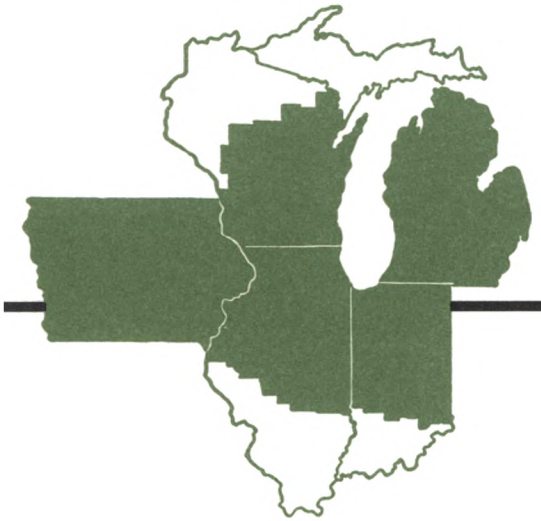
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1964 June

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THE Trend OF BUSINESS

Output growth leads employment gains

Industrial production in the United States averaged 6 per cent above the level of a year earlier during the first quarter while total spending on goods and services (GNP) was up 4 per cent and nonfarm employment was up almost 3 per cent. These increases were larger than those recorded from the first quarter of 1962 to the first quarter of 1963.

Expansion has continued in the second quarter. Output of manufactured goods in April was 5.8 per cent above the level of a year earlier while total employment of manufacturing firms was up 1.5 per cent. Part of the difference in the growth of output and employment reflects a somewhat longer average week for production workers—40.6 hours compared with 40.1—but the major factor has been a continuance of the rapid increase in output per man-hour that has been in evidence for the past several years.

Increases in output during the past year have occurred in virtually all industries, and most manufacturing centers have reported some rise in employment. Nevertheless, there have been pronounced differences in trends among industries and localities.

The materials breakthrough

Convenient "basing points" for longer-term comparisons are the first quarters of 1957 and 1960, both periods of record levels of activity. The major "special" factor in early 1957 was a high rate of crude oil output associated with the Suez crisis while in early 1960 steel production was abnormally high because of restocking following the 1959 strike. In neither case, however, did these special factors dominate trends in the economy as a whole.

The first quarter of 1957 marked the beginning of a new era for the economy. Before then and as far back as Pearl Harbor, physical output had been limited in times of heavy demand by the nation's capacity to produce steel, aluminum, copper, cement and other basic materials. Major programs to expand productive facilities for these goods were nearing completion early in 1957. Total out-

BUSINESS CONDITIONS is published monthly by the Federal Reserve Bank of Chicago. George W. Cloos was primarily responsible for the article "The trend of business—Output growth leads employment gains," Dorothy M. Nichols for "Trends in banking and finance" and Charlotte H. Scott for "Slowing in savings deposit growth and turnover?"

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, Illinois 60690.

Nonfarm wage and salary employment in the United States

	First quarter average			
	1957-64	1960-64	1961-64	1963-64
	(per cent change)			
Total nonfarm	**9.6**	**6.7**	**8.3**	**2.8**
Mining	—25.0	—13.9	— 7.8	— 1.1
Contract construction	4.1	7.3	11.0	5.7
Manufacturing	— 1.3	0.4	6.6	1.7
Transportation and public utilities	— 7.7	— 2.4	0.8	1.6
Wholesale and retail trade	11.2	6.6	7.2	3.0
Finance, insurance and real estate	18.6	10.1	7.6	2.5
Service and miscellaneous	27.4	16.6	13.6	4.5
Federal Government	5.6	3.4	4.9	— 0.4
State and local government	39.6	20.6	14.9	4.3

put of business equipment began to decline in the second quarter of the year—several months before a general recession began.

Large blocks of new capacity came "on stream" in early 1957. Meanwhile, output of most major materials had peaked in 1956 and the highwater mark for steel was—and remains—1955.

The overall performance of the economy in the past seven years has not been completely satisfactory, with the period marred by two recessions and an excessively high rate of unemployment. Nevertheless, sizable increases have occurred in output, employment and income while prices of commodities, overall, have been relatively stable and the provision of additional "elbow room" has helped most businesses to improve the quality of their products and the efficiency of their processes. The picture is even more impressive for the period since 1959 which has included only a very moderate recession and no major strikes.

Seven years of plenty

The rate of growth of the American economy from the first quarter of 1957 to the first quarter of 1964 is almost exactly the same whether measured by industrial production (based on physical volume, output of factories, mines and electric and gas utilities) or by deflated gross national product (the value of total purchases of goods and services adjusted for price changes). This also holds true for the period from early 1960 through the first quarter of 1964. Over the seven-year period the rise was 25 per cent; in the shorter time span, 15 per cent. Activity rose at an annual rate of 3.2 per cent for the seven-year period —2.9 per cent from 1957 to 1960, accelerating to 3.5 per cent from 1960 to 1964.

Nonfarm employment in the nation has risen 9.6 per cent since 1957 and more rapidly (6.7 per cent) since early 1960. Employment increases have been greatest in state and local government, wholesale and retail trade and service industries other than public utilities (see the table on page 3). In the case of manufacturing, employment averaged slightly less in the first quarter of 1964 than seven years earlier while employment in mining and the transportation and public utility industries was substantially less.

Many manufacturing categories have had substantial increases in output in recent years with only modest increases and in some cases decreases in employment. These developments imply rapid growth in output per worker, resulting from new equipment, new

techniques, improved management and a better trained, more experienced work force. For manufacturing as a whole, a small part of the rise in output has reflected an increase in the average length of the workweek for production workers. The average week in such major Midwest industries as motor vehicles and steel was not appreciably different in the periods selected for comparison. These trends are shown in the table on page 5.

In every major manufacturing industry, output has risen strongly relative to employment whether comparisons are made for the past year, the past four years or the past seven years. Spectacular examples are found both in hard and soft goods lines. Output in the motor vehicle industry in the first quarter of 1964 was 34 per cent above the level of the same period of 1957 while total employment was 6 per cent less. Textile mills were turning out 23 per cent more goods with 11 per cent fewer people. Nonelectrical machinery output was 21 per cent higher while employment was off 4 per cent. The chemical industry had increased employment 8 per cent, but output had risen 66 per cent!

How fares the Midwest?

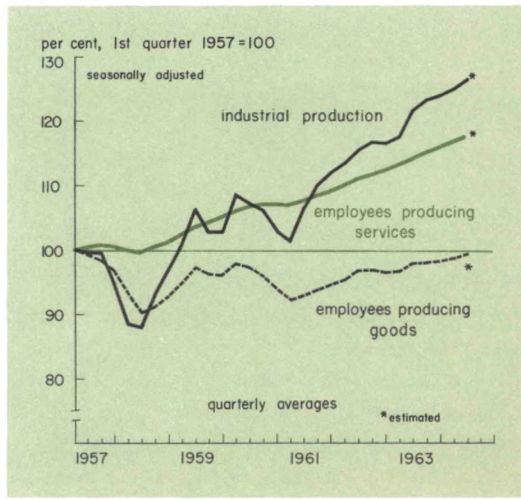
Measures of physical output are not available for regions or states. Employment data comparable to the national figures, however, are published for all states. Because major industries in the Seventh Federal Reserve District include leading firms that have engaged in large-scale expansions and renovations in recent years, it seems plausible that changes in output per man or per man-hour in the industries of this region have been similar to those for the nation.

Except for Iowa, the states of the Seventh District have a relatively larger proportion of employment in manufacturing than does the United States as a whole. Also with the exception of Iowa, there is relatively greater concentration in this region on durable goods —mainly those made principally of wood or metal.

United States	First quarter average 1964 Ill.	Ind.	Iowa	Mich.	Wis.
	(per cent)				
Manufacturing employment to total nonfarm wage and salary employment					
30	34	41	26	41	38
Manufacturing employment in durable goods					
57	65	75	55	80	65

The nature and importance of durable goods production to the local economies varies substantially among the states of the Seventh District. No state approaches Michigan in terms of dependence upon a single industry. Motor vehicles directly account for 36 per cent of Michigan's manufacturing employment and inclusion of workers in primary

Output of goods
has risen more than employment in goods producing industries



Output and employment in selected United States manufacturing industries

	First quarter average			
	1957-64	1960-64	1961-64	1963-64
	(per cent change)			
Total manufacturing				
Employment	— 1.3	0.4	6.6	1.7
Output	25.6	15.2	25.2	6.5
Iron and steel				
Employment	—19.2	—15.6	7.6	4.7
Output	— 9.0	—13.1	45.8	10.1
Nonelectrical machinery				
Employment	— 4.3	3.2	10.5	3.8
Output	21.0	22.6	33.2	9.8
Electrical machinery				
Employment	15.5	5.1	8.0	— 1.8
Output	29.0	14.7	22.9	3.1
Motor vehicles				
Employment	— 6.1	0.5	24.0	5.7
Output	33.5	12.1	58.6	7.2
Clay, glass and stove				
Employment	2.0	0.1	7.7	3.9
Output	23.2	11.9	20.0	8.3
Textile mills				
Employment	—10.8	— 5.2	1.2	0.4
Output	22.6	10.5	21.7	4.9
Apparel				
Employment	7.7	4.7	8.7	2.2
Output	36.6	17.2	24.8	7.6
Paper and products				
Employment	9.6	4.3	5.0	1.5
Output	34.1	18.8	19.8	5.3
Chemicals and products				
Employment	8.2	6.1	6.5	2.1
Output	65.9	34.7	33.4	8.8
Foods and beverages				
Employment	— 4.6	— 3.0	— 2.5	— 0.7
Output	23.7	13.2	10.0	3.8

metals, fabricated metals and machinery firms—products utilized in large part by the motor vehicle firms—would greatly increase this proportion. In Illinois, 30 per cent of all employees in manufacturing are in electrical or nonelectrical machinery. More than 45 per cent of all manufacturing workers in Indiana are in three groups: primary metals (mainly steel), electrical equipment, and transportation equipment (mainly motor vehicle parts). In Iowa more than 20 per cent of all manufacturing workers produce nonelectrical machinery (mainly agricultural equipment). The heaviest concentration in Wisconsin also is in nonelectrical machinery (especially heavy capital goods) which accounts for over 20 per cent of the state's total manufacturing employment.

Seventh District states have some relatively important nondurable goods industries. These include food processing in Illinois, Iowa and Wisconsin; paper products in Wisconsin and printing in Illinois. These industries are not greatly influenced by general business fluctuations. Most of the durable goods industries important to the District, however, are highly volatile fluctuating markedly over the business cycle.

From the recession low in early 1961 to the first quarter of 1964, employment increases were greater in Michigan and Indiana than in the nation. During the past year, moreover, employment increased about as rapidly in these states as in the nation. In Illinois, Iowa and Wisconsin, however, increases—both from the 1961 low and from the year-ago level—have been somewhat less than for the nation.

When comparisons of recent levels of total nonfarm employment are made with the corresponding periods of 1957 or 1960, it appears that each of the five District states has lagged the national growth of employment. For Indiana, Iowa and Wisconsin growth over the past seven years was not far behind the national increase of 10 per cent. In Illinois, however, employment in the first quarter averaged only 1 per cent above the 1957 level while in Michigan—despite relatively

large gains in the past three years—employment averaged 4 per cent *lower* than in the earlier period.

For the most part, employment changes in individual manufacturing lines in the Midwest have followed national trends during the past seven years. One reason for the relatively slower growth of the Midwest is found in the fact that durable goods manufacturing is relatively more important here. During the past seven years, employment in durable goods manufacturing for the nation has declined 3 per cent while nondurable goods firms have increased their employment by about one-half of 1 per cent. Another factor is the shift in defense work from the more prosaic products of the Midwest to the electronics-space-missile complexes of the West, East and South. But some important Midwest industries also in non-military lines have lost position during the past several years.

Employment in Michigan's motor vehicle industry was 18 per cent below the level of seven years ago in the first quarter, compared with a 6 per cent decline for the nation. The downtrend in Michigan's share of auto industry employment appears, however, to have been interrupted. In early 1957 Michigan accounted for 52 per cent of employment in the motor vehicle industry; by 1960, this share had dropped to 44 per cent, but thus far in 1964 has been 46 per cent.

Food processors in Illinois reduced employment 13 per cent from early 1957 to early 1964, as against a decline of only 5 per cent for the nation, mainly because of a continued exodus of meat packing from Chicago and East St. Louis. Illinois also has substantial employment in furniture, building materials, electrical equipment, apparel and printing. In each of these lines employment, nationally, now is appreciably above the level of early 1957. For Illinois, however, employment in these industries is below the level of seven years ago, except for printing where the number of workers has been approximately stable.

The other important industrial states of the District, Indiana and Wisconsin, have lost some ground relative to the nation since 1957, but in the vital machinery industries their declines have not been of great significance. Indiana's proportion of employment in motor vehicles has slipped since 1957, but Wisconsin's has increased considerably. In recent months, however, layoffs have been announced in Wisconsin by the state's principal manufacturer of autos even though the industry in general has been maintaining production and employment.

In Iowa, employment in both electrical and nonelectrical machinery is up more than 20 per cent from seven years ago—a much stronger performance than that for the nation. Relative improvement has not continued in the past year, however, when employment changes in these industries have been very close to those of the nation. Manufacturing in Iowa continues to be relatively small, accounting for only 26 per cent of nonfarm wage and salary employment. This compares with 41 per cent in both Michigan and Indiana.

One promising note for the Seventh District states is the relative growth of the primary metals industries, which include both iron and steel and nonferrous metals. In the first quarter of 1964, employment in primary metals was below the level of seven years ago almost everywhere, mainly because of productivity gains. Declines ranged from 7 per cent in Indiana to 10 per cent in Wisconsin. But for the nation the reduction during this period was 16 per cent.

All District states have improved or at least held their positions in the primary met-

Nonfarm wage and salary employment in the United States and Midwest

	First quarter average			
	1957-64	1960-64	1961-64	1963-64
		(per cent change)		
United States				
Total employment ...	9.6	6.7	8.3	2.8
Goods producing[1] ...	— 1.5	0.8	6.7	2.1
Service producing[2] ...	17.0	10.3	9.2	3.2
Illinois				
Total employment ...	1.0	2.4	5.0	2.0
Goods producing[1] ...	— 9.4	— 3.6	3.9	2.0
Service producing[2] ...	8.9	6.6	5.7	1.9
Indiana				
Total employment ...	6.8	5.2	9.2	2.6
Goods producing[1] ...	— 2.9	0.6	10.5	2.6
Service producing[2] ...	16.3	9.4	8.2	2.5
Iowa				
Total employment ...	7.5	4.5	3.9	2.1
Goods producing[1] ...	3.0	1.5	3.0	2.1
Service producing[2] ...	9.5	6.4	4.1	1.9
Michigan				
Total employment ...	— 3.7	2.4	10.6	2.7
Goods producing[1] ...	—13.8	— 2.2	15.7	2.9
Service producing[2] ...	6.5	6.3	6.5	2.3
Wisconsin				
Total employment ...	6.8	3.7	6.9	1.9
Goods producing[1] ...	— 3.1	— 2.5	7.2	1.0
Service producing[2] ...	15.2	8.7	6.8	2.9

[1]Includes manufacturing, mining and contract construction.
[2]Includes transportation, public utilities, trade, finance, other services and government.

als industries since early 1960 and also during the past year. A major element in this development has been the relative growth in steel output in the Chicago and Detroit areas. In 1957 these steel centers produced 27 per cent of the nation's total. By the first quarter of 1964 this proportion had risen to 31 per cent. Large-scale expansion and modernization plans now under way in both the Chicago and Detroit areas indicate that the District's proportion of the nation's steel production will continue to grow and thus the great steel consuming industries of the region will be served with increasing efficiency.

Further growth needed

Increases in employment are projected for most Midwest areas in the months ahead. Some areas will benefit from the fact that capital goods firms are increasing output more rapidly than total output in the nation. In many cases these firms are handicapped by a lack of trained personnel needed to perform skilled tasks.

Shortages of semi-skilled and unskilled workers are reported in some instances. At least one large steel firm, for example, has found it difficult to hire all the semi-skilled men it requires.

Where local conditions are heavily influenced by trends in motor vehicles, the prospects for further gains are less favorable because output now is at a very high level and is not likely to be exceeded appreciably through the remainder of the year. Seasonal reductions are in prospect for July and August when model changes begin. On the other hand, virtually all centers report that the supply of suitable office and service workers is relatively tight.

Despite the slower growth in employment during the past several years, labor departments of all Seventh District states estimate their unemployment rates to be less than the national average. In April only one Midwest area, South Bend, was classified as having a "substantial labor surplus" (more than 6 per

cent of the labor force unemployed) while there were 38 such areas elsewhere in the nation. Moreover, seven of the nation's 17 centers with unemployment rates below 3 per cent were in the District. These were the Davenport-Rock Island-Moline area, Cedar Rapids, Des Moines, Flint, Lansing, Muskegon and Madison.

Trends in banking and finance

Commercial bank loans have risen roughly 40 billion dollars—an increase of almost one-third—in the past three years of business expansion. If there is an acceleration in the expenditures of businesses and consumers during the second half of 1964, the accompanying demands for credit will be added to the normal seasonal increases. Loan expansion during the second half of each of the past three years has averaged 9.5 billion dollars.

Both the magnitude of loan demands and the ease with which the banks are able to meet them will have an impact on the credit and securities markets. Should banks find it necessary to liquidate a sizable amount of investments in order to meet loan demands, upward pressure on interest rates would be likely to develop.

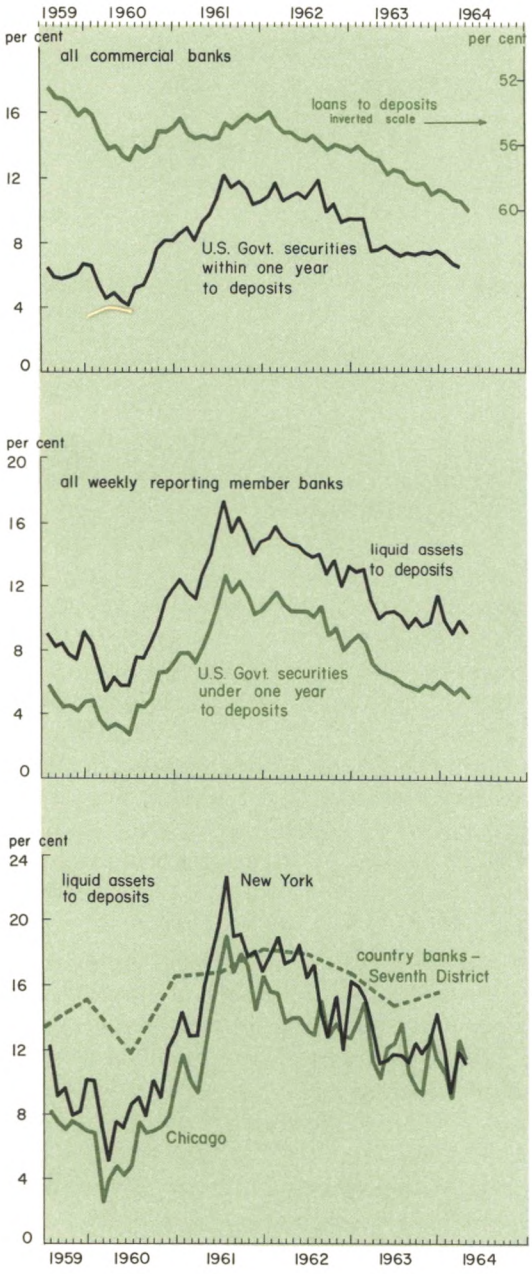
Liquidity a factor

Ability to mobilize funds quickly to meet either loan demands or deposit withdrawals is the essence of bank liquidity. Liquidity can come from many sources—short-term investments that mature soon or can be sold with little market loss, inflows of cash from loan repayments and new deposits, cash assets in excess of required amounts and even the ability to borrow. While the individual bank possibly can construct a reasonable picture of its own liquidity position, liquidity is very difficult to measure for the banking system. Two ratios often used as approximate measures are shown in the top panel of the accompanying chart. The upper line represents the relation of loans to deposits and the lower line the ratio of short-term U.S. Government securities to deposits for all commercial banks. The loan ratio is plotted on an inverted scale so that both lines reflect the direction of change in liquidity.

The loan-deposit ratio is related to liquidity only in an indirect way. On the assumption that loans are nonliquid assets, a proportionate rise in loans implies a proportionate decline in other items assumed to be more liquid. There is clearly an upward long-term trend in loans as a percentage of deposits; temporary shifts have been attributable more to periods of rapid increase in deposits than to reduction in loans.

Not all non-loan items are, in fact, liquid, but Government securities maturing within a year can be easily turned into cash through either sale or redemption. In addition, such items as Federal funds sales and one-day

"Liquid asset" ratios near mid-1959 levels



loans to securities dealers as well as the ability to buy Federal funds, borrow and even offer negotiable certificates of deposit at rates that will attract time money are important elements of liquidity to some banks. These may move inversely with holdings of short-term Governments, especially over fairly short periods. For the banking system as a whole, however, the effects of these factors tend to cancel out or be fairly constant over time so that they do not importantly distort short Governments as a measure of changes in the liquidity of the banking system.

The center panel of the chart compares the short-term Government securities ratio for the weekly reporting member banks in leading United States cities with a measure that includes certain other identifiable sources of liquidity—the latter consist of loans to securities dealers, loans to domestic commercial banks (Federal funds sales) and balances held with other commercial banks *less* borrowings both at the discount window and from other sources. For all weekly reporting banks, movements of the two liquidity measures are strikingly similar and the spread between them fairly constant.

At the end of April both of these measures were at levels near those prevailing about the middle of 1959. The low point was reached almost simultaneously with the upper turning point of the last business cycle in mid-1960. Both ratios rose rapidly in the following year of reduced business activity and have gradually declined throughout the past three years of business expansion.

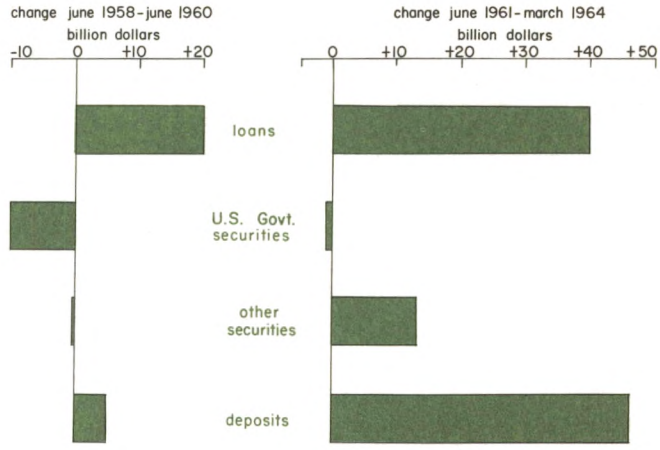
The bottom panel of the chart shows monthly variations in the broader liquidity measure for New York and Chicago banks since mid-1959 and for country banks on midyear and end-of-year call dates. For banks in other leading cities, this ratio is less volatile but has the same general pattern and

average level as New York and Chicago. For all country member banks the ratio is virtually identical with that shown for the Seventh District. Country banks show much less cyclical variation as well as a generally higher level of these assets relative to deposits than the city banks. The higher level reflects, in part, larger interbank balances; but their holdings of short-term Governments at the end of last year were also proportionately greater than those of the large banks.

Although the liquid asset ratio at the city banks has declined quite sharply from the 1961 peak, it has changed very little in the past year, remaining at a level well above the 1960 low. Moreover, there is substantially more liquidity in other parts of loan and investment portfolios and more flexibility in reserve and earning asset management. These factors have made it feasible for city banks to operate with smaller "secondary" reserves, while increased costs on time and savings deposits provided a strong incentive to do so.

All commercial banks hold about the same amount of total U. S. Governments as in mid-1959 but with a larger proportion in short-term issues. Their holdings of state and municipal securities are 75 per cent higher than five years ago, and available data on the composition of these securities indicates that for most banks 10 to 25 per cent mature within a year, with the proportion of short municipals highest at the large banks where liquid asset ratios are lowest. Estimates of holdings of short state and local and U. S. Government agency issues suggest that these may now be equal to half of short-term direct Treasury securities in bank portfolios.

Deposit growth exceeded loan expansion at all commercial banks since mid-1961



Other elements of liquidity are to some extent offsetting. Acceptances held in bank portfolios are almost five times the 1959 volume. The amount of commercial paper outstanding is more than double that of 1959 of which an undetermined proportion is held by banks. On the other hand, there is evidence that many banks have increased their long-term loans to business. Even these provide inflows of funds through amortization.

Relation to interest rates

Trends in the actual liquidity position of the commercial banking system could be expected to be reflected in interest rates. But the relationships between the "liquidity ratios" and yields in the securities markets have not shown consistent patterns either with respect to levels or direction of change, as the table below illustrates. The overall ratio of loans to deposits, for example, which stood at 54 per cent at the end of 1959 when inter-

est rates were at a peak for that cycle, is currently near 60 per cent despite a considerably lower rate level.

While swings in short-term Governments in relation to deposits correspond somewhat more closely to rate changes, there is substantial variance in the rate levels associated with a given liquid asset ratio and even in the short-run direction of change. This is evidenced by the sharp decline in rates in the first six months of 1960 when the ratios were indicating a further decline in liquidity. With approximately the same relationship between short Governments and deposits as obtained late in 1959, rates are currently at much lower levels.

	Ratio to deposits		Yields on U.S. securities	
	Loans	Short Govts	Long bonds	3-mo. bills
	(per cent)			
December 1959	54.0	7.4	4.32	4.57
June 1960	56.7	4.2	3.97	2.39
June 1961	55.3	12.0	3.90	2.31
March 1964	59.3	6.5	4.20	3.50

Deposit trend important

Clearly, the need to convert liquid assets into cash to meet loan demand depends in large part on the trend of deposits. Individual bank ratios are affected by the shifting of deposits among banks, but for all banks together deposit trends reflect the effects of monetary policy and preferences of the public for time deposits. So long as reserves expand sufficiently so that loans can be financed by new deposit creation, liquidation of other assets is not necessary.

Deposit growth has more than matched the increase in loans at all commercial banks for the current expansion period as a whole. From mid-1961 through last March, deposits rose more than 45 billion dollars—5 billion more than loans — although the relative growth in loans was faster, as reflected in the rising loan to deposit ratio. Although Government security holdings declined about 6 per cent in the final year of this period, this was accompanied by a rise in holdings of other securities as well as loans.

The current experience stands in sharp contrast to the 1958-60 period of business expansion (see chart). In the two-year period ended in June 1960, the rise in loans amounted to 20 billion dollars compared with deposit growth of only 5 billion, a liquidation of 10 billion dollars in Governments and virtually no change in other securities. The leveling off and decline in deposits in 1959 and early 1960 was a major factor that caused a squeeze on banks in meeting their loan demand. In part, this reflected the necessity to limit bank reserves to keep yields from falling below levels competitive with those abroad for balance of payments reasons.

Largely because of deposit growth, but also because of other sources of liquidity (for example, large holdings of short-term U. S. Agency and municipal securities), the shrinkage in standard liquidity ratios is probably not indicative of the same pressure on banks as when they were faced with the need to reduce their investments sharply in order to finance loan expansion in 1959-60.

During the past three years, total deposits have risen at an annual rate of about 7 per cent, even with the constraints placed on monetary expansion by the deficit in the balance of international payments. If deposits were to continue to rise at this rate, it would be possible to accommodate a 12.5 per cent loan growth in the next 12 months without any absolute reduction in other assets—roughly equal to the rise that has occurred during the past year. Such a development would, of course, result in a further decline in the liquidity measures.

Slowing in savings deposit growth and turnover?

Personal savings deposits rose 3 per cent at urban banks in the Seventh Federal Reserve District during the first quarter of 1964.[1] While this gain was virtually the same as that recorded during 1963, performance among the areas of the Seventh District differed considerably. Banks in urban areas of Indiana registered a deposit gain of 7 per cent in the first quarter of this year, compared with only 2 per cent in early 1963. In the other four states, however, savings deposit growth during the first quarter of 1964 not only was much slower than in Indiana, but it dropped to 2 per cent compared with 3 per cent during the same period of last year.

The sharp pick-up in growth of personal savings deposits at Indiana banks is attributable mostly to recent increases in interest rates. Since January 1 of this year, when the state regulation was liberalized and brought close to alignment with the limits applicable elsewhere, nearly 80 per cent of the urban banks in Indiana have announced rate increases. Typically this has meant a move to 3½ per cent on passbook accounts and 4 per cent on time certificates of deposit (CDs) from 3 per cent on both types of account. Elsewhere in the District the number of banks changing rates has been small, a comparable wave of increases having taken place in 1962.

Personal savings deposits at Indiana banks rose 3.1 per cent in January 1964 as against 0.4 per cent in January 1963. In March the rise had dropped to 1.7 per cent but this was still above the 1.3 per cent increase during March 1963. If the pattern observed at other times and in other areas following rate increases develops, deposit gains will taper off somewhat further in coming months.

In the 43 urban areas in Illinois, Iowa, Michigan and Wisconsin, growth in personal savings deposits during January also exceeded—on balance—the year-earlier rate. The growth rates in February and March, however, were below those of the same 1963 months.

Changes in deposits reflect the net effects of deposit inflows and deposit withdrawals. At times it is helpful to know whether a change in balances has resulted largely from changes in one or the other and if these changes have been complementary or partially offsetting.

In the 43 District areas outside of Indiana gross inflow in March was down 1 per cent from the 1963 month, while withdrawals were up 9 per cent. This general pattern held by and large in the major cities; declines in gross inflow from a year earlier were reported at 8 per cent in Chicago, 6 per cent in Milwaukee and 3 per cent in Detroit. These decreases in inflow occurred despite the boost in personal disposable income resulting from the income tax reduction.

On the other hand, at banks in most of the smaller urban areas outside Indiana (31 of

[1] In this article, unless stated otherwise, savings deposits refer to individuals' combined holdings of "passbook" savings accounts and time certificates of deposit at commercial banks in 51 metropolitan and smaller urban centers in the Seventh District.

the remaining 40 areas), gross inflow in March was higher than in March 1963. In a majority of them (35 of 43), withdrawals in March exceeded the year-ago amounts.

Personal savings deposits at District banks have at times been greatly affected by changes in interest rates paid on these deposits (see *Business Conditions,* May 1962). Some holders of savings deposits are responsive to relative yields. Therefore, a question arises: were net inflows into savings accounts down in March because of increased personal spending or because of rate-related switches into other assets?

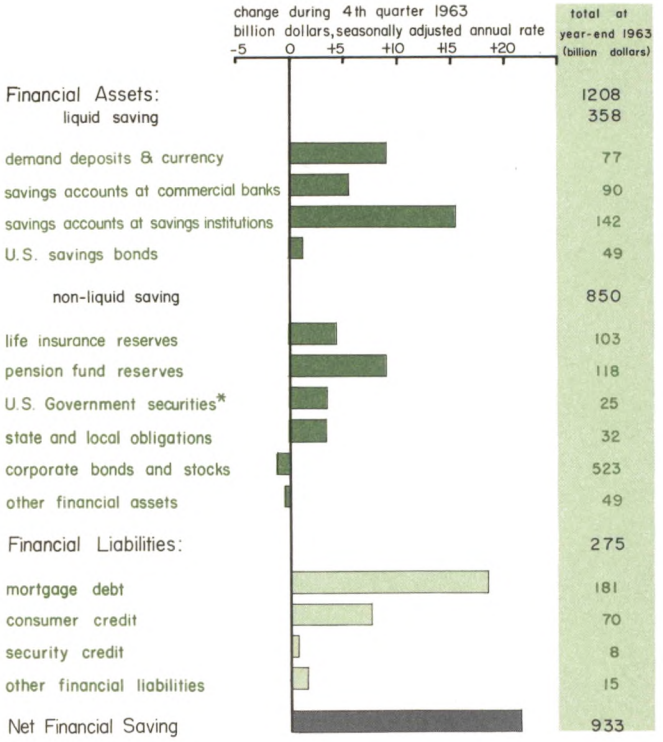
Savings deposits vs. other savings

Total individual holdings of *liquid saving* include not only savings deposits but holdings of currency, demand deposits, mutual savings bank deposits, savings and loan and credit union shares, postal savings certificates, savings bonds and short-term Government securities. Total *personal financial saving* includes, in addition to liquid saving, net acquisitions by individuals of shares of stock, build-ups of equity in life insurance and pension plans and net reductions in mortgage, instalment and other indebtedness (see chart).

Net inflow into liquid assets held by all individuals in the United States was at a seasonally adjusted annual rate of 31 billion dollars during the fourth quarter of 1963; this compares with 39 billion dollars in the fourth quarter of 1962. The averages for the first three quarters of 1962 and 1963 were close—around 27 billion.

The proportion of liquid saving represented by additions to savings accounts at banks dropped from 27 per cent in late 1962 to 17 per cent in the fourth quarter of 1963—lower than in any quarter since mid-1956. The decline in individual preferences for savings deposits relative to other forms of liquid saving was accompanied by a rise in the proportion of liquid saving channeled into savings and loan associations and credit unions (see chart on page 14).

Composition of financial saving of individuals



*Includes short-term issues which may be classified as "liquid".

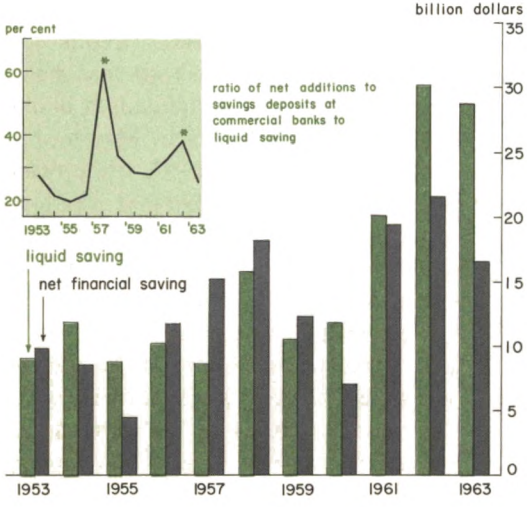
Net additions to life insurance and pension reserves changed only slightly during 1963. Net acquisitions of securities and mortgages moved irregularly, and in the final three quarters of 1963 were somewhat above early 1963 and most of 1962. This increase in saving in non-liquid assets was in contrast to the decrease in saving in liquid form. Amounts added by individuals to all financial assets, including the liquid component, were at a seasonally adjusted annual rate of 49 billion dollars in the fourth quarter of 1963, down from the 56 billion dollar annual rate in the fourth quarter of 1962 but slightly higher than the average rate for all of 1963.

Borrowing by individuals to purchase homes, automobiles and other goods and services rose during 1962 and remained at a high level during most of 1963. Individuals thus continued to borrow heavily while adding less to financial assets. As a result, net financial saving dropped to 17 billion dollars in 1963 from 22 billion the year before.

As a ratio of disposable income, financial saving also was lower in 1963 than in the preceding year. The ratio in 1962 was as high as 7 per cent—in the first and fourth quarters—but it did not go above 5 per cent during 1963. Hence the residual factor, the proportion of income spent, went up. Increases in the spending rate often occur during periods of rising business activity.

These developments in late 1963 suggest that recent changes in savings deposit net inflow may have resulted as much from shifts in saving among different types of assets as from variations in cash flows from income and spending. The combination of increased confidence in the stability of income and an increase, albeit moderate, in market rates of interest, have undoubtedly continued to exert a downward pull on savings deposits, as in 1963.

Difference between liquid saving and net financial saving larger in 1963 than in most earlier years



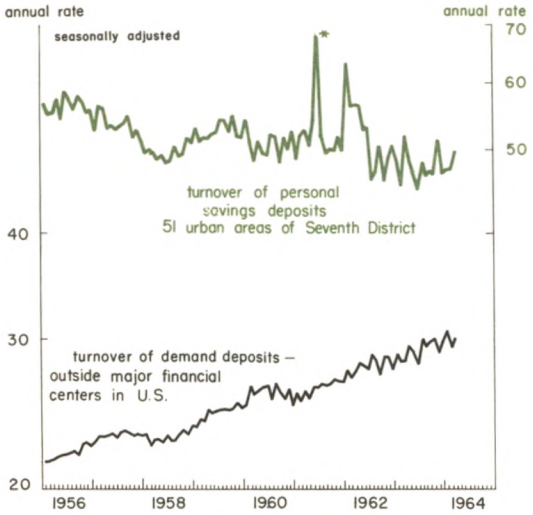
*Revision of regulation permitting higher rates to be paid on time deposits.

Turnover remains low

To the extent that savings deposits represent an accumulation of long-term savings, their turnover could be expected to be fairly low. In March 1964, personal savings deposits at banks in the District's urban areas turned over at a seasonally adjusted annual rate of 0.49, or about once in two years. This contrasts with the markedly greater rate of 30.1 times per year for demand deposits at 337 urban centers in the nation (outside New York).

Moreover, savings deposit turnover at the Seventh District banks was lower in 1963 and in early 1964 than in most other recent years (see chart). Thus, the sizable transfers of funds from demand deposits to savings ac-

Turnover of savings deposits has remained low in 1964



*Reflects in part debit and inflow transactions from transfers from time certificates to savings accounts after several banks in Detroit began to offer the same maximum rates on both types of account.

counts that occurred in 1962 evidently involved mainly balances that had been substantially "idle" and did not lead to any rise in the overall rate of savings deposit use.

Lower turnover in 1963 and early 1964 is in part a reflection of the increase in the proportion of individuals' savings in the form of time certificates. For banks in all 51 urban District areas combined, the ratio of time certificates to total personal holdings climbed from 3 per cent at the end of 1961 to 8 per cent at the end of 1963. Gains recorded in some areas were substantially greater than the average—several in Iowa and Wisconsin went from 3 per cent or less to more than 20 per cent over this period. The shift from passbook accounts to time certificates lends further support to the notion that total savings deposits include large idle balances to which depositors are willing to give up immediate accessibility in return for a higher rate of interest.[2]

Turnover of savings deposits
(annual rate, *not* seasonally adjusted)

	March 1963	March 1964
8 Indiana areas		
Passbook	0.328	0.398
Time CDs	0.330	0.097
Total, savings deposits	0.328	0.360
43 areas outside of Indiana		
Passbook	0.494	0.481
Time CDs	0.454	0.510
Total, savings deposits	0.492	0.484

The transfer of funds out of passbook accounts into time CDs to obtain higher interest shows up in the March 1964 turnover figures for Indiana banks. Turnover of passbook accounts at these banks was greater this March than a year earlier, while the turnover in time CDs was down substantially from the 1963 month.

Outside of Indiana turnover trends ran just the opposite to those within that state. Time certificates held by individuals at banks in the 43 areas turned over in March at a higher rate than in March 1963, while turnover in passbook accounts declined. The rate of turnover in the combined total of the two types—passbooks plus CDs—was also down.

The performance of personal CDs in March is especially interesting in view of the 1.2 billion dollar sale of American Telephone and Telegraph Company stock and the possibility that some portion of the increase in turnover of CDs can be traced to this source.

[2]For further explanation of types of time accounts see *Business Conditions*, May 1962 and October 1963.

Certificates of deposit purchased by individuals are often of large size and may be more sensitive than "passbook" deposits to yield differentials on alternative assets. The March results for CDs appear to confirm bankers' reports that savings deposit activity during the month was affected markedly by the AT&T stock sale.

One immediate effect of the recent reduction in Federal personal income taxes apparently has been to spur debt repayments. While individuals have been incurring new debt, they have chosen to clear up, to an even greater extent, certain of their outstanding obligations. Also it seems that in April, individuals responded to the added income from the tax reduction by stepping up additions to time CDs; savings deposit growth at large Seventh District banks had slackened during March but in April it accelerated. While deposit flows during April tend to be markedly affected by divergent seasonal influences, they usually are down during the month. Total retail sales in April remained approximately at their March level. Over the long pull, the tax cut should, among other things, bolster confidence in the further growth and stability of personal income and hence lead to some lowering in the share of saving in liquid form. If past experience is a guide, the addition to income attributable to the tax cut will flow predominantly into current spending.

Personal savings deposits at banks in urban areas of the Seventh District*

	Illinois	Indiana	Iowa	Michigan	Wisconsin	51 Urban Areas
			(million dollars)			
Gross inflow, first quarter						
1961	581	102	50	509	114	1,356
1962	893	101	78	895	165	2,133
1963	777	105	62	730	137	1,811
1964	849	191	72	738	151	1,999
Withdrawals, first quarter						
1961	531	78	40	455	118	1,222
1962	595	81	58	707	151	1,592
1963	620	86	53	610	121	1,490
1964	736	130	57	588	133	1,644
Balances, December 31						
1961	4,390	790	341	3,173	920	9,614
1962	5,377	843	389	3,666	1,017	11,293
1963	6,052	885	421	4,052	1,108	12,518
Balances, change December 31 to March 31						
			(per cent)			
1961	1.2	3.2	2.9	1.9	—0.4	1.5
1962	6.8	2.5	5.9	5.9	1.6	5.6
1963	2.9	2.3	2.1	3.3	1.6	2.8
1964	1.9	6.9	3.5	3.7	1.6	2.9

*Includes "passbook" savings accounts and individuals holdings of time certificates of deposit.