

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

# Business Conditions

**1963 June**



## **Contents**

- Trends in banking and finance—  
banking in spotlight again 3
- The growth of industrial production 10

**BUSINESS CONDITIONS** is published monthly by the Federal Reserve Bank of Chicago. George W. Cloos was primarily responsible for the article "The Growth of Industrial Production" and George G. Kaufman for "Trends in Banking and Finance—Banking in Spotlight Again".

Subscriptions to **Business Conditions** are available to the public without charge. For information concerning bulk mailings, address inquiries to the Federal Reserve Bank of Chicago, Chicago 90, Illinois.

Articles may be reprinted provided source is credited.

# Trends in banking and finance

---

## Banking in spotlight again

In any modern society production is highly specialized and consumers purchase most of their needs from others. Convenient and efficient financing must be available at each stage of production and distribution if the economy is to function satisfactorily.

Financial establishments, therefore, are "everybody's business." These institutions not only provide necessary money and credit but also provide a means by which the savings of many individuals are channeled into productive investment, essential to the nation's further growth and development. In addition, a nation's monetary and credit facilities form a convenient means through which public policies, designed to help achieve full employment and stable prices, can be transmitted to the private economy. Because, therefore, the performance of the economy is closely tied to that of the financial institutions, there is widespread interest in the performance of banks and other financial establishments and in the public policies affecting them.

In recent years, this interest has resulted in several comprehensive reviews of the country's financial institutions and markets by prominent study groups. Three major reports have been completed within the past two years.

In June 1961, the Commission on Money and Credit (CMC), a group of prominent

citizens drawn from all major sectors of American life, published a report based on an extensive study of the entire financial system. In the fall of last year, a committee appointed by the Comptroller of the Currency and consisting mostly of representatives of national banks reported a sizable list of proposed changes in existing policies affecting the national banks. Last month, a cabinet-level committee appointed by the President of the United States and headed by Walter Heller, the Chairman of the Council of Economic Advisors, completed a review of many aspects of our financial structure. On a smaller scale, studies are conducted more or less continuously by congressional committees, individual economists, members of the financial community and others.

The present wave of studies, unlike similar ones in the past, does not stem from any obvious weakness in the financial structure. The relative mildness of the changes proposed by the studies attests to the soundness and effectiveness of the prevailing establishments and practices. Rather, the investigations originate from a desire to test whether a financial structure designed largely to accommodate the needs of the thirties (when much of the legislation currently applicable to commercial banks was enacted or substantially amended) can also accommodate ade-

—continued on page 8

---

Summary of existing regulations

---

---

Commission on Money and Credit

---

I. MONETARY POLICY OPERATIONS OF THE FEDERAL RESERVE SYSTEM

A. Reserve requirements

The Board of Governors may vary reserve requirements on demand deposits of member banks of the Federal Reserve System between 10 and 22 per cent for Reserve City banks and 7 and 14 per cent for Country banks. Current requirements are 16½ and 12 per cent, respectively. Reserve requirements for nonmember banks are determined by the respective state statutes and may or may not be equal to the requirements applicable to member banks.

Reserve requirements on time and savings deposits at member banks may vary between 3 and 6 per cent. The current requirement is 4 per cent.

Banks are classified as Reserve City or Country banks according to geographical location and character of business.

B. Federal Reserve discounting

Federal Reserve Banks normally make advances to member banks for periods not exceeding 15 days on promissory notes secured by Treasury securities (notes may be renewed) and for periods not exceeding 90 days on promissory notes secured by "eligible" paper. Advances on promissory notes secured by collateral not considered "eligible" and payable in not more than four months may be made at a "penalty" rate of not less than ½ of 1 per cent above the discount rate. Federal Reserve Banks may also discount certain "eligible" notes, drafts and bills for member banks. With the exception of agricultural paper, which may have a maturity not exceeding nine months, the maturity of the notes, drafts and bills may not exceed 90 days.

Discount rates are set by the Board of Directors of each Federal Reserve Bank subject to the "review and determination" of the Board of Governors of the Federal Reserve System.

C. Payment of interest on deposits

All commercial banks whose deposits are insured by the Federal Deposit Insurance Corporation are prohibited from paying interest on demand deposits and may pay interest on time and savings deposits only within the limits determined by the Federal Reserve System for member banks (Regulation Q) and by the FDIC for nonmember banks.

The range within which reserve requirements on demand deposits of member banks can be varied should be set so that the needs of a growing economy can be met. Tentatively suggested 8 to 18 per cent range.

Requirements on time and savings deposits should be eliminated. Pending such change, banks should be permitted to hold reserves in the form of Treasury securities not exceeding five-years in maturity.

Uniform reserve requirements should be established for all banks regardless of geographical location.

Uniform discount rates and administrative standards should be established at all Federal Reserve Banks. The determination of the discount rate should be vested in the Board of Governors.

Authority to regulate interest rates on time and savings deposits should be placed on a standby basis. Differentiation among types of deposits should be permitted.

## Recommendations

### Advisory Committee on Banking

### Committee on Financial Institutions

Reserve requirements on demand deposits of member banks should be reduced to 10 per cent and the range within which the Board of Governors can vary the requirements narrowed to between 8 and 12 per cent.

Reserve requirements on demand deposits should be graduated according to volume of demand deposits. The requirements should be imposed on deposits at nonmember as well as member banks.

Requirements on time and savings deposits should be eliminated. Pending such change, requirements should be reduced to 3 per cent.

Reserve requirements on time and savings deposits should be continued at member banks and extended to non-member banks.

Uniform reserve requirements should be established for all banks regardless of geographical location.

Uniform reserve requirements should be established for all banks of like deposit size regardless of geographical location.

Collateral eligibility requirements for advances should be liberalized to "secured to satisfaction" of Federal Reserve Banks. All advances should be for periods of 90 days, "penalty" discount rate should be eliminated and all advances made at the regular discount rate.

All commercial banks should have access to the discount window.

Authority to regulate interest rates on time and savings deposits should be placed on a standby basis and transferred to the Treasury Department.

Authority to regulate interest rates on time and savings deposits should be placed on a standby basis. Differentiation among deposits should be permitted according to type, holder, maturity or other characteristics.

---

Summary of existing regulations

---

---

Commission on Money and Credit

---

D. Federal Reserve membership

All national banks are required to be members of the Federal Reserve System. State chartered banks may become members by meeting prescribed requirements.

All insured commercial banks, whether state or national, should be required to become members.

II. COMMERCIAL BANKS

A. Lending, investing and borrowing

Banks are subject to limitations on their lending, investing and borrowing activities according to the laws applicable to the respective regulatory agencies—Comptroller of the Currency, Federal Reserve System, FDIC and state banking authorities—and the regulations issued by these agencies.

Banks should be given greater flexibility with respect to their lending, investing and borrowing activities, e.g., restrictions which impede lending over a wider geographical area than at present should be liberalized.

B. Taxation

Commercial banks are permitted to deduct annually from taxable income for bad debt reserves an amount based on their average loss experience on loans over a 20-year period. The total reserve may not exceed three times this amount. For all banks, such reserves are currently equal to about 3 per cent of loans.

Commercial banks, mutual savings banks and savings and loan associations should be subject to Federal income tax in a way that insures competitive equality.

Savings and loan associations and mutual savings banks may deduct annually for losses on qualifying real estate loans an amount not exceeding 60 per cent of taxable income until the total reserve is equal to 6 per cent of qualifying real estate loans outstanding. Alternative methods based on loan-loss experience are also permitted.

C. Branching

State banks are permitted to establish branches where state laws permit but only within the state of operation. National banks may establish branches subject to the same limitations applicable to state banks by state law.

All commercial banks should be permitted to establish branches within "trading" areas irrespective of state boundaries.

D. Supervision and regulation

Primary authority relating to Federal supervision and examination is divided according to type of bank. The Comptroller of the Currency has jurisdiction over national banks, the Federal Reserve System over state member banks and the Federal Deposit Insurance Corporation over state nonmember banks whose deposits are insured by the FDIC. State banking authorities have primary jurisdiction over state banks.

All authority relating to supervision and examination of banks at the Federal level should be transferred to the Federal Reserve System.

## Recommendations

### Advisory Committee on Banking

Compulsory membership for national banks should be continued. (A strong minority, however, favored voluntary membership.)

Banks should be given greater flexibility with respect to their lending, investing and borrowing activities, e.g., limits on bank lending to any one borrower should be raised from 10 per cent of unimpaired capital and surplus to from 10 to 15 per cent of capital, surplus and undivided profits.

Tax deductible reserves for bad debts should be permitted up to 5 per cent of outstanding loans.

National banks should be permitted to establish branches within 25 miles of principal office within state of operation regardless of state law.

All authority relating to supervision and examination of national banks (including formation and expansion of holding companies) should be transferred to the Comptroller of the Currency.

All authority relating to supervision and examination of state banks should be transferred to the FDIC. The FDIC should be reorganized and transferred to the Treasury Department.

Authority to approve branches of state banks should rest exclusively with state authorities.

### Committee on Financial Institutions

Membership should continue to be compulsory for national banks and voluntary for state banks. All banks should, however, be subject to Federal Reserve reserve requirements and have access to the discount window.

Lending and investing alternatives should be broadened without abandoning the specialization of financial institutions. Within statutory guidelines, many detailed regulations presently in the statutes should be left to the discretion of the supervisory authorities.

Federal and state governments should review present branching legislation with a view to developing a more rational pattern while preserving competition and avoiding excessive concentration.

Existing agencies should strive for greater cooperation and coordination of regulation standards and procedures, with reviews at the discretion of the President and, if uniformity still not being achieved, consideration given other alternatives including consolidation of supervisory agencies.

---

Summary of existing regulations

---

---

Commission on Money and Credit

---

III. NONBANK FINANCIAL INSTITUTIONS

A. Reserve requirements

The Federal Home Loan Bank Board may vary reserve requirements on share capital or deposits of member savings and loan associations and savings banks between 4 and 8 per cent. Current requirements are 7 per cent and may be satisfied by either cash or U. S. Government securities. Reserve requirements for non-member institutions are determined by the respective state statutes. Reserve requirements on nonbank financial institutions are imposed primarily for liquidity purposes and need not be changed in sympathy with Federal Reserve monetary policy.

Direct Federal Reserve controls should not be extended to nonbank financial institutions.

B. Payment of interest and dividends on deposits and share capital

A few states regulate interest and dividend payments of state chartered nonbank financial institutions. Federally chartered savings and loan associations are not subject to dividend regulation.

Standby authority to regulate dividends and interest rates should be imposed on savings banks and savings and loan associations. Maximum rates need not be identical for different kinds of institutions or for different kinds of accounts.

C. Branching

State chartered savings banks and savings and loan associations are permitted to establish branches where state laws permit but only within the state of operation. Federally chartered institutions are not limited in establishing branches by Federal law. As a matter of policy, however, the Federal Home Loan Bank Board permits Federal savings and loan associations to establish branches only in those states in which state law does not explicitly prohibit other financial institutions from establishing branches.

All mutual savings banks and savings and loan associations should be permitted to establish branches within "trading" areas irrespective of state boundaries.

**BANKING**—*continued from page 3*

quately the needs of the Sixties. Since the Thirties, the economy has undergone spectacular changes. The recent investigations, therefore, have been concerned primarily with pinpointing those areas where some updating of current regulations, policies or practices may be advisable.

studies differed somewhat. The Commission on Money and Credit undertook to examine "the adequacy of the nation's monetary and financial structure and its regulation and control," while the Advisory Committee to the Comptroller (popularly referred to as the Saxon committee) was concerned primarily with the functioning of the national banks.

8 The stated objectives of the three major

The Committee on Financial Institutions



## Recommendations

### Advisory Committee on Banking

### Committee on Financial Institutions

Cash reserve requirements similar to those imposed on time and savings deposits at commercial banks should be extended to share capital at savings and loan associations and deposits at mutual savings banks.

Standby authority to regulate dividends and interest rates should be imposed on savings banks and savings and loan associations. Differentiation among accounts should be permitted according to type, holder, maturity or other characteristics.

Upon completion of a review of branching standards applicable to national banks, Federal savings and loan associations should be subject to the same standards as national banks.

was directed "to take the recommendations of the Commission on Money and Credit as a point of departure and to determine what changes, if any, are desirable in the Federal Government's approach to private financial institutions in order to contribute to economic growth and stability, remove apparent inconsistencies, inequities and impediments in the financial structure."

Selected recommendations of the three groups are summarized on pages 4-9 along with a brief statement of the relevant laws, regulations and policies currently in force. On some points, only two of the groups submitted recommendations. For the most part, only those recommendations which propose changes in the prevailing structure or legislation are included in this summary.

# The growth of industrial production

Industrial production in the United States has increased more than 80 per cent since 1947, for an annual growth rate of 4 per cent.<sup>1</sup> But in the latter part of the postwar period, between 1957 and 1962, the rise was somewhat less rapid—about 3.2 per cent per year. However, the index increased sharply in 1962 and further gains have occurred thus far in 1963.

Industrial production provides a useful

measure of short-term changes as well as longer-term growth in an important sector of economic activity. The index includes the output of factories, mines and electric and gas utilities. It does not include activity in other major industries such as agriculture, trade, transportation, construction, services and government.

The industries included in the index account directly for about 35 per cent of all economic activity. Goods and utility products—taken at the value at which they reach final users, including trade markups, transportation costs, financing and other charges—account for more than 60 per cent of total spending (gross national product).

During business cycles industrial production tends to fluctuate more than over-all activity, principally because of the rather steady growth of service industries and government. Over periods of several years, however, industrial production and gross national product adjusted for price changes have risen, more or less, proportionately.

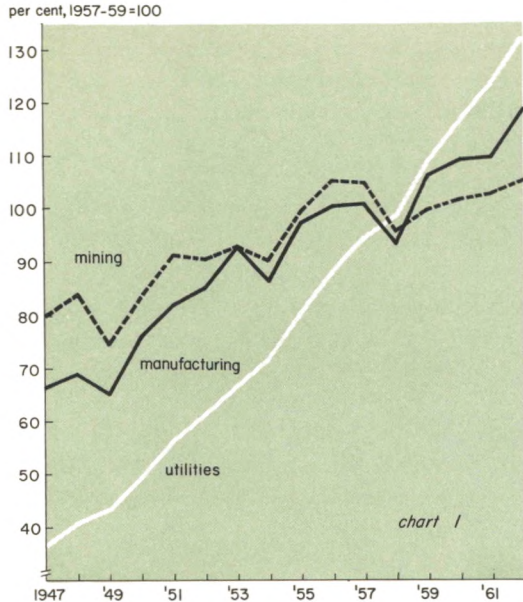
## Industry patterns vary

The postwar years have seen mixed patterns among industries as the accompanying charts indicate. Some lines, such as chemicals, have shown continuous substantial growth; some, such as business equipment, have moved upward in stages, interrupted by declines; others, such as steel and autos, have fluctuated sharply and have not regained highs set in the mid-Fifties, and still others,

<sup>1</sup>Growth rates, here and elsewhere in the article, are the compounded annual rate of rise from the beginning to the end of the period.

### What is industrial production?

The Federal Reserve Board's index of industrial production, often referred to as "the FRB index," is one of the economic barometers commonly consulted to determine the current trend of economic activity. It shows United States output in physical, as opposed to dollar terms, in manufacturing, mining and electric and gas utilities. First published in 1927, the FRB index has undergone several major revisions, most recently in 1959. Successive revisions have broadened the coverage, introduced new seasonal adjustments and taken into account changes in relative importance of various industries. The index and its components are published as percentages of the level during a base period—now the average of the years 1957-59—which is set equal to 100. Each month the index and its components are published in the *Federal Reserve Bulletin* and in the release "Business Indexes." Detailed information on the method of preparation of the FRB index along with historical data are available in *Industrial Production, 1957-59 Base* (1962, 172 pp., \$1.00 per copy) obtainable from the Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington 25, D. C.



such as coal mining, have trended downward.

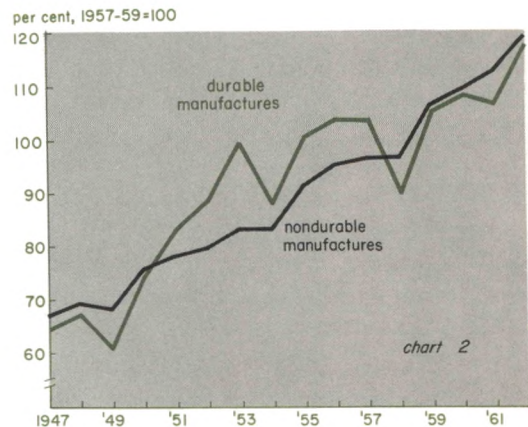
Trends in three major components of industrial production—manufacturing, mining and electric and gas utilities—are shown in chart 1. Manufacturing output has moved very closely with total industrial production; in fact, the two lines when superimposed hardly can be distinguished. There are two reasons: first, manufacturing accounts for 86 per cent of the total index and, second, the slow rise in mining has been largely offset by the rapid rise in electric and gas utilities.

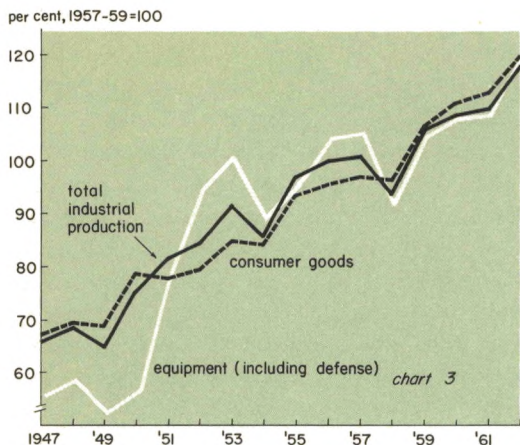
Total output of mines (including oil and gas wells as well as minerals) rose only 31 per cent between 1947 and 1962 and was virtually the same in the latter year as in 1957. Output of utilities, on the other hand, increased substantially in each postwar year and in 1962 was more than two and one-half times the 1947 level.

The contrast between output trends in mining and in utilities spotlights some of the

major features of the postwar United States economy. First, imported minerals, such as iron ore and crude oil, have been supplying an increasing proportion of consumption. Second, the most rapid growth in manufacturing has occurred in such industries as chemicals and electronics which utilize relatively small quantities of the materials produced by the extractive industries compared with the value of the final product. Meanwhile, the utilities have benefited from the strong trend toward the use of more energy per unit of goods produced and from the increasing utilization of energy in the form of electricity and natural gas—generally considered superior to coal and fuel oil for many business and consumer uses.

Within the manufacturing segment of industrial production, the rise in output of durable goods (those principally composed of metal) and nondurables (soft goods such as apparel and chemicals) has been about the same for the entire 1947-62 period (chart 2). However, in each of the years most affected by the postwar recessions—1949, 1954, 1958 and 1961—output of the hard goods declined sharply. Purchases of durables, such as autos, refrigerators or machine





tools, which involve substantial initial outlays and relatively long useful lives, often can be postponed. Most nondurables, however, must be replenished continuously.

The final products of industrial production are grouped into two categories—equipment (including defense), which accounts for one-third of the total, and consumer goods, which account for two-thirds (chart 3). Between 1947 and 1962 output of equipment rose more than output of consumer goods, partly because of the increase in military procurement starting with the Korean War. Since the mid-Fifties, the increase in output of equipment and consumer goods has been similar. Equipment output, however, dropped sharply in the 1957-58 recession in contrast with a very small decline for consumer goods.

### Rapid growth industries

Impressive gains have been scored in the postwar period in chemicals, electrical equipment and commercial equipment (chart 4).<sup>2</sup> Since 1947, output in these industries has

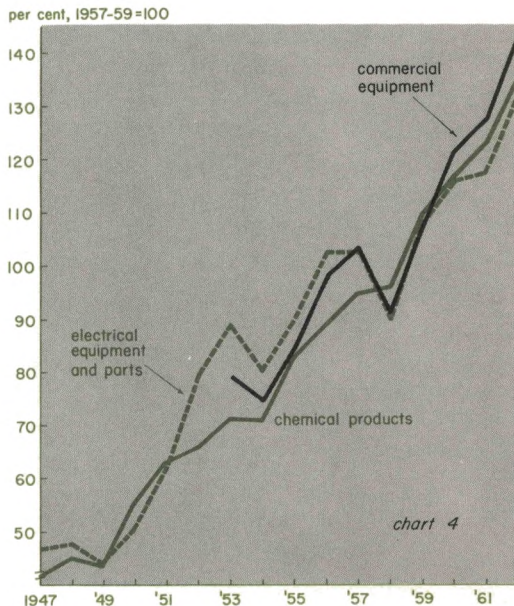
<sup>2</sup>Electrical equipment and commercial equipment include some components which are in both groups of industries.

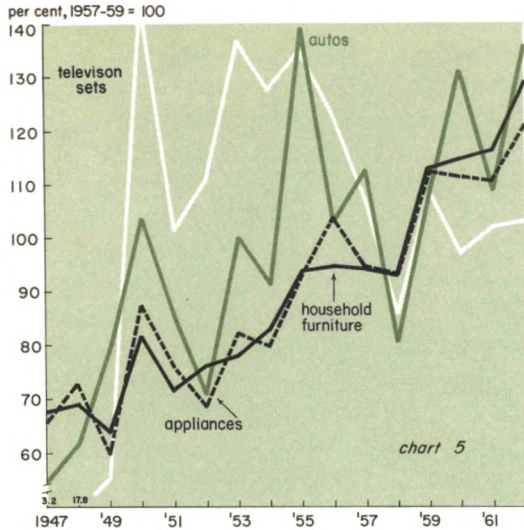
about tripled. Between 1957 and 1962 the average annual rate of growth was 6 per cent for electrical equipment and 8 per cent for chemicals and commercial equipment.

These rapidly growing industries have produced some of the most spectacular new products. Chemicals include materials incorporated into plastics, synthetic fibers, detergents and pharmaceuticals. Electrical equipment includes output of electrical generating and transmission apparatus, communications equipment and components for missiles and space exploration. Commercial equipment is highlighted by the giant computers and a broad array of other data processing machines which have mechanized many clerical jobs.

### Shifts in consumer goods

Production of consumer goods has risen fairly steadily in the postwar period with only slight setbacks in recession years. But some





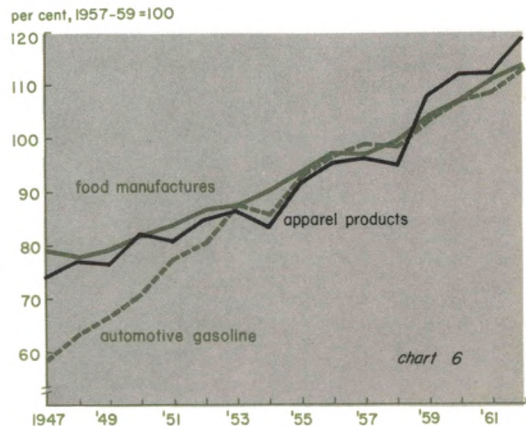
components have shown large fluctuations. Particularly good auto years—such as 1950, 1955 and 1960—have tended to be followed by years in which production declined sharply (chart 5). The postwar car market has been influenced by many special factors. These include: labor strife and other difficulties that slowed the build-up in output after VJ day; the restriction of production during the Korean War; the easing of credit terms during 1955; and the increase in imports in the late Fifties. Nevertheless, the underlying trend has been upward. Since 1947 auto output has grown almost twice as fast as total industrial production although between 1957 and 1962 the increase in autos was only slightly greater than the over-all rise.

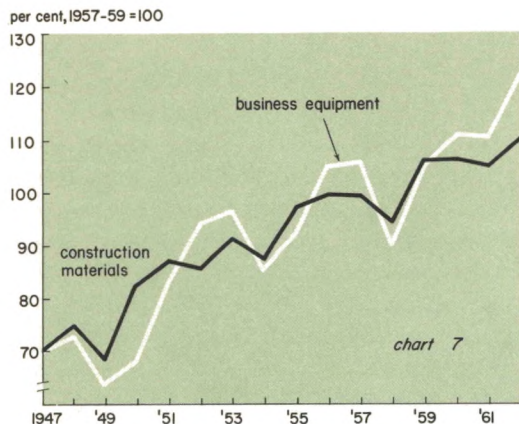
Output of all types of appliances combined has trended upward somewhat less erratically than that of autos in the postwar period, but recession years have brought substantial declines. For the entire postwar period, output of appliances has risen faster than total industrial production. Trends, however, differed for various appliances.

Although production of appliances was at a record high in 1962, most of the major types reached their individual highs, as measured by the index, some years earlier. For washing machines the peak was 1956, for refrigerators and stoves it was 1950. There has been a trend toward electric ranges with production at a record in 1962 whereas gas range production reached a high in 1948. Production of both types of stoves combined has been fairly stable for the past decade. Television output in 1962 was far below the level of the 1950-56 period when most families were acquiring their first sets.

Among the consumer hard goods, household furniture has shown the most vigorous growth since the mid-Fifties. Apparently, many families delayed the purchase of furniture until other needs such as appliances and autos had been satisfied.

In contrast with purchases of hard goods, consumer buying of less durable or perishable items has risen fairly steadily in the postwar years (chart 6). Apparel output has increased continuously with only minor reactions while processed food has followed a stable uptrend. Automotive gasoline also has gained consistently and more rapidly than





apparel or food. Output of soft goods has risen considerably faster than population, reflecting steadily improving living standards.

### Private investment

Private fixed investment has fluctuated much more than consumer purchases in postwar booms and recessions. Trends in output of business equipment and construction materials are shown in chart 7. For the entire postwar period, as well as the years since 1957, production of business equipment has risen slightly less than total industrial production. The gain in construction materials has lagged behind the total index.

While each of the postwar recessions is clearly evident, output of construction materials has tended to decline less than that of equipment. Once started, construction projects usually are completed. Moreover, credit became easier to obtain in recessions and supported various types of construction, especially housing.

Production of business equipment declined 5 per cent between July 1960 and March 1961. However, there was no decrease between 1960 and 1961 on an annual average

basis as in the case of autos and other durable goods. There were a number of reasons. The 1960 recession started in the late spring and ended in February 1961 and was relatively mild. In addition, exports of machinery and equipment rose in both 1960 and 1961.

Farm machinery and equipment production rose sharply in 1962 to the highest level in three years. Nevertheless, production remained well below the rate of the 1948-53 period when net farm income was higher and planted acreage was greater than in recent years. The trend in output of farm machinery and equipment contrasts sharply with the vigorous growth in output of the commercial fertilizers that farmers have been employing in steadily increasing amounts.

### Competition among industries

The fact that production in a number of domestic industries has trended downward after reaching a peak in the late Forties or early Fifties can be explained, in part, by the growth of competing products.

Output of wood containers has declined





substantially while paperboard production has risen sharply with short interruptions since the early postwar period (chart 9). Producers have turned increasingly to cardboard cartons in preference to wood crates.

Wool fabric production rose last year but remained far below the levels of the early postwar period when American men were restocking their wardrobes (chart 10). Man-made fabrics—nylon, dacron, acrilon and others—have taken over an increasing share of the market not only for clothing but also for carpets, upholstery and industrial fabrics. Production of cotton fabrics also has been affected by the synthetics. In contrast with wool, cotton fabric output was at a new high by a slight margin in 1962.

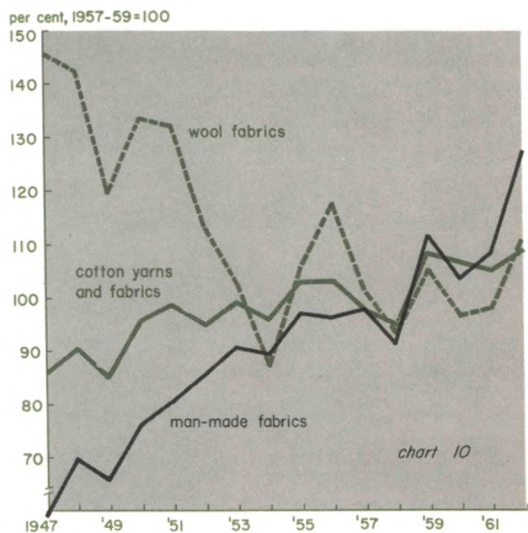
One of the most spectacular contrasts between industries is found in the trends of output of bituminous coal and natural gas (chart 11). Natural gas has been favored as a fuel not only by home owners but also by industrial plants and utilities. In addition, natural gas has been used increasingly as a raw material in the production of various chemicals and plastics for which demand has risen

sharply. The rise in natural gas, until recently at least, has been limited by the rate of expansion of transmission facilities.

Annual production of iron and steel has been fairly stable since 1959 (chart 12). Production in each of these years, however, was well below the annual average for 1950-57 for a number of reasons. Larger imports, weight-saving design and material improvements and the less rapid growth of steel-using industries relative to the rest of the economy provide part of the answer. But growth in the use of alternative materials such as aluminum and cement and plastics also has been a significant factor.

### Future production trends

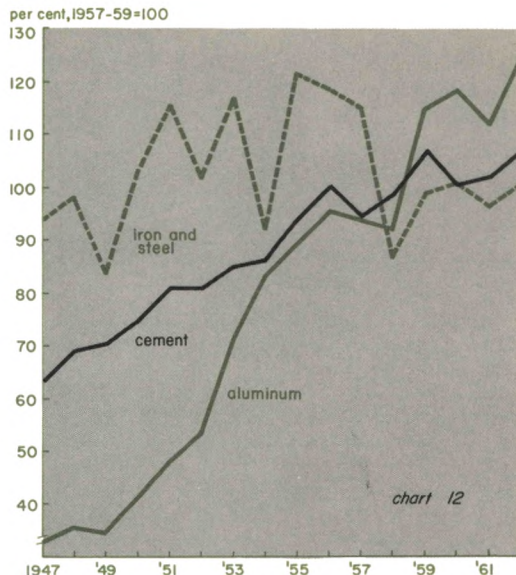
Over the postwar period the population of the United States has increased at an average rate in excess of 1½ per cent annually. During the same period industrial production has increased more than twice as fast. Only in 1949, 1954 and 1958 did output decline on a year-to-year basis. In every other post-



war year, production not only rose but reached successive record highs.

The growth of production during the postwar period has varied greatly by industry. In some there have been declines because competing products have been introduced and public requirements and private tastes have changed. Growth in total production obviously does not assure continued gains for all individual industries.

It is often suggested that the United States economy has grown at a slower rate since 1957 than in the postwar period as a whole. This is borne out by the industrial production index. However, further analysis shows that this is because of extremely rapid expansion in the early postwar years. Between 1947 and 1953 the annual rate of rise in output averaged 5.6 per cent under the stimulus of postwar backlogs of demand and, later, by the Korean conflict. For the years 1953-57



the rate of growth in output dropped to 2.5 per cent per year. But the nation was not entering a period of "stagnation." Rather, between 1957 and 1962 the annual rate of growth in industrial production increased to 3.3 per cent. The recent period shows further improvement if recognition is given to developments thus far in 1963.

Capacity to produce has increased even faster than output during the postwar period. At the end of 1962, according to a McGraw-Hill survey, manufacturing industries were operating at about 83 per cent of capacity compared with an average "preferred" rate of 92 per cent. Capacity, moreover, is expected to increase an additional 4 per cent in 1963. Clearly, there is room for a substantial further rise in output. The months and years ahead may reveal that the "flattening of the growth curve," discussed so extensively in the early Sixties, reflected mainly the temporary effects of the recessions which reached their troughs in 1958 and 1961.

