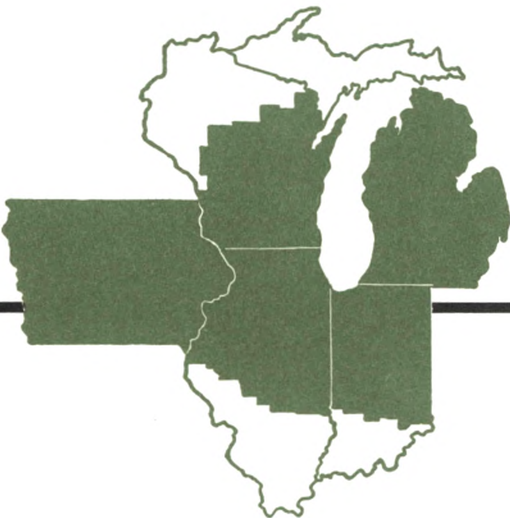
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



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Negotiable time certificates of deposit—one year later

The outstanding volume of negotiable time certificates of deposit was estimated at about 10 billion dollars at the end of 1963.[1] Although CDs, as they are popularly referred to, have been a money market instrument for only three years, their volume now exceeds that of many older short-term securities. The outstanding volume of commercial paper at year-end, for example, was only about 9 billion dollars while bankers acceptances totaled less than 3 billion dollars. This article reviews the more important developments in the CD market in the past year; earlier developments were described in the February 1963 issue of *Business Conditions*.

Briefly, CDs are receipts issued by commercial banks for funds left on deposit for a stated period of time and rate of interest. Since the beginning of 1961, CDs issued by large nationally known commercial banks in large denominations have been traded on an active secondary market. Thus, while the issuing banks are assured that the funds will remain on deposit until the date of maturity, the holder of the certificate may reacquire his funds at any time by selling it.

Since banks can vary the interest rates offered on new CDs quite readily, they can control quite closely the amount of funds acquired in this way. By raising its rates above current market rates, an individual bank can attract additional deposits; by decreasing rates, it can reduce deposit inflows.

The flexibility in selling CDs contrasts with the relative inflexibility in acquiring both demand and savings deposits. Demand deposits are acquired largely through the concurrent extensions of loans or purchases of investments, while passbook savings are normally accepted continually at an advertised interest rate that is changed only infrequently.

In addition, the development of the CD has greatly increased the ability of large banks to attract deposits from beyond their normal

[1]In this article reference is made only to those certificates in denominations of at least 100,000 dollars, the minimum unit which can generally be traded on the secondary market.

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CORRECTION: In "Banking Trends" on page 9 of the January issue of **Business Conditions**, it was incorrectly stated that the increase in margin requirements from 50 to 70 per cent lifted "from 30 to 50 per cent the proportion of purchase price provided by share buyers." This should read "lifted from 50 to 70 per cent."

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service areas thus reducing their dependency on local areas for deposit growth.

Since CDs generally are issued in denominations of 1 million dollars while deposit insurance is limited to 10,000 dollars of the account of any one depositor, holders of CDs have a strong interest in the financial strength of the issuing banks. As a result, CDs are issued primarily by the larger, more widely known banks in major financial centers.

Large banks in the Second Federal Reserve District, which includes New York City, accounted for 44 per cent of the CDs outstanding at the end of 1963. Large Seventh District banks—primarily in Chicago and Detroit—accounted for another 13 per cent, while banks in the Fourth (Cleveland and Pittsburgh), Eleventh (Dallas) and Twelfth (San Francisco and Los Angeles) Districts accounted for 26 per cent. The remaining 17 per cent of the outstanding CDs were scattered among large banks in the other seven Reserve Districts.

Banks continued to make increasing use of CDs during 1963 to acquire time deposits. The volume of outstanding CDs issued by large banks in leading United States cities increased 4.2 billion dollars in 1963, or more than 75 per cent. By year-end, CDs, which had accounted for only a negligible percentage of deposits three years earlier, accounted for 16 per cent of time and savings deposits at these banks and 7 per cent of their total deposits. For large New York City banks, the increase in CDs during the year represented about three-fifths of the rise in all time and savings deposits at these banks and almost half of the increase in total deposits.

Maximum and quoted interest rates on new CDs[1]

	December 31, 1962		December 31, 1963	
	Maximum	Quoted[2]	Maximum	Quoted[2]
	(per cent)			
Initial maturity:				
30-89 days	1		1	
90 days but under 6 months	2½	2½	4	3¾-⅞
6 months but under 1 year	3½	3-⅜	4	3⅞
1 year or more	4	3¼-⅜	4	3⅞-4

[1]Official foreign deposits are exempted from interest rate ceilings.

[2]Large New York City and Chicago banks.

Since CDs do not have the absolute security of U. S. Governments and are a relatively new type of money market instrument, they yield somewhat higher interest rates than Government securities of comparable maturity. For CDs issued by the country's very largest and best known banks, this spread generally averages from 20 to 40 hundredths of a per cent.

With the increase in the Federal Reserve discount rate from 3 to 3½ per cent in mid-1963 and the concurrent sharp rise in short-term interest rates, the CD market received its first major test in its short three-year history. The rise was accompanied by an increase in the maximum interest rates commercial banks were permitted to pay on 3 to 12 month deposits to 4 per cent, the same limit as existed on funds on deposit for one year and over.

Maximum permissible interest rates at the end of 1962 are shown in the accompanying table. Because yields on Treasury bills with less than six months to maturity exceeded the ceiling rates banks were permitted to pay,

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banks were effectively precluded from selling CDs in this maturity range. The interest rate structure did, however, permit banks to issue CDs with six or more months to maturity and at the end of 1962 almost 90 per cent of the certificates outstanding had been issued with maturities of from 6 to 12 months.

Although CDs of less than six months to maturity could not be bought directly from banks at competitive interest rates, passage of time made such CDs available on the secondary market at interest yields above those banks were permitted to pay. Investors who did not wish to buy CDs with over six months to maturity could therefore purchase shorter-term issues on the secondary market. Transactions involving such short-term CDs accounted for a large proportion of the volume of trading on this market.

Trading on secondary market falls

Raising the interest rate ceiling on three-to-six-month deposits to the same level as on longer-term deposits permitted banks to offer CDs of short maturities and eliminated the need of investors to go to the secondary market. In addition, the rise in market interest rates had the effect of reducing the market values of outstanding CDs and some investors who normally would have sold CDs before maturity chose instead to hold them to maturity rather than accept a loss. As a result, the volume of trading on the secondary market declined sharply after midyear.

The adjustment of the CD market to the abrupt rise in interest rates was, as may have been expected from its brief existence, somewhat more sluggish than that of the Treasury bill market. The spread between interest rates on three-month CDs on the secondary market and rates on Treasury bills narrowed sharply in July and remained narrow until October. During these months, the volume of transactions on the secondary market declined to a very low level. Since October, volume has picked up somewhat with most of the activity concentrated in time certificates with less than three months to maturity.

In contrast to the fall-off in trading on the secondary market, the volume of CDs outstanding rose sharply following the midyear hike in the rate ceiling and a concurrent strengthening of loan demand. CDs outstanding at large New York City banks, for example, increased 57 per cent in the second half of 1963, compared with an increase of only 17 per cent in the first six months. By the end of 1963, large New York City and Chicago banks were again quoting rates on CDs very close to the 4 per cent maximum rate permitted on time deposits.

If short-term interest rates were to climb further and the present maximum rates on time deposits were to remain in effect, banks could be expected to experience difficulty in selling additional CDs and in "rolling over" maturing CDs. First to feel such effects would be the banks large enough to issue CDs in denominations of 1 million dollars (the standard trading unit) but not large enough to have a nationwide reputation among investors.[2] These banks must generally offer somewhat higher interest rates on their CDs than the very largest banks. Continued increases in interest rates without a change in the ceiling rate, however, would reduce the ability of all banks to acquire time deposits through the sale of CDs.

Developments in the CD market during 1963, including the adjustment to shifts in interest rates, reflect both continued strength-

[2]Because large corporations, the chief buyers of CDs from the banks, rarely hold large balances at small banks, small banks have been little effected by the introduction of negotiable CDs. CDs have tended primarily to increase the competition for time deposits among the larger banks.

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ening and broadening of the market. The instrument has attained an important and seemingly permanent position as both a source of bank deposits and a high-grade money market instrument. Last year's article concluded that ". . . the dollar amount of CDs outstanding may be expected to expand at a rapid pace until either banks no longer wish to attract additional deposits or market interest rates rise to a level where banks are effectively precluded by legal interest rate ceilings from offering competitive rates." Events in the past year give little reason to alter this conclusion.

THE Trend OF BUSINESS

A new look at the Sixties

The current economic expansion is three years old this month—relatively long-lived as compared with most upswings of activity in past decades. Nevertheless, the common expectation is that the business trend will continue upward for a large part, perhaps all, of this year.

Extravagant projections for economic growth in the Sixties had been publicized widely just before the period began. But a general business downturn developed unexpectedly in the very first year of the new decade after the shortest expansion of the post-World War II period. Despite an early and vigorous reversal of the 1960-61 recession, it has been common ever since to lament the "failure of the soaring Sixties" to materialize. But an examination of evidence now available suggests that this assessment was premature.

The end of the current year will mark the midpoint of the Sixties. Although the statistics are not complete for 1963, an evaluation of the first four years of the decade is now possible. Analysis of the period is facilitated by the fact that the initial year, 1960, provides a good base for comparison because it was characterized by neither boom nor depression. Most measures of activity rose in the first half of 1960 and declined moderately in the latter months of the year. The pattern was similar to those of 1948, 1953 and 1957. Each of these years was generally prosperous and witnessed new record highs for economic activity, although recessions of greater or lesser severity were in progress well before year-end. In each case the downswing was arrested and reversed in the following year.

Comparisons of economic change over given time spans are subject to question if starting and closing dates are arbitrary in some degree. Activity may be artificially high or low at a given time for a variety of reasons —strikes, war scares and the like—with compensating developments in succeeding months. Moreover, there are difficulties in

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adjusting data adequately for seasonal patterns that may shift over time. When yearly totals or averages can be used for comparisons, these data problems are mitigated substantially.

It is possible now to compare changes in economic measures between the whole years 1960 and 1963 with developments in the comparable periods 1948-51, 1953-56 and 1957-60 (see the table on page 7).

It will be noted that output and employment increased substantially more in the 1960-63 expansion than in either of its two immediate predecessors. There was a larger increase in the 1948-51 period, but this was accompanied by war and inflation.

There is little difference among the four expansion periods in terms of increases in output per man-hour in manufacturing. Substantial increases in corporate profits after taxes in the 1953-56 and 1960-63 periods contrast with declines in 1948-51 and 1957-60. The record for price stability is favorable for the recent period, especially wholesale prices.

The persistence of relatively high unemployment in the recent expansion is well known. There has been a trend toward higher rates of unemployment in each of the four expansion periods except the first. In 1951, with the Korean War in process, the unemployment rate averaged 3.3 per cent compared with 3.8 per cent in 1948. For the other periods under review the percentages were as follows:

	First year	Last year
	(per cent)	
1953-56	2.9	4.2
1957-60	4.3	5.6
1960-63	5.6	5.7

Estimates of unemployment for Seventh District states are available for the recent expansion period. In each state the estimated rate of unemployment was *lower* on the average in 1963 than in 1960 in contrast with the national experience.

	1960	1963
	(per cent)	
Illinois	4.6	4.4
Indiana	5.3	4.1
Iowa	3.1	2.7
Michigan	6.8	5.3
Wisconsin	4.1	4.0

This improvement in District unemployment since 1960 apparently reflects outmigration and withdrawals from the labor force, as well as increased employment, since the rise of employment has not been as great in this region as in the nation as shown in the table on page 8.

While growth in nonfarm employment has lagged the national rate in all District states in recent years, the difference has been relatively small in Indiana, Iowa and Wisconsin. In Illinois and Michigan average employment in 1963 was only slightly higher than six years earlier.

Slower employment growth in the Midwest may result from larger increases in output per man-hour in the major industries of this area than in the economy as a whole. The five Seventh District states, with 17 per cent of the nation's nonfarm employment, have 62 per cent of the motor vehicle workers and about one-third of those producing steel, appliances and television, and business equipment, including farm and construction equipment. Except for steel, increases in output of these industries prominent in the Midwest have compared favorably with those for total manufacturing.

Has the growth rate slowed?

The decade of the Sixties may be compared with the earlier postwar periods in terms of compounded percentage rates of

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growth. In this manner the average performance of the 1960-63 period can be measured against the longer span, 1948-60. The reason for selecting 1948 rather than 1946 or 1947 as the starting point is that the earlier years were distorted by sharp price inflation and shortages and maladjustments resulting from the turmoil of conversion from war production and military service to civilian needs.

Compounded annual growth rates

	1948-60	1960-63
	(per cent)	
Gross national product in constant dollars	3.4	3.9
Industrial production	3.9	4.6
Nonfarm wage and salary employment	1.6	1.7
Output per man-hour in manufacturing	3.3	3.7

Judged in this manner the decade of the Sixties thus far shows an appreciably higher average growth rate for output and output per man-hour than the 1948-60 period. Nonfarm employment has increased slightly more rapidly. Certainly the nation has its problems in 1964, but these cannot be attributed to slower economic growth in the Sixties. In fact, growth appears to have accelerated. If optimistic forecasts for the current year are achieved, the record of the first half of the current decade will appear even more favorable.

One little noticed factor that has aided growth in output and output per man-hour in recent years has been the absence of major strikes. In the years 1948 through 1959 an annual average of 39 million man-days were lost because of strikes, not counting secondary layoffs by firms that buy or sell goods and services to those involved in labor disputes. In the four-year span, 1960-63, the annual number of idle man-days caused by strikes averaged less than 18 million.

The data on idle man-days understates the importance of the improvement in labor-management relations in recent years. First, since employment averaged 23 per cent more in the recent period than in the earlier one, the ratio of man-days lost because of strikes to total man-days worked declined almost 60 per cent. Second, when there were long strikes in basic industries such as steel or railroads, a large but unknown number of additional man-days were lost because of secondary layoffs caused by shortages of supplies or services.

Selected economic measures in five business cycles

	1948–51	1953–56	1957–60	1960–63	1948–63
			(per cent change)		
Gross national product in constant dollars	16.6	8.6	7.7	12.1	67.9
Industrial production	18.9	9.4	7.9	14.4	81.7
Nonfarm wage and salary employment	6.6	4.3	2.8	5.1	27.3
Output per man-hour in manufacturing	11.6	10.4	10.8	11.5	64.7
Consumer prices	8.0	1.6	5.2	3.5	27.3
Wholesale prices	10.0	3.8	1.7	−0.4	14.1
Corporate profits					
Before tax	27.9	16.7	2.5	19.7*	60.6*
After tax	− 3.9	29.8	− 1.3	22.3*	31.2*

*Adjusted for introduction of tax credit on equipment purchases and new depreciation guidelines.

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Growth rate can be accelerated

Although the record of the Sixties compares favorably with the earlier postwar period, further improvement is both possible and desirable. Some factors are almost certain to work to this end; others will do so if circumstances are favorable.

Output is determined by the degree to which our potential labor force and facilities are utilized and the efficiency with which these resources are employed. Employment can rise through a reduction in unemployment to more acceptable levels and, even more, by an increase in the participation rate of the potential labor force which has been declining since 1956. Reduction of the rate of unemployment from the 5.7 per cent average of 1963 to the commonly accepted goal of 4 per cent would have increased average employment by 1.2 million. An increase in the labor force participation rate to the 1956 level would have added 2.6 million workers, mainly in the youngest and oldest groups.

In part the reduced labor force participation rate reflects longer schooling and earlier retirement. Moreover, changes in production techniques have increased the difficulties of matching workers' skills and employers' needs. Nevertheless, many persons, not now counted as unemployed, would obtain jobs if effective demand increased rapidly.

The vastly expanded outlays on research and development and training of technicians in the past 10 to 15 years is paying off increasingly in terms of improved production processes and better products. And the proportion of total resources devoted to research and education continues to rise.

Efforts to reduce those Government expenditures, not deemed to be sufficiently productive, also would aid efficiency if any resulting slack is taken up by private outlays. Perhaps the most likely development in the sphere of Government would be a reduction in military outlays and personnel.

Growth in production would be promoted by measures that help maintain or establish competitive conditions and thereby broaden markets for both goods and labor. Competition may be encouraged also by removing or mitigating barriers to trade between nations. Domestically, benefits can accrue from measures to help upgrade skills, increase mobility and reduce hurdles that impede employment because of age, sex or race.

Many of the paths to more rapid growth are difficult to follow. But it is clear that the number of young people reaching working age is increasing. Between 1950 and 1960 the number of persons 18 to 25 years of age rose about 100,000. In the decade of the Sixties the number in this age bracket will increase more than 8 million. If the economy can provide training and jobs for these individuals, total employment and total output will accelerate. If not, unemployment will grow substantially, and billions of dollars of potential output will be lost.

Nonfarm wage and salary employment

	U. S.	Illinois	Indiana	Iowa	Michigan	Wisconsin
			(per cent change)			
1948–51....	6.6	2.8	10.3	5.9	8.2	5.5
1953–56....	4.3	2.8	−1.1	2.7	−0.7	4.6
1957–60....	2.8	−1.1	1.6	3.8	−1.1	3.5
1960–63....	5.1	2.6	4.6	2.9	1.2	3.4
1957–63....	8.0	1.5	6.3	6.9	0.1	7.0
1948–63....	27.3	12.5	22.0	17.3	13.6	21.5

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