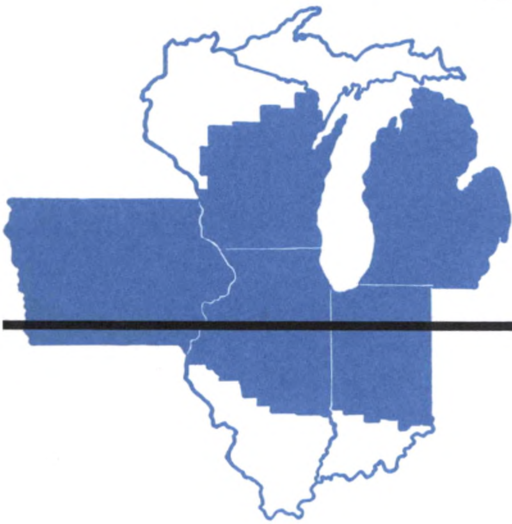
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1959 August

Contents

THE Trend OF BUSINESS

Business activity in the spring and early summer continued the broad advance which has been under way for the past year and a quarter. Pools of idle men and facilities have been receding, and, as a result, current gains in output are being achieved less easily than was the case in late 1958 and early 1959. Under these circumstances, it appears more likely that any substantial further increases in demand may exert additional upward pressures on prices.

During the first quarter of 1959, total output of goods and services per worker was 8 per cent above the recession low of a year earlier and 5 per cent above the pre-recession high set in the third quarter of 1957. In the April-June period, however, the rate of gain in output per worker slowed as the number of job holders rose substantially, almost as rapidly as production. A similar slowing in the rise in output per worker was apparent in the spring of 1955. From that point through the remainder of the 1954-57 upswing, there was very little additional growth in gross real product per worker.

When a good deal of slack is present in the economy, substantial increases in output can be achieved fairly rapidly. However, after expansion has been under way for a considerable period of time, obstacles to further sharp increases in output become apparent. Even when major bottlenecks are not encountered as activity rises (the case in recent months), resources of manpower and facilities of lesser quality are utilized, and the competitive pressures to perform all tasks more efficiently, strongest during a period of recession, tend to be relaxed. These symptoms are always in evidence as the "buyer's market" characteristic of a depressed period shifts toward the "seller's market" of prosperity.

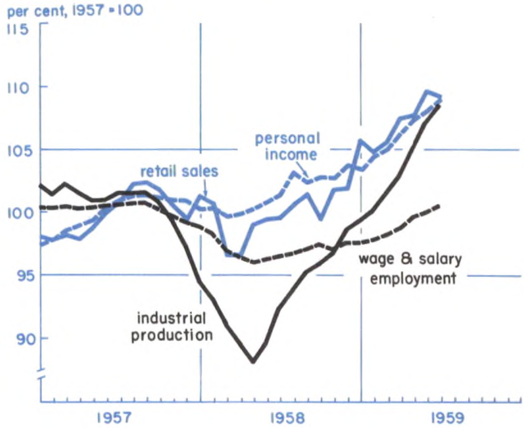
In recent months, there has been a tendency for delivery lead times on newly-placed orders to lengthen. There have been scattered reports of shortages of freight cars and trucking rigs. Orders for machinery and equipment of all kinds, particularly transportation equipment, have risen sharply. Personnel managers are having greater difficulty filling the requisitions of operating departments, and many of the skilled trades are again in short supply.

A major difference between the situation in 1959 and 1955 is that supplies of basic materials such as copper, aluminum, cement, glass and, barring a long strike, steel are far more adequate. This favorable aspect of the current situation is a legacy of the industrial expansion programs of 1955-57. Usage of basic materials is, of course, greater than four years ago.

Despite further gains in income and an apparent slowing in the rise of output per worker during the second quarter, the overall price picture continues to be one of stability. This fact, though noteworthy, provides no assurance that the recent stability will continue indefinitely. The basic price indexes did not rise appreciably during 1955 either. It was not until early 1956 that a broad upward movement became apparent.

Numerous price increases have been noted during recent months, but, as in 1955, they have been offset in the over-all indexes by declines elsewhere. Increases have been announced for most types of textiles, apparel and shoes. Declines have predominated in farm products and foods. Copper has declined as a result of an easier world supply situation. Other nonferrous metals, along with hides and rubber, have tended to hold the increases posted in the spring. Price trends in lumber and building materials have been mixed, with recent increases nullifying part of the decline of earlier months. Prices of some types of machinery and equipment have been increased in response to improved demand, but others, electrical generating equipment for example, have been reduced. The same varied picture characterizes the situation in consumer durables. In short, price developments have reflected the working of a competitive economy in an atmosphere of general prosperity. An uncertain note, however, is sounded by reports that producers in some lines are postponing decisions on price changes until the conclusion of the steel industry's wage negotiations.

Uptrend in major indicators undiminished through second quarter



Steel stocks rise

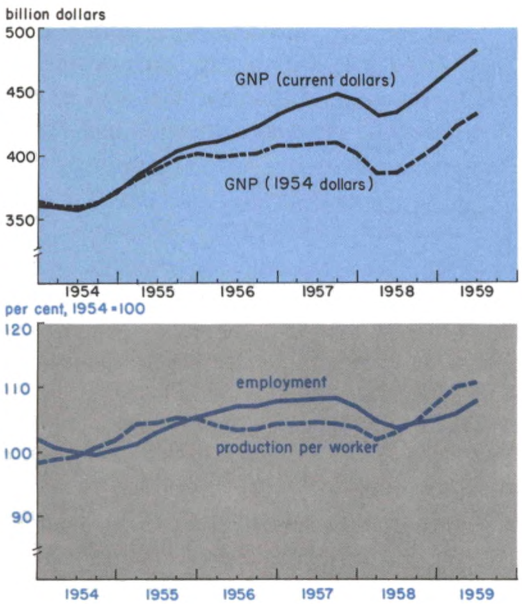
During the first half of 1959, the nation's steel firms turned out over 64 million tons of steel—70 per cent more than in the same period of last year—when inventories were being reduced. If continued for an entire year, that rate of operation would mean a new record by a substantial margin. But not all of this metal was finding its way into production. Inventories of steel in the hands of users were estimated by industry sources at about 20 million tons at midyear, about half again as great as the stocks at the start of the year and equal to a more than two-months supply at the current rate of usage.

Despite the intense demand for steel in the second quarter, both to support higher levels of utilization and to add to inventory, the basic ingot rate averaged only 92 per cent of rated capacity and never rose above the 94 per cent level. Order books for all major types of steel products were reported to be full in the second quarter, suggesting that either the ingot capacity of the industry had been overestimated at the start of the year or that finishing capacity has not been adequate to handle the potential output of the steel furnaces. The substantial increases in capital expenditure programs announced by steel firms in recent months reflect largely an industry-wide attempt to increase finishing capacity.

There have been various attempts to evaluate the impact on other sectors of a work stoppage in steel, but the results are of limited value because of important unknowns in the picture. Just how adequate are steel inventories and to what extent would production of steel have declined in the second half if there had been no strike? Of even greater import is the question, how long will the strike last?

In the Chicago area, there are about 75,000 steel workers affected directly by the shutdown. They account for about 3 per cent of the employment and personal income in the area. But spending of these workers does not, of course, drop to zero when current wages cease. Moreover, the secondary and tertiary effects are not subject to precise measurement. Some thousands of transportation workers in railroading and trucking are affected also. Persons working for firms which use steel would be affected after inventories were drawn down. Service and trades employees, whose income is derived from the spending of manufacturing workers, would be affected in varying degrees and times; some even before a stoppage actually occurred. The impact on total personal income of a long strike could be far greater than the direct effect on steelworkers.

Recent changes in output, employment and production per worker



Optimism in autos

At midyear, car dealers had 900,000 vehicles on hand. This is a new high for that time of year, by almost 200,000. Nevertheless, an air of confidence pervades the industry both at the production and distribution levels. Most of the "experts" believe that recent sales trends indicate this total can be worked down to an acceptable level of about 300,000 by the start of October when the new models are introduced. Retail sales in May and June rose more than seasonally, and, of course, the size of the production runs on 1959 models was already largely determined by decisions made earlier.

The last of the 1959 models were turned out in the second half of July by some manufacturers—the earliest change-over date in the postwar period. If retail sales had been less strong in the late spring, the total production of 1959 models would probably have been spread over a somewhat longer period. Current plans indicate that nearly all 1960 model cars will go on sale in the first half of October.

The daily rate of deliveries of new cars rose from less than 17,000 early in 1959 to over 22,000 in June. In the latter month, the gain over last year was 45 per cent—the biggest margin of increase for any month this year. After allowance for seasonal variation, the annual rate of sales of new cars, both domestic and foreign, in May and June was believed to be approximately 6.5 million, by far the highest since 1955.

An interesting feature of the car market during 1958 and 1959 has been the strength in used car prices. In the spring, prices of used cars had returned to the level of 1953 (based on autos of comparable age), a rise of about 15 per cent from early 1958. Sales of used cars have been aided by more liberal instalment credit terms granted by lenders on used cars. Maturities of more than twenty-four months have become very common for loans on late-model used cars granted by District banks. Meanwhile, thirty-six months on new cars continue to become more common, but very few contracts are written for longer periods.

Crop prospects

Crop prospects so far in 1959 are quite favorable, with the index of total crop production estimated to be second only to last year's phenomenal output. A decline in wheat production of 20 per cent accounts for most of the decline in the index. An average yield of about 22 bushels per acre of wheat will be second only to last year's record of 27 bushels.

A corn crop of 4.2 billion bushels is indicated, 11 per cent above last year's record. This increase, however, is largely offset by expected declines in production of oats, barley and grain sorghums. Hence, total production of feed grains may be about equal to the 1958 output and large enough to provide ample supplies for continued expansion in cattle feeding and hog production. Acreage planted to corn in District states is 18 per cent above last year, compared with an 11 per cent increase in the rest of the nation.

The severe winter weather damaged many wheat fields in District states. In the spring and early summer, generally good weather has prevailed in the District, though wet weather in southern Iowa delayed crop planting, and a dry spell across central Illinois brought shortages of surface moisture in the early summer.

Hog prices in mid-July were more than one-third below the year-earlier level and were the lowest since 1956. A further price decline is in prospect this summer and fall, in part seasonal, and in part reflecting the 12 per cent larger spring pig crop. Farmers' intentions for the number of sows to farrow this fall show a continuation of the expansion in hog production which started a year ago.

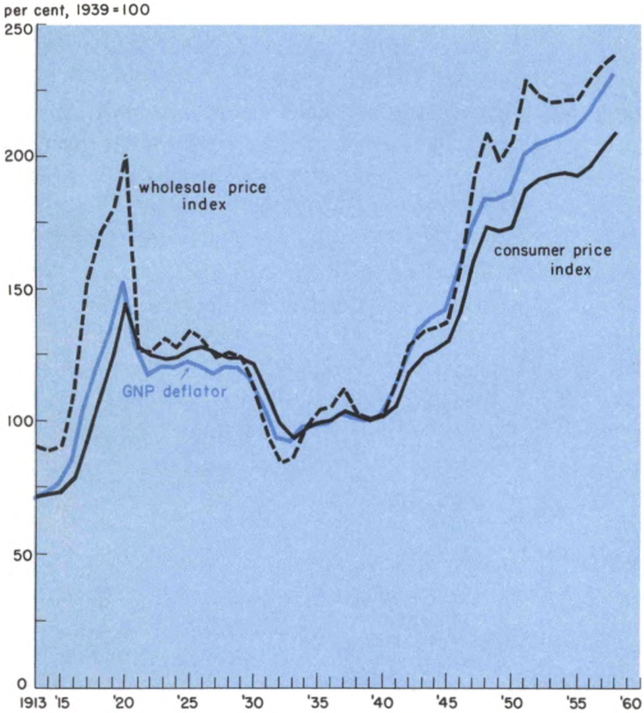
Cattle feeding continues at a record level in District states, with inshipments of stocker and feeder cattle during the first half of the year nearly 25 per cent above first half 1958.

What is a dollar worth?

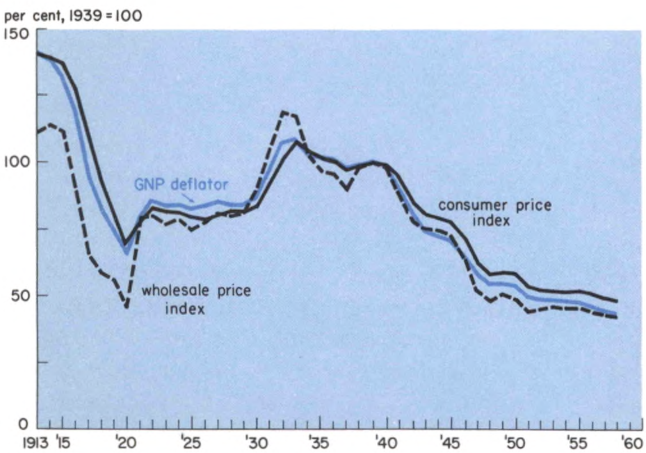
Discussions of inflation commonly include references to "the declining value of the dollar." In recent months it has been said frequently that "the dollar is worth only 48 cents." This statement means that a dollar will purchase only 48 per cent as many commodities and services at the present time as it would in 1939, as measured by the consumer price index.

It is self-evident that the value of a monetary unit is determined by the quantity of goods and services it can command in ex-

Major price indexes
have risen over the years . . .



which means that the "purchasing power of the dollar" has declined



change. As prices rise, the purchasing power of a dollar declines; as prices fall, its purchasing power rises.

When individual commodities are considered, the value of the dollar does not ordinarily come to the fore. We may note, for example, that wool was priced recently at 43 cents per pound and that a year earlier the price was 36 cents. But we do not think of the dollar as being worth 2.3 pounds of wool, and we do not conclude that the dollar has declined nearly 20 per cent in purchasing power during the past year merely because the price of wool has risen. It is true, in a sense, that there are as many values for the dollar as there are commodities. However, movements in these prices are often quite different. For example, the prices of many agricultural commodities and imported raw materials are substantially lower than they were in 1947. Prices of most other things are higher, but by varying proportions.

To be useful, the idea of a shifting purchasing power of money must be related to changes in the prices of a wide variety of commodities and services. To measure the change in the value of the dollar, then, requires the computation of an average of many prices. Usually the prices of the individual items are weighted according to their relative importance.

Even the broadest measures of the price level do not attempt to include all prices. Secondhand items, stocks and bonds and real estate prices usually are not included.

To facilitate making comparisons of groups of prices through time, price indexes are constructed. The average of prices as of some specified date—the "base period"—is taken to be equal to 100. The average computed for other dates is presented as a percentage of the base. The base period may be a year or even a shorter period, but it is common to use an average of several years. At the present time, many indexes use the 1947-49 base period. The selection of the base period is merely for convenience in making comparisons. It does not indicate, necessarily, that the relationships which existed during the base period were more normal, reasonable or desirable than those in any other period.

Prior to the time when the 1947-49 base period came into fairly general use, 1935-39 was widely used. In the future, other base periods will be used.

The most widely used indexes of prices are the *consumer price index,* which measures changes in the prices of goods and services purchased by families of urban wage earners and salaried clerical workers, and the *wholesale price index,* which measures changes in the prices paid by business firms in the primary markets. A third measure, and one that is coming into more general use, is the *gross national product deflator*. This index is the result of efforts to remove the effects of price movements from estimates of total spending so that the estimates of total output of the U. S. economy can be presented in "real" terms.

When a value is assigned to the general purchasing power of the dollar, it is derived from one of these measures which represents changes in a broad category of prices. The statement that "the dollar is worth 48 cents" is based upon the over-all rise in the consumer price index since 1939. If the wholesale price index were used for this purpose, it would be said that the dollar was worth 42 cents. According to both indexes, therefore, the value of the dollar has dropped by more than half since 1939, or, to put it in another form, prices have more than doubled.

The following table shows the different "values" (May 1959) of the dollar which result from using different "base" years for the consumer and wholesale price indexes.

	Current purchasing power relative to the base period	
Base period	CPI	WPI
1913	34c	38c
1920	69	83
1929	59	52
1933	45	37
1939	48	42
1948	83	87
1953	92	92
1958	100	99

When reference is made to a "48 cent dollar," it is desirable to keep in mind several important qualifications. For example, is the particular price index employed the most reasonable one available for a particular purpose? No index will accurately represent the purchases made by a given individual or firm. In this sense, everyone has his own price level or purchasing power of the dollar.

Another problem is encountered when price indexes are used for purposes which require a high degree of precision. For example, the fact that the consumer price index declined or rose a tenth of a point in a given month is often offered as front page news.

Those who construct such indexes hardly ever claim such a high degree of accuracy for their product. If the consumer price index were "rounded" to the nearest full percentage point, it would be unchanged from April 1958 through May 1959, the latest figure available.

Other problems are presented by the difficulty of obtaining accurate price quotations in periods of scarcity or abundance. Under such circumstances, special concessions may significantly affect prices actually paid even though list prices remain relatively stable. Another difficulty is encountered in periods, such as 1946, when many kinds of goods are not available in usual qualities and styles.

Comparisons of price movements over long periods of time involve additional difficulties. This is because of the introduction of new products, changes in the characteristics of existing products and changes in the proportions of income spent in various ways. No method has been developed to allow for new products and quality improvements in price indexes.

The limitations discussed above do not mean that available measures of the purchasing power of the dollar are without significance. They provide, in a general way, a means of evaluating the nation's success or failure in combatting inflationary pressures. Their limitations are most troublesome when precise measurements are desired.

Retail trade at midyear

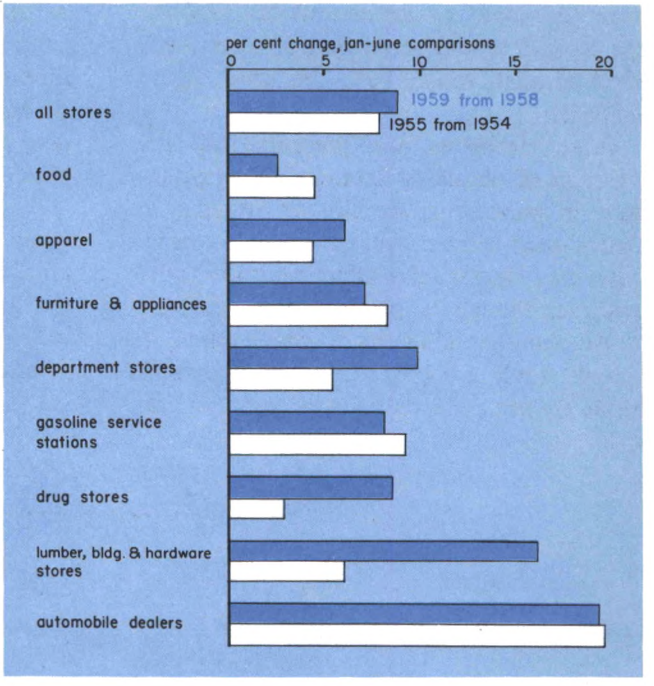
Consumers were earning and spending at a record pace in the first half of 1959. Strength in this sector, which accounts for about two-thirds of total purchases of goods and services, has been largely responsible for the tendency of business analysts to revise upward the more cautious forecasts made at the start of the year.

For the January-June period, personal income after taxes was at an annual rate of about 325 billion dollars, 6 per cent more than in the same period of 1958 which was also a record to that date. Consumption expenditures on all types of goods and services were higher by about the same proportion.

Retail sales showed a greater proportional gain than total consumption spending in the first half, about 9 per cent. This is because some of the sharpest increases in retail trade have come in categories in which sales to business are important. Trucks and trailers, farm machinery and building materials, all included in retail trade, are purchased in large part by businesses. Each of these groups has performed well.

Retail trade had been one of the first barometers to show substantial improvement in the spring of 1958, and further increases occurred as the uptrend in general business continued. Successive new highs were established in March, April and May of this year, and preliminary reports indicate that June about maintained the excellent May level. In May and June, total retail sales were at an annual rate of 220 billion dollars which compares with 200 billion in the same

Retail sales rise in 1959 is broadly based; pattern similar to 1955



months of last year—a 10 per cent increase. Thus, the year-to-year margin improved somewhat as the first half proceeded, despite a rising level of sales in the previous year. Since retail prices, over-all, have changed little since last year, virtually all of the 1959 gain in sales represents higher physical volume.

The willingness of consumers to increase spending as their incomes have risen, of course, reflects the improvement in income and job prospects which has occurred since last year. Impressive evidence of the more confident attitude on the part of consumers is offered by data on the growth in use of instalment credit, much of which involves two- and three-year commitments. During the first half of 1959, instalment debt rose at an annual rate of over 4 billion dollars. This contrasts with a decline in the same period of 1958 at a rate of 1.3 billion. The switch from debt reduction to debt expansion, therefore, added about a third as much to consumer buying power between the two periods as did the growth in disposable income.

All groups higher

The faster pace of sales in 1959 has been reported in all major retail lines. However, gains were concentrated in "hard goods" lines which were up 16 per cent from first half 1958, compared with a rise of only 5 per cent for soft goods stores.

Within the durable goods sector, automobile dealers showed the largest January-June increase—19 per cent—over the depressed level of last year. In addition to new cars, domestic and imported, these sales include used cars, trucks, accessories and parts. Appliance and furniture stores registered a more modest gain—7 per cent. Sales of these stores had dropped much less than autos in 1958. Sales of lumber, building material and hardware dealers were up more than 16 per cent, largely because of the high level of home-building activity.

Apparel stores showed a 6 per cent gain for the first half of 1959. Food stores, which reported exceptionally strong sales in the year-ago period, increased only 3 per cent. A year-to-year drop of 2 per cent in food prices indicates about a 5 per cent increase in physical volume for these stores.

Another 1955?

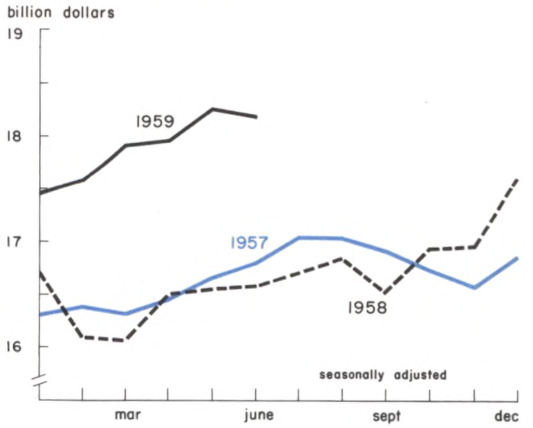
Both 1959 and 1955 represent periods of expansion following recessions. Thus, comparisons of retail sales trends in the two periods are of interest. Retail sales showed a year-to-year increase of 8 per cent in the first half of 1955, close to the 9 per cent gain in the first half of the current year.

Despite a smaller increase in the number of new car deliveries in 1959 as compared with 1955, dollar sales of automobile dealers showed the same proportional increase—about 19 per cent. Sales of furniture and appliance stores also increased by similar proportions in the two periods, with gains of 8 per cent in 1955 and 7 per cent in 1959. However, the 16 per cent rise in lumber, building and hardware sales this year is more than double the 1955 increase.

In the Midwest

Department stores, for which sales data are available by city, give some indication of regional trends in retail sales. For January through June, sales at Midwest department stores were 10 per cent ahead of 1958, slightly more than the increase for the nation as a whole. In general, Midwest centers which felt the recession most severely in 1957-58 chalked up the largest gains in the first half of 1959. In Detroit, for example, department store sales were 10 per cent below 1957 during the first half of 1958. For the first half of 1959, sales were 16 per cent above year earlier. However, all of the Seventh District's major areas were running well ahead of the 1957 pace in the first half of 1959.

Retail sales push to new record



Housing in 1959: another 1950?

Residential construction has been a stellar performer during the business rebound of the past year and a quarter. Between early 1958 and the end of the year, the private nonfarm starts' rate climbed by more than 40 per cent, after allowance for seasonal influences. The peak was reached in November and December, at a yearly pace of more than 1.4 million units for the United States. Although the rate dipped slightly during the first six months of 1959, the number of starts was within 1 per cent of the 696,500 total for the same months of record 1950.

In the huge *Chicago* housing market, construction so far in 1959 has been running well ahead of 1958. Permits issued in the first six months covered 54 per cent more dwelling units than in the corresponding months of 1958. The year-to-year comparison, moreover, suggests that 1959's margin progressively widened during the season.

In the *Milwaukee* area, the five-month total for this year exceeded 1958, but by only about 5 per cent. The May figure, though, was below last year, and the cumulative gain, comparing 1959 with 1958, steadily narrowed from January onward.

The number of permits granted in *Indianapolis* during the opening four months was 12 per cent higher this year than last. The early months of the year showed a deficit, but it was more than offset by large gains in March and April. Lower-priced housing and prefabricated units selling for around $15,000 were reported as receiving greater emphasis this year than last.

For *Detroit,* the figures for the first four months of 1959 showed a gain in total permits of about one-third. April, however, was off slightly and preliminary reports indicate that May, also, was down from 1958.

In the other metropolitan areas of the Seventh District, experience varied widely but with a preponderance of gains for the 1959 season through April. For all the District's urban centers combined, the 38 per cent gain in four-month permit volume matched the rise in national housing starts in the same period.

A recent canvass of builders and lenders in the District's major metropolitan areas reveals a close correspondence between experience to date and expectations for the remainder of the year. In the Chicago area, for instance, respondents typically look forward to a good second half, with volume roughly matching the high level in the latter half of last year. Builders and lenders in the Detroit area, however, expressed the view that weakness evident first in April and again in May would likely persist during the remainder of the year. In Milwaukee, the narrowing lead of 1959 over 1958, in terms of permits issued, was taken as a sign that activity during the second half would likely run below last year. In the Indianapolis market, the second half is expected to better last year's performance in unit volume, although the shift to lower-priced units may mean no appreciable rise in dollar outlay.

Mortgage credit tighter

Conjecture on probable developments in the mortgage credit situation figured prominently in reports received from both lenders and builders. "Last year it was the market for houses that worried us; this year it's financing," is the way one builder put it. An early-1958 survey turned up little concern over the availability of mortgage money but a good deal of uncertainty over the appeal or salability of new housing at a time of business recession. This year, on the other hand, the buyer's interest in the industry's product and his willingness to assume debt obligations are taken more or less for granted. But will suitable financing be readily available in the amount required to support the current volume of residential construction?

Since the turn of the year, signs of tightening in the mortgage market have gradually appeared. Widening discounts on FHA and 4¾ per cent VA home mortgages have been symptomatic of a relative shift from mortgages to corporate and municipal bonds and other investment alternatives available to large institutional investors such as life insurance companies, mutual savings banks and commercial banks. These investors have responded to the vigorous demand for long-term funds on the part of business firms and governmental bodies. Housing markets in which Government-underwritten mortgages have traditionally figured prominently—Detroit, for example—have felt the effects of this change in allocation of funds rather more keenly than areas in which conventional financing plays a paramount role.

In the Chicago area, a combination of comparatively high housing prices and leadership in home financing by savings and loan associations has gone hand in hand with the predominance of conventional mortgage financing and a commensurately smaller role for the FHA and VA varieties. A disposition of lenders in the national mortgage market to curtail their acquisitions of Government-underwritten mortgages, therefore, tends to have only a moderate impact on this market, in terms of the availability of funds for mortgage financing. But a tendency toward higher mortgage rates appears nonetheless to have been under way since the turn of the year. Advances in "basic" residential mortgage rates were posted in June and July by some of the area's major lending institutions. While 5½ per cent had been the going rate earlier in the year, commitments to lend at 5¾ and even 6 per cent were common by the end of July.

New VA rate an aid?

The boost in early July from 4¾ to 5¼ per cent in the maximum interest rate on VA home mortgages was expected to reduce discounts appreciably, to something like the 2 to 3 point range prevailing on FHA mortgages bearing the same contract rate. This discount compares with the 8 to 10 point markdown in recent months on 4¾ per cent VA loans. By itself, this move should give a fillip to the lagging volume of VA lending, but doubt was expressed in some quarters that it would help materially if yields on alternative long-term investments were to rise further.

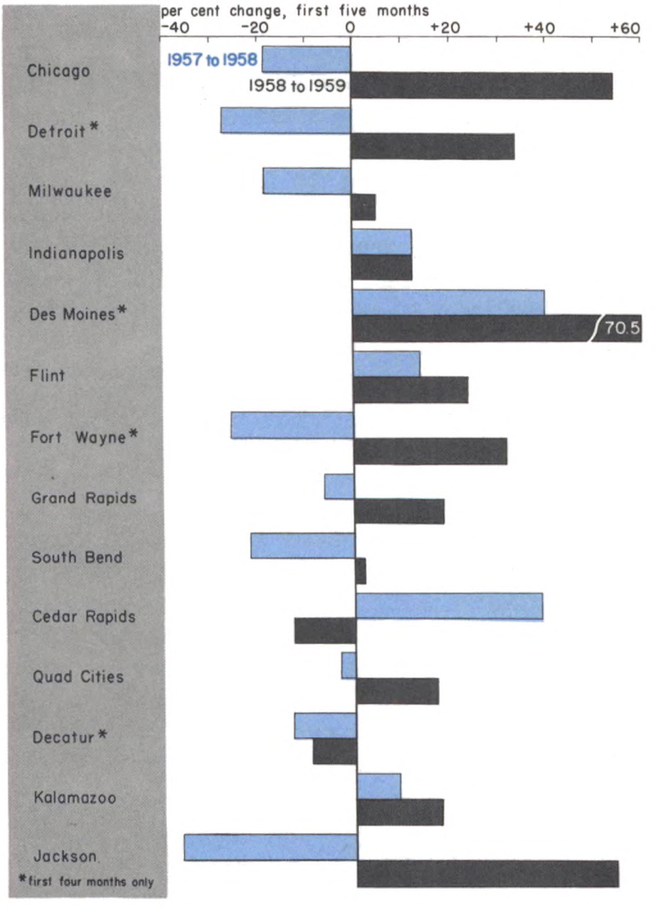
In a time of advancing yields on long-term investments, interest rate ceilings of FHA and VA mortgages tend, sooner or later, to reduce the supply of funds seeking these mortgages, with the result that borrowers shift to conventional financing. But conventional loans typically entail equity and amortization requirements that screen out some would-be borrowers. The net result, therefore, tends to be some narrowing of the effective demand for homes as investment demands for other purposes strengthen.

Buyer interest generally evident

Builders typically reported an encouraging reception of their current offerings. Showings of new models had been well attended. The houses featured for sale this season most commonly were reported to lie in substantially the same price ranges as last year and to be basically similar in design, size and construction. Selling from models for future delivery remains the typical practice, with little of the tract-scale speculative building so common until two or three seasons ago. Prefabricated housing is receiving considerable emphasis during the 1959 season; several builders reported sizable gains in volume over 1958—mostly in the under $20,000 range, although units selling for upwards of $35,000 reportedly are also in demand.

Once again, builders in the largest centers cited the short supply of improved sites and the spiraling cost of undeveloped land as factors presenting special difficulty. If it is true, as some industry spokesmen assert, that most suburbanites will balk at devoting more than an hour's time to the drive or ride to and from work, the market value of close-in sites would seem destined to continue climbing indefinitely, or as long as metropolitan area growth takes place. An offsetting development, of course, is substantial improvement of urban travel arteries. All three of the District's biggest cities—Chicago, Detroit and Milwaukee—have major expressway projects under way currently. Completion of these in the next two to three years could well serve to alleviate pressure on the limited numbers of in-city building sites that remain. Decentralization of trade and industry within the metropolitan areas also is a force tending to widen the area of feasible residential settlement and thereby lessen the premium on locations most accessible to downtown business districts.

Early 1959 building permits up substantially from year ago in majority of larger Seventh District centers



Apartment volume up

In the national housing market, the construction of multifamily dwelling units (both private and public) appreciably widened its share of all residential construction during both 1957 and 1958, particularly in the latter year. Early 1959 saw a continuation of this trend, with starts of apartment units in January and February up more than 50 per cent from the year before.

For the first six months of 1959, permits for apartment units in the Chicago area were nearly 70 per cent ahead of 1958, according to Bell Savings and Loan Association.

In the Milwaukee area, apartment (including duplex) construction this year has fallen behind last year's pace, judging from data for the first five months. The dip has been due, however, to a decline in the two-family structures; permits for buildings containing three and more units have run ahead of 1958. Permits for multifamily units in the Detroit metropolitan area were well down for the first quarter, with volume off for both two-family and larger units.

Behind the rise in interest rates

The Treasury last month offered investors the option of exchanging a maturing one-year security for a new one-year obligation bearing a 4¾ per cent coupon. This issue, like its four-and-three-quarter-year companion also included in the exchange offering, represents the highest coupon yield on U.S. securities in 20 years. Interest rates have climbed sharply since business activity turned strongly upward in 1958. The fact that the Treasury certificate coming due, issued just twelve months ago, bore a 1⅝ per cent coupon dramatically illustrates the steep rise that has occurred in the cost of borrowed funds over the past year.

Short-terms lag

The experience of the Treasury in having to pay the highest interest rates for several decades on new issues characterizes all but the very shortest end of the maturity range. Yields on intermediate- and long-term Governments and on corporate and state and local government obligations—just about a year and a quarter after the 1958 trough in production—have matched or surpassed the 1957 peaks (see table). A 4.38 per cent yield on Treasury issues with three to five years to run is a third of a point above the previous postwar high reached in October 1957. Both long-term Treasuries and high-grade corporates are about four-tenths of a percentage point or more over the earlier peaks.

Three-month Treasury bills, however, are somewhat below the 1957 high. In large part, this is the result both of the heavy demand for such issues by corporations accumulating liquid funds and the decline in the amount outstanding of such securities.

With depreciation charges continuing to increase and corporate profits on the way to a record or near-record year, the amount of funds at the disposal of business continues to rise. Capital expenditures, moreover, while strengthening, have not been rising at a pace commensurate with the inflow of corporate liquid assets. During the year ending March 1959, corporations increased their holdings of Governments by 3.5 billion dollars, compared with a decrease of 2 billion in the previous twelve months. Even with this boost in holdings of Governments, corporate businesses also increased their bank deposits by more than 1.5 billion, about three times the gain from March 1957 to March 1958.

While corporate demand for shortest-term Governments has grown, the supply of such issues has in fact declined. The total amount of Treasury bills outstanding has increased substantially, but the rise has been in the longer-term issues. With the recent sale of 5 billion in additional bills, the aggregate outstanding was boosted to 36 billion dollars, 14 billion over the mid-1958 level. Yet, those maturing in three months or less declined from 22 to 18 billion dollars.

Some of the relative strength in the shortest segment of the Government security market may also reflect a desire of investors to remain liquid in expectation of further increases in interest rates. By staying in the very short issues, an investor may be foregoing some return that could be earned on longer maturities. On the other hand, he is thereby insulating that portion of his portfolio from any decline in market prices of outstanding obligations that would accompany rising interest rates. At the same time,

Market yields on selected securities—range of fluctuations
(monthly averages of daily rates)

	The trend of business: contraction	expansion	contraction	expansion	
	1953 peak	1954 low	1957 peak	1958 low	Week ending July 17, 1959
			(per cent)		
3-month Treasury bills	2.23 (June)	0.65 (June)	3.59 (Oct)	0.88 (June)	3.37
3-5-year Treasury issues	2.92 (June)	1.69 (July)	3.99 (Oct)	2.25 (June)	4.38
Long-term U.S. bonds	3.13 (June)	2.47 (July)	3.73 (Oct)	3.12 (Apr)	4.08
Aaa corporates	3.40 (June)	2.85 (Apr)	4.12 (Sept)	3.57 (June)	4.47
Baa corporates	3.88 (Sept)	3.45 (Dec)	5.09 (Nov)	4.53 (July)	5.09
Aaa state-local gov'ts.	2.64 (June)	1.90 (July)	3.43 (Sept)	2.69 (May)	3.51

he maintains a readiness to buy longer-term securities if rates do move up. Any tendency for investors to stay liquid in anticipation of additional advances in interest rates, therefore, tends to hold down yields in the shortest sector of the market and accentuates the upward pressure in other sectors.

Medium-terms favored by banks

The increases in rates on medium-term obligations have also exceeded those farther out on the maturity spectrum. The market yield on Governments coming due within three to five years has risen from a low of 2.25 per cent in the spring of 1958 to about 4.40 per cent as of mid-July. Over the same period, the return on issues with over ten years to maturity has gained about 1 percentage point. As a result, the rate on the medium-length U. S. securities is about a third of a percentage point higher than the yield on longer-term issues.

This is the second time in the postwar period that rates on intermediate-term issues have exceeded not only short-term Governments but longer maturities as well. In the autumn of 1956 and through much of 1957 this same "humped" type of interest pattern prevailed, the first time such a structure had appeared since the 1920's. In the interim, most financial experts had come to regard as normal a profile of yields in which the longer the maturity, the higher the yield. Experience with the 1956-57 period and now with the current yield structure has indicated that there is no "normal" pattern of interest rates —different market conditions resulting in a variety of interest rate profiles.

The intermediate-term sector of the market, as well as the short-term area, is extremely sensitive to changes in bank reserve positions. Various groups of investors concentrate their purchases in particular segments of the market. The bulk of commercial and industrial corporate holdings are in Treasury bills of short maturity. In fact, these nonfinancial businesses account for the major share of all Treasury bills owned outside the Federal Reserve System and Treasury investment accounts and are substantially greater than the bill portfolio of commercial banks, the next most important holder.

At the other end of the maturity range, life insurance companies and pension funds *purchase* predominantly long-term issues. The liabilities of these financial intermediaries are mainly of a long-term nature. Liquidity needs are small, since both the inflow of funds from premiums and pension contributions and the payments of benefits can be projected quite accurately. Most such investors can, therefore, adjust their portfolios so that the stream of maturing issues will match any excess of disbursements over receipts.

In the medium-term maturity range, commercial banks are the dominant purchasers. At the end of 1958, 63 per cent of all Treasury securities outstanding that, when put on the market, had maturities of from one to ten years were held by commercial banks. At the same time, issues maturing from 1960 through 1969 constituted 88 per cent of total commercial bank holdings of U. S. Government securities. With loan demand rising, some banks reduced their portfolios of U. S. securities in order to expand their loans. Since intermediate-term securities make up such a big portion of bank holdings, many banks have been net sellers of these securities.

Competition with equities

Yields on long-term bonds, while not rising as much as those in the intermediate-term area, are also above the peaks reached in 1957. In part, this reflects the increase in demand for long-term funds, as the expansion in mortgages and outstanding state-local obligations has more than offset the reduction in the issuances of new corporate bonds.

In part, this also reflects the greater emphasis by individuals and some nonbank financial intermediaries on the purchase of equities rather than debt issues. In the year ending March 1959, the latest month for which data are available, purchases by individuals of corporate stocks or investment company shares exceeded sales by 1.5 billion dollars, a boost of more than 50 per cent in net purchases from the preceding twelve months. Life insurance companies and pension funds also added to their holdings of stocks at a faster pace.

The increases in interest rates that have taken place over the past year have largely reflected the expansion in business activity that has been under way since the spring of 1958. As employment and output rise, the growth in the demand for credit usually exceeds the increase in the availability of funds, with the result that the cost of borrowing rises. The extent of the rise and the structure of various rates in relationship to each other, however, will differ with the particular influences on the supply and demand for funds then prevailing, including expectations as to future changes in rates.

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