Higher-grade issues of all classes gained on the average 3/4 of a point. Lower-grade public utility bonds lost about half a point, continuing the severe decline of the preceding week. The average yield on corporate Aaa bonds was 3.31 percent on Friday, in comparison with 3.34 percent at the beginning of the week. Yields on municipal bonds showed little change from the level of the preceding two weeks. The volume of bond transactions on the New York Stock Exchange declined further last week to new low levels for the year.

Corporate security issues offered during the week totalled $24,-000,000, in comparison with $42,000,000 in the week ending May 15.

Stock market

The general level of stock prices advanced during the week ending May 22 by about as much as it had declined during the preceding week. Among the factors reflected by the advance was a firmer tone in the London market. The New York market continued to be relatively inactive, with average daily sales amounting to about 940,000 shares.

Complete returns have now been received for April 30 from member firms of the Exchange that carry margin accounts for customers. They show that the amount of credit extended by these firms to their customers, reported as customers' debit balances, increased very little during April. The borrowings of these firms from banks increased by $43,000,000 during the month, but this increase reflected chiefly a decline of $32,000,000 in their customers' free credit balances.

Foreign buying of American stocks

There was little net buying or selling of American stocks by foreigners during the week.

Gold and capital movements

While foreigners have not yet regained their earlier enthusiasm for American securities, their desire to accumulate short-term dollar balances, which developed strongly in April after a lapse of some months, still seems to be vigorous. The movement of gold to this country, which slackened during the early part of May, is currently running at nearly the April rate. Gold engaged for shipment to the United States or released from foreign earmark here amounted to $45,-000,000 last week as compared with $26,000,000 in the week ending May 8.

Business conditions

Further information about business and credit conditions is included in the current National Summary, a preliminary draft of which is attached.

RELATION OF GOVERNMENT BOND AND CORPORATE BOND PRICES

The following analysis of the relation between prices of Government and corporate bonds has been adapted from Moody's Bond Survey of May 17, 1937:

Government bonds are often said to be in a "cheaper" position today than other high-grade investment bonds. There are some statistical indications to support this contention. Government yields are larger today in relation to yields on gilt-edge corporate bonds than at any time in the past dozen years.

Since 1919 there have been three apparent phases of yield relationship. From 1919 through 1923 yield spreads were relatively narrow -- always less than one percent. Then, from early 1924 to mid-1932, the spread irregularly widened, so that after 1924 it was almost without exception greater than one percent, while in 1932 it briefly exceeded 1 1/2 percent. The third phase then followed, consisting of an irregularly narrowing trend in the spreads until recently it was as little as 0.65 percent.

Changes which have occurred in the past few years seem to argue against any early return to conditions such as existed in the 1924-32 period. In briefest terms, a big transformation took place in the debt structure of the country between 1929 and the present day, a change which involved a substantial readjustment in the assets held by banks (and others). And all this occurred in such a way as to leave Government bonds in unwilling hands, comparatively speaking.

In 1929, the Federal Government debt was only 6.4 percent of the estimated total debt of the country, whereas in 1935 it was 14.2 percent of the total and now probably amounts to 15 percent. Looked at broadly, the rise in Government debt merely served to offset or partially offset the shrinkage in other kinds of debt. And the same kind of thing that was happening to the country's debt structure was necessarily happening to the composition of bank assets, though in a different and greater degree. In the banking system Government bonds replaced loans. In both 1929 and 1936 total assets of member banks were close to $50,000,-000,000. In the seven past years loans declined from 54 percent of total assets to 27 percent, but investments grew from 20 percent of total assets to 40 percent while Government bond holdings (including guaranteed issues) had increased from 40 percent of total investments to 69 percent. In terms of dollars, loans declined by $12,800,000,000, while investments increased by $9,900,000,000 and of this Government (and Government guaranteed) issues increased by $9,700,000,000. The balance is accounted for chiefly by an increase in reserves.

Thus, the present large holdings of Governments constitute a rather unfamiliar circumstance for the banking system, certainly unfamiliar in relation to the latter 1920s and early 1930s. And unfamiliarity breeds nervousness. Moreover, a great part of the large Government holdings has been acquired at relatively high prices, which merely adds to the timorousness of the holders and makes them especially price-conscious.

Adding to these facts, the equally important point that the banking system dominates the bond market, and we may say without much fear of going wrong, that the Government bond market is in a somewhat weaker "technical" position than is the corporate bond market. Probably this is all quite fully reflected in the already mentioned narrow yield spread between the two groups. But at least one should not expect the gap to widen at all rapidly and one can legitimately presume that if any scare should hit the market over the nearby future, Governments would be at least as sensitive as corporates and perhaps more so.

May 24, 1937

NATIONAL SUMMARY OF BUSINESS CONDITIONS

Industrial activity in April and the first half of May was maintained at the relatively high level of recent months. The general level of wholesale commodity prices declined slightly, reflecting considerable reductions in prices of commodities traded in on organized markets.

Production, employment and trade

The Board's seasonally adjusted index of industrial production in April continued at 118 percent of the 1923-1925 average. Manufacturing production rose further, reflecting increased output of durable goods. Activity at steel mills was at a rate slightly higher than in March and about equal to that in the peak month of 1929. Automobile production continued to expand. In the first three weeks of May output in these industries was maintained at the levels reached at the close of April. Increases in output in April were also reported for lumber and plate glass. There was a reduction in output at textile mills where activity has been at a high rate in recent months.

At bituminous coal mines output declined by about one-half following a sharp increase in March, when consumers accumulated stocks of coal in anticipation of a strike. Crude petroleum output showed further growth in April, continuing the sharp rise that has been in progress since last autumn. Production of most metals also increased.

Value of construction contracts awarded, as reported by the F. W. Dodge Corporation, increased more than seasonally from March to April and continued higher than a year ago, reflecting, as in earlier months of the year, a larger volume of residential building and of other privately-financed work. Contracts awarded for publidy-financed construction have been considerably smaller in the first four months of this year than in the corresponding period of 1936.

Employment and payrolls rose further between the middle of March and the middle of April. There was a considerable growth in employment in manufacturing, with the principal increases reported by the steel, machinery, automobile, and textile industries, while employment in the clothing industry declined. The number employed on the railroads also increased. In the public utility industries and in trade there was little change in the number employed and at bituminous coal mines employment declined.

In April sales at department stores showed little change and mail order sales were also maintained at the March level, while sales at variety stores declined.

Commodity prices

The general level of wholesale commodity prices, as measured by the index of the Bureau of Labor Statistics, declined from 88.3 percent of the 1926 average at the beginning of April to 86.9 in the middle of May. Prices of nonferrous metals, steel scrap, cotton, and rubber declined considerably and there were also decreases in the prices of grains, cotton goods, silk, hides, and chemicals, while prices of shoes and clothing showed further small advances. During the past ten days prices of hogs and pork have advanced sharply and grain prices have also risen.

Bank credit

Following upon the final increase in reserve requirements, which became effective on May 1, excess reserves of member banks declined from $1,600,000,000 to about $900,000,000. In the three weeks ending May 19, excess reserves fluctuated around the new level. Adjustments by banks to the new requirements were reflected in a decrease in interbank balances and in a small increase in borrowings. The Federal Reserve System in April purchased $96,000,000 of United States Government securities, for the purpose of easing the adjustment to the new requirements and preserving orderly conditions in the money market.

Total loans and investments of reporting member banks showed little change from the middle of April through May 19. Holdings of United States Government obligations and other securities held by New York City banks showed some decline, which was offset in part by increases in all classes of loans, particularly in loans for commercial purposes.

While interbank and United States Government deposits declined further, balances of foreign banks and other demand and time deposits at reporting member banks increased.

Money rates

The open-market rate on 90-day bankers' acceptances, which between January and the latter part of March had advanced from 3/16 to 9/16 of 1 percent, was reduced to 1/2 of 1 percent on May 7. Other open-market rates showed little change.