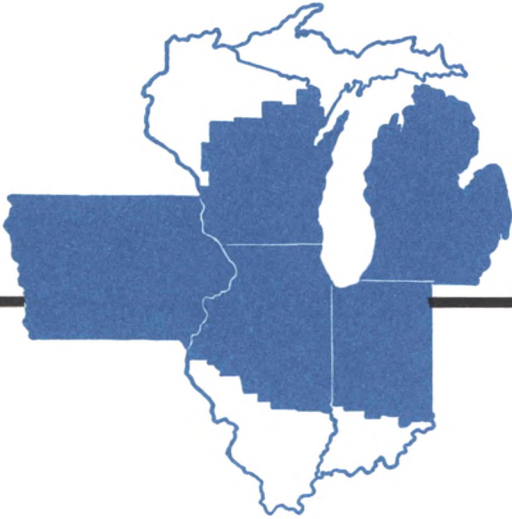


*A review by the* **Federal Reserve Bank of Chicago**

# Business Conditions

**1964 August**



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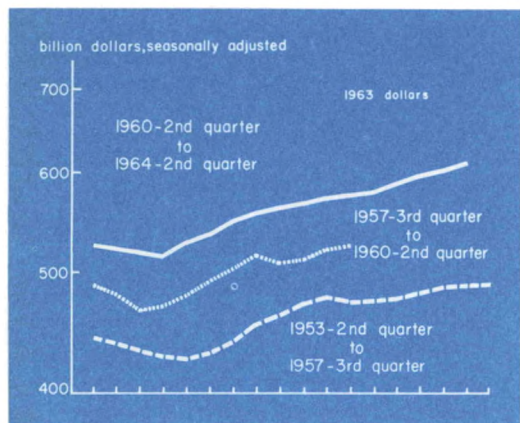
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# THE Trend OF BUSINESS

Midway in the third quarter, the United States economy is well on its way to fulfilling the highly optimistic forecasts for 1964 made at the start of the year. If recent trends continue, output of goods and services this year will be more than 5 per cent greater than in 1963—a relatively large gain.

Confidence in the business outlook is wide-

## Uptrend in gross national product continues after 3½ years



spread, as it was six to nine months ago. Bullish views are fortified by evidence that inventories are rising only moderately, that the increase in capital expenditures is proceeding smoothly and that prices of commodities continue to be quite stable in wholesale and consumer markets. If recent optimistic projections are realized, the business expansion—now three and one-half years old—will be extended sufficiently to validate the hopes of a year or two ago that the economy might “skip a recession.”

In June industrial production was 5 per cent above the year-earlier level, employment was up 1.6 million or 2.3 per cent and retail sales were 6 per cent higher—somewhat less than the increase in disposable personal income. Order backlogs of durable goods manufacturers increased steadily during the first half of the year.

### Some sectors slackening?

Nevertheless, the pace slowed somewhat in some segments of the economy during the second quarter. Construction activity, season-

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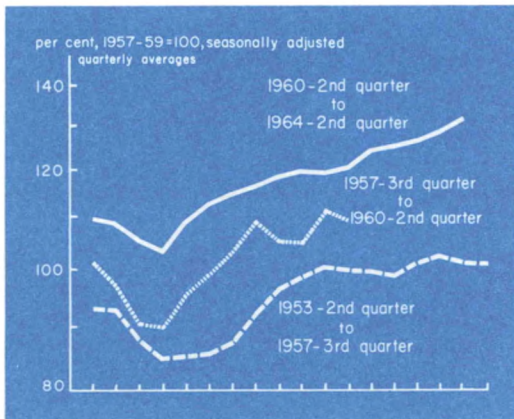
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ally adjusted, in June was about 2 per cent less than at the March peak, mainly because of a slackening in the rate of home building. Early in the year, however, residential construction was favored by a mild winter and progressed at an extremely high rate for the season. Construction contracts have been awarded in large volume this year—8 per cent above the comparable months of 1963 in the January-June period, according to F. W. Dodge.

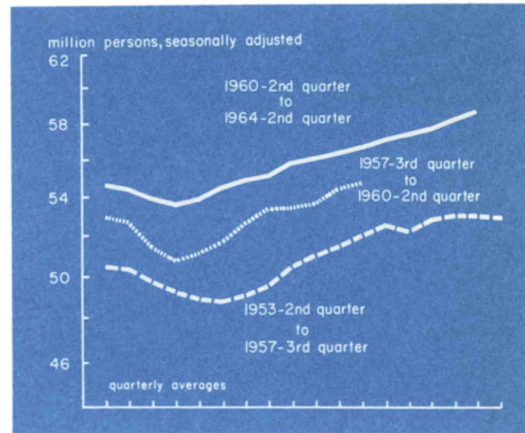
Auto sales declined in June, partly because of a truck haulers' strike in the East that prevented thousands of newly assembled autos from reaching dealers. Because of high output and reduced sales, inventories of domestically produced new cars reached a record high of 1,267,000 at midyear—a 49-day supply at the June sales rate compared with a 39-day supply a year earlier at the then prevailing sales rate. Production of 1964 model cars approximated 7.9 million and was 8 per cent above the 1963 model run which had set a new high.

Barring a lengthy strike, some auto indus-

### Rise in industrial production outpaces gains in earlier expansions



### Wage and salary employment increased steadily since early 1961



try analysts foresee the possibility of excessive inventories of "old" model cars this fall—the first time since 1960. If this should occur, used car prices might be adversely affected as inventories of 1964 cars were worked off. Strong used car prices have played an important role in the excellent sales of new autos during the past two years.

### Steel and capital goods

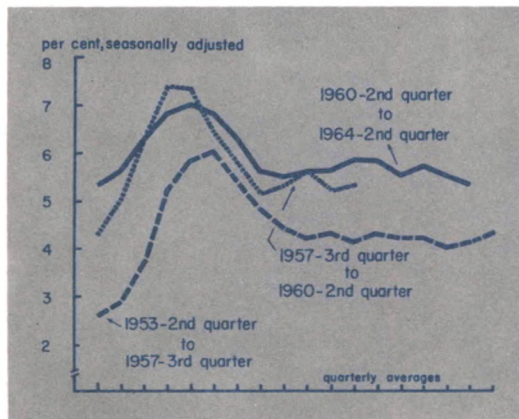
Countering the leveling tendencies in the construction and automotive industries, the continued high rate of orders for steel and capital equipment in recent months has been highly encouraging to Midwest producers. Demand from all types of users has been strong, particularly for structural steel, plates and sheets. Steel ingot production now is expected to reach or surpass 120 million tons in 1964—8 million tons more than forecast at the start of the year and above the previous high of 117 million tons in 1955. Because of higher imports and lower exports, domestic consumption of steel in 1964 will

show an even larger gain than ingot production relative to 1955. Inventories of finished steel increased only moderately during the early months of this year and at the end of May totaled 20.5 million tons, slightly less than a year earlier.

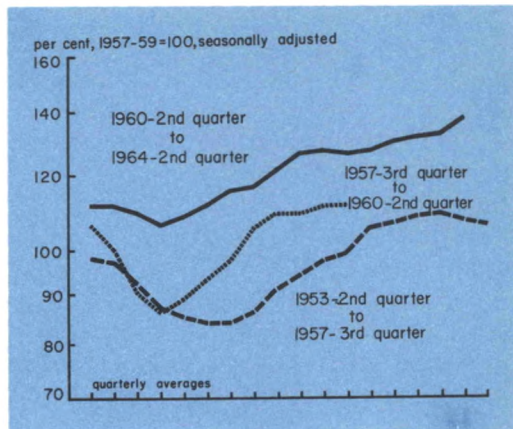
Capital expenditures are expected to rise 12 per cent in 1964 over 1963 after somewhat smaller gains in each of the two previous years. A survey by McGraw-Hill indicates a further increase of about 8 per cent in 1965. This augurs well for a continued rise in economic activity inasmuch as business firms have tended to underestimate their anticipated capital spending in past periods of expansion when queried about outlays to be made many months in the future.

Output of business equipment has been rising vigorously in recent months and in June was 9 per cent above the level of a year earlier. Order backlogs of capital goods firms producing such items as machine tools and heavy presses—used in large volume by the automotive and steel industries—have risen sharply since the start of the year and some

### Unemployment remains close to 5½ per cent of labor force



### Rise in output of business equipment accelerated in the second quarter of 1964



customers have been forced to accept delivery dates farther in the future than desired. Nevertheless, there appear to have been relatively few price increases and capital outlay programs of most firms are proceeding in an orderly manner—in contrast with the experience of the mid-Fifties.

### Four years in review

The accompanying charts permit comparison of the current expansion with those that began in 1954 and 1958. Lines on the charts represent changes beginning with the high points in gross national product (GNP) that preceded the three most recent recessions.

Measured in dollars of comparable purchasing power, total spending on goods and services in the second quarter of 1964 was 16 per cent above the high-water mark reached four years earlier. A similar time span from the 1953 peak saw a rise of less than 10 per cent. GNP increased 8 per cent in the middle period, 1957-60, but the two

peaks were separated by an interval of less than three years. Comparisons for the three periods based on movements in industrial production yield results roughly similar to those for GNP.

Nonfarm wage and salary employment in the second quarter was 7 per cent above the level of four years ago compared with an increase of 5 per cent in the 1953-57 period. In mid-1960 wage and salary employment had moved up only 3 per cent from the 1957 high.

Judged on the basis of the rate of unemployment, the current expansion compares less favorably with its predecessors. Unemployment remained relatively high in the second quarter and averaged 5.3 per cent of the labor force, exactly the same as in the second quarter of 1960.

### Getting tired?

An assessment of the economy's performance thus far in the Sixties yields favorable results. But is it possible that the expansion has about run its course? Could the favorable reports for the second quarter, in retrospect, mark peaks or near peaks in activity?

Individuals sometimes are said to be "only as old as their arteries," and analogously this holds for business expansions. A long-extended upturn need not falter if rigidities and excesses that impede the free flow of production and consumption are avoided. Have the signs of trouble that heralded the end of earlier upswings begun to appear?

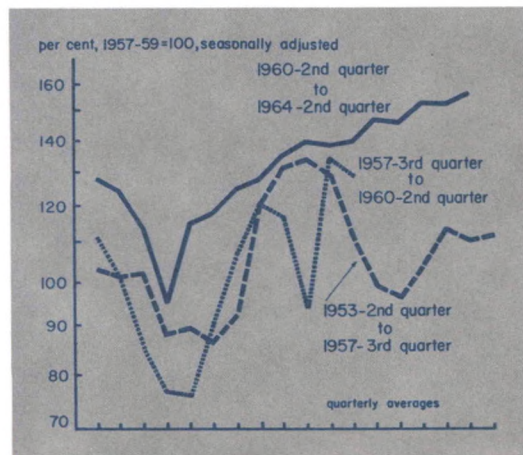
One striking fact is that the current expansion is still continuing at a good pace. In the final stages of the two preceding upturns, relatively little further progress occurred after the momentum of the initial upsurge from the recession low had been spent. Between the fourth quarter of 1955 and the third quarter of 1957, a period of almost two years, real

GNP increased only 2.5 per cent; in the final year of the expansion ended in 1960, the increase was only 1.9 per cent. The experience of these earlier periods contrasts markedly with the current expansion. Clearly, if a slowing of the rate of advance tends to precede a downturn, none is currently in sight.

The performance of major Midwest industries during the present expansion also contrasts with previous experience. Output of both motor vehicles and steel slumped sharply in 1956, and output of business equipment began to decline in the first quarter of 1957, six months before the peak in total activity. Each of these industries increased output substantially in the first half of 1964.

It is noteworthy and perhaps more than coincidental that business activity turned down in the years that followed the last three steel strikes, which occurred in 1952, 1956 and 1959. Most of the accompanying charts reveal turbulence associated with these labor disputes. The longevity of the current upswing owes something to the absence of such

### Motor vehicle output has risen steadily in sharp contrast with earlier periods



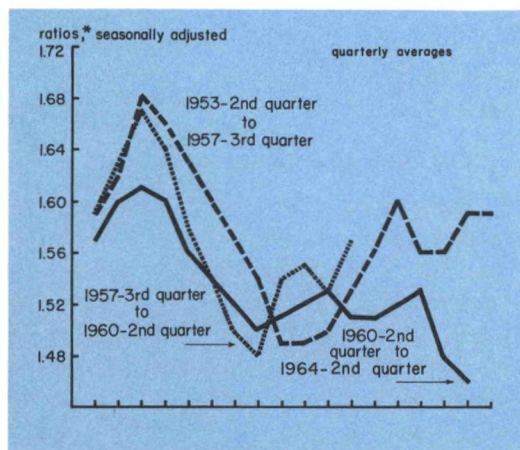
highly disruptive influences.

### Inventories and prices

The behavior of business inventories in the current expansion also contrasts with earlier experience. At the start of 1964 rapid inventory accumulation—probably at an unsustainable rate—was widely expected. Additions to inventories in the first half, however, were moderate, running at an annual rate of about 2.5 billion dollars compared with a rise of 4 billion dollars in 1963 and 5 billion in 1962. Total inventories actually declined somewhat in May both at the trade and manufacturing level.

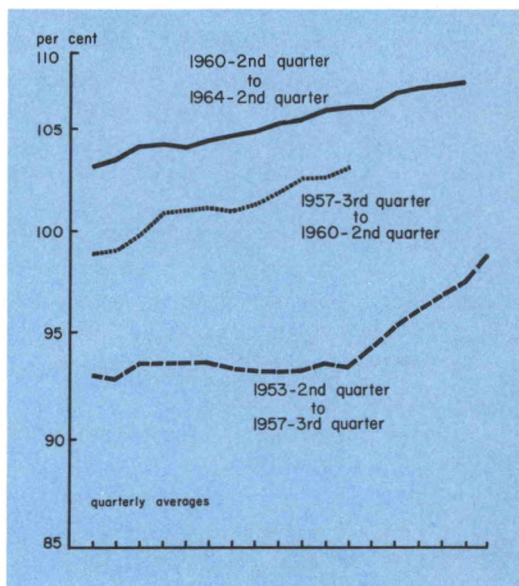
With sales rising faster than inventories, total business inventories in May were equal to only 1.45 months of sales, the lowest ratio of the past decade. Prior to the peaks of activity in 1953, 1957 and 1960, inventories were rising relative to sales and at each of these peaks were close to 1.60 times the monthly volume of sales.

### Inventories declined sharply relative to sales in the first half



\*Total business inventories to total sales.

### Consumer prices have risen gradually



Business inventories doubtless will rise in the second half of 1964 as business firms attempt to expand production and sales, but there is reason to hope that the movement will not be carried to excess. Except for certain types of capital goods, delivery schedules are being maintained and purchasing agents believe they can obtain additional shipments quickly when needed. In addition, buyers have seen little need to acquire additional supplies to hedge against price increases.

The consumer price index was only four-tenths of 1 per cent higher in June than it had been in December. During this same period, average wholesale prices declined slightly. In comparison with last year, consumer prices in June were up 1.3 per cent while average wholesale prices were slightly lower.

Prior to the peak in general business in

1960, consumer prices had been increasing slowly as in other recent years. In the year prior to the 1957 peak, however, consumer prices rose almost 4 per cent. Wholesale prices also increased sharply in the 1956-57 period, and it is probable that dislocations caused by these general price rises played a role in precipitating the 1957 downturn.

A physical check-up of the economy in the summer of 1964 reveals a remarkably sound constitution. Developments of recent months have not been accompanied by the signals of danger that, in retrospect, can be seen to have preceded most earlier business declines.

The rate of growth has not slowed and ex-

cesses in capital expenditures, inventory building and price increases have been avoided. Credit has remained readily available and the February tax cut appears to be having a gradual stimulatory impact. Nevertheless, the economic future never can be read with certainty. Continuance of the expansion has been aided by moderation on the part of business, consumers, labor and government with regard to spending, price and wage policies. Any tendency to abandon such restraints in the months ahead could provide both temporary stimulation and an earlier termination to the further rise now in prospect.

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## Beef supply to rise further

Cattle account for about one-fifth of total sales of farm commodities by the nation's farmers and ranchers. In the Seventh Federal Reserve District states—Illinois, Indiana, Iowa, Michigan and Wisconsin—such sales are even more important, accounting for nearly one-fourth of the cash receipts from farm marketings. Furthermore, more than a third of all cattle “fattened in feedlots” in the 28 major feeding states for which data are available are “fed” in the District states.

Beef herds and beef production have expanded tremendously in recent years and both are presently at record levels. The total number of cattle on farms and ranches, including dairy cattle, reached 107 million head on January 1, 1964—up 17 per cent since 1958 when the current rise began. The number of beef cattle has risen one-third, to almost 79 million head at the beginning of this

year, setting a new high in each successive year. Beef cattle now account for nearly three-fourths of the total compared with less than two-thirds just six years ago. Also, fewer animals are being slaughtered as calves and an increasing proportion of cattle are being fattened for slaughter on grain rations in farmers feedlots, thereby increasing average output of beef per animal slaughtered.

### **Income large, outgo larger**

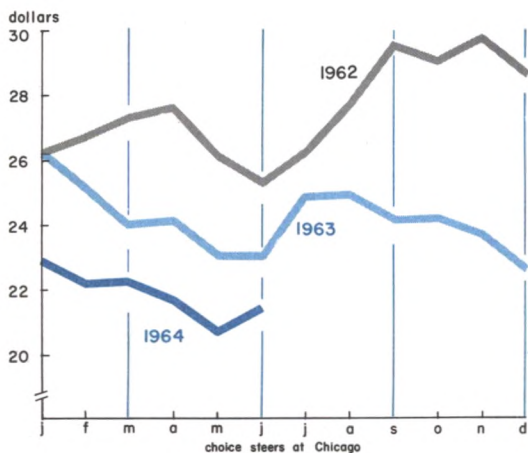
Many farmers lost money on their cattle feeding operations in 1963 and during the first half of 1964; for some the losses were disastrously large. Under a hypothetical but fairly “typical” Corn Belt feeding program involving the purchase of good-to-choice 650 pound steer calves in the fall and the sale of the fattened animals the following spring at weights of about 1,030 pounds, losses would

have averaged about \$25 per head in 1962-63. For farmers following this type of feeding program in 1963-64, losses would have averaged about \$29 per head. The losses in the past two years under this type of feeding program were by far the largest since 1952-53 when it was nearly \$50 per head.

Feed costs during the past two years have advanced somewhat from previous levels—mainly because of rising corn prices—but this added cost accounts for only a relatively small part of the decline in net returns from cattle feeding. Transportation and marketing costs have remained virtually stable. Lower net returns, therefore, have stemmed largely from changing price relationships between feeder calves and the fattened slaughter animals.

The margin (the difference between prices paid per hundredweight for feeder steers in the fall and those received for fat cattle sold the following spring) have been negative and large during the past two feeding seasons.

### Slaughter steer prices remain at low levels



During the season just past, farmers worked against a negative margin of nearly \$3 per hundredweight and in the 1962-63 feeding season, against one that averaged nearly \$4 per hundredweight.

In contrast, during the 1961-62 feeding season, prices received for slaughter animals during the spring of 1962 exceeded those paid for feeder animals in the previous fall by more than \$1.50 per hundredweight.

Negative margins alone, of course, do not necessarily lead to losses in cattle feeding. Farmers usually can overcome negative margins when cattle prices are relatively high, since the gain in weight realized from a given amount of feed adds proportionately more to the value of the animal than it does when prices are low. Prices for fat cattle during 1963, however, were substantially below those of a year earlier and during 1964 prices have been depressed even further.

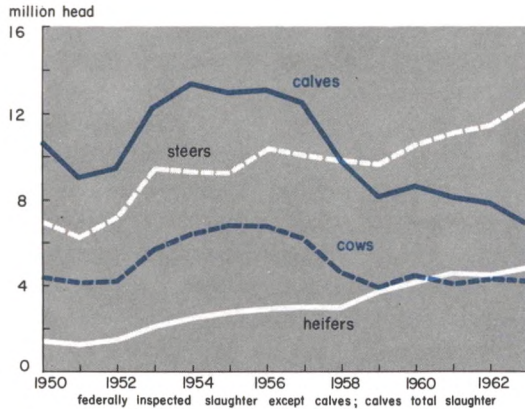
Cow and calf operations have also been adversely affected because of the depressing effect that low fat cattle prices have had on feeder cattle prices. Information on the costs and returns of western livestock ranches indicates that many ranchers' incomes were substantially reduced from previous levels during the last half of 1963 and thus far in 1964.

### Cattle prices plummet

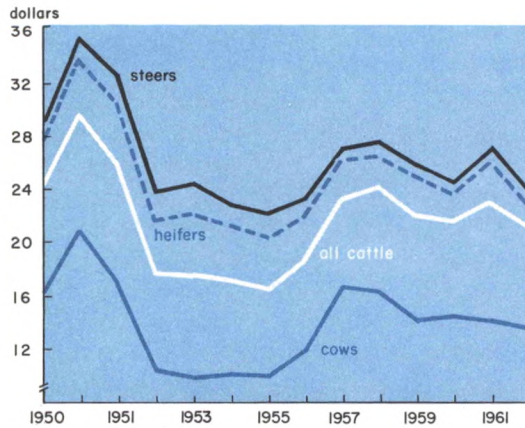
Prices of choice 900-1,100 pound steers reached nearly \$30 per hundredweight at Chicago in November 1962—more than \$4 above the year-earlier level and the highest price at Chicago since April 1959. Prices then began a downward trend and in May 1964 were at the lowest level in more than eight years. The sharp price decline has been attributed to numerous factors but the most important by far was the large increase in supply of the top grades of beef resulting from the large number of animals that have



### Slaughter of cows and calves fluctuate sharply with changes in cattle cycle



### Cattle prices\*



\*Steers and heifers (all grades) and cows (canner and cutter) at Chicago; all cattle under Federal inspection.

been fed to unusually heavy weights.

During 1963 the total number of cattle slaughtered rose to 28 million head—4 per cent above the year-earlier level; throughout the first half of 1964 cattle slaughter exceeded the corresponding year-earlier level

by nearly 10 per cent. Beef output expanded even more, reflecting the increase of nearly 20 pounds per head over the 1962 average weight. Beef production in 1963 totaled about 16.4 billion pounds, up 7 per cent from 1962, and through June of this year has been nearly 12 per cent above the corresponding period in 1963.

The substantial gain in cattle slaughter and the record slaughter weights are a “natural” sequel to the increase in total number of cattle on farms during recent years. Currently, cattle slaughter can increase substantially without causing a reduction of herds.

Under the impetus of generally rising demand for beef and the long-term upward trend in beef prices, the proportion of cattle being fed in feedlots has risen substantially. Commercial feedlots with several thousand head capacities and year-round feeding programs have entered the field and farmers who had been feeding only small numbers of cattle have enlarged their operations.

Nearly 9 million cattle were on feed in the 28 major feeding states last January—a gain of 50 per cent over 1958 and double the number in 1950. More than 15 million head of fed cattle were marketed in 1963 or about 18 per cent more than in 1960. Moreover, judging from the number of cattle on feed and the volume of cattle marketings thus far in 1964, fed cattle marketings this year may exceed the 1963 figure by a sizable margin.

The growth in relative importance of fed cattle is reflected in the increasing proportion of animals marketed through the 12 major markets that are placed in top U. S. grades. From 1958 to 1963 the proportion of steers and heifers grading prime and choice rose to about 59 per cent of the total marketed from less than 49 per cent. On the other hand, steers and heifers grading good accounted for only 34 per cent of the total marketed in

1963—down from over 40 per cent five years earlier. Those falling into the lower grades declined from slightly above 7 per cent to below 6 per cent during the same interval.

### Where now beef cow?

Any attempt to evaluate the longer-run outlook for cattle must take special note of the slaughter of cows and calves since the plans of ranchers and farmers are reflected in these figures. If the breeding herds are to be expanded further at a rapid pace, then cows and calves will be retained in herds and slaughter of these will remain at low levels. On the other hand, if herds are stabilizing or being reduced, slaughter will increase sharply.

Thus far in 1964, slaughter of cows under Federal inspection has been running 13 per cent above a year ago. Calf slaughter for the first quarter was below last year but has risen markedly in recent months and in June exceeded the year-earlier number by 7 per cent.

Weather conditions can, of course, strongly

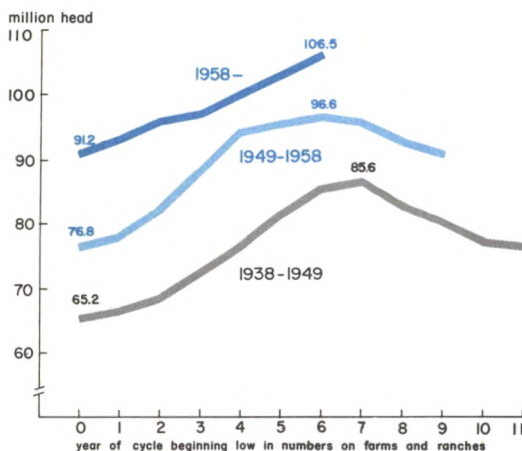
influence the volume of slaughter: drought conditions throughout the range areas in 1952 triggered the sharp increase in slaughter at the end of that year. While local areas of the West have experienced drought and poor grazing conditions this year, these have not been sufficiently widespread to have any unusual impact.

The present upswing in cow and calf slaughter must be ascribed mainly, therefore, to the impact of present and anticipated prices on the profitability of producing cattle. The increased number of cows and calves moving to packing plants in recent months reflects, in part, the greater hesitation of Corn Belt farmers and commercial feedlot operators in making purchases at current prices and in part, a reluctance on the part of ranchers to make further rapid additions to their breeding herds.

Inasmuch as the number of cattle is at a relatively high level, it would take a substantial increase in slaughter to stop the build-up in numbers. If slaughter continued at the level experienced thus far this year—up about 10 per cent—it would still permit a small increase in cattle on farms and ranches. A further increase in the rate of slaughter during the remainder of this year or continued high slaughter volume in 1965, therefore, would be needed to cause the number of cattle on farms and ranches to stabilize or decline.

The effect of weather on range conditions will have an important influence on the trend of cattle numbers. Severe drought conditions over large areas of the West would probably trigger a sharp increase in marketings, with prices responding in the opposite direction. Even if good weather prevails, a continued relatively high rate of slaughter, with prices fluctuating near present levels, would seem to be a reasonable prospect.

### Expansion of cattle numbers continues



# CDs as a money market instrument

Negotiable time certificates of deposit (CDs) issued by the country's large commercial banks continued to expand at a rapid pace in the first seven months of 1964. At the end of July, CDs outstanding in denominations of 100,000 dollars or more totaled over 12 billion dollars, about 25 per cent above the year-end 1963 level.<sup>1</sup> The increase reflects both continued bank demands for additional funds to help finance the current expansion in business and consumer spending and increased acceptance by investors. CDs can be tailored to the purchasers' needs in terms of both amount and maturity and yield a return above that obtainable on Treasury bills of comparable maturity.

Previous articles in the February 1963 and February 1964 issues of *Business Conditions* have discussed the development and major characteristics of CDs. This article explores these certificates primarily as a money market instrument, describing changes in the volume outstanding, seasonal patterns, location of issuing banks, maturity structure and recent trends on the secondary market.

Following the organization of a secondary market in the spring of 1961, the volume of CDs outstanding rose rapidly from less than 1 billion dollars at the end of 1960 to 9.6 bil-

lion dollars at the end of 1963. Their volume now exceeds that of commercial paper, bankers acceptances or short-term obligations of state and local governments. Among short-term securities, CDs are exceeded in volume only by Treasury bills.

## Selected money market instruments

|  | December 31       |                  |
|--|-------------------|------------------|
|  | 1960              | 1963             |
|  | (billion dollars) |                  |
| CDs .....  | 0.8               | 9.6              |
| Treasury bills .....                               | 39.4              | 51.5             |
| Commercial paper .....                             | 4.5               | 6.7              |
| Short-term municipal securities <sup>1</sup> ..... | 3.2               | 4.9 <sup>e</sup> |
| Bankers acceptances .....                          | 2.0               | 2.9              |

<sup>1</sup>June 30.

<sup>e</sup>Estimate.

CDs are issued primarily by the country's largest banks both because these are the only banks large enough to issue them in denominations of 1 million dollars, the standard unit of trade, and because investors are most familiar with these banks.

Two-thirds of the total volume of CDs outstanding at large banks in the Seventh Federal Reserve District on July 1 were issued by the District's three largest banks. The 12 banks with deposits in excess of 500

<sup>1</sup>These figures do not include the CDs issued by small banks. These are generally issued in denominations of under 100,000 dollars and, while technically negotiable, are not generally marketable because of the small size of the certificate and limited reputation of the issuing bank.

million dollars accounted for almost 90 per cent of the total.

The same pattern holds true for the country as a whole. Forty-two per cent of the total volume of CDs outstanding at all weekly reporting banks were issued by banks in the New York Reserve District. Chicago and San Francisco District banks accounted for another 23 per cent. Fourteen of the 15 largest banks in the country are located in these three Districts. As may be seen from the table, the distribution by Federal Reserve District has changed only slightly since such data were first collected at the end of 1962.

### Maturity

A recent Federal Reserve survey of weekly reporting member banks found that 80 per cent of the CDs outstanding at the end of May 1964 were scheduled to mature within six months, more than half of them within three months. Twelve per cent had six to nine

months remaining to maturity, 6 per cent nine to 12 months and only 2 per cent over one year. A very similar maturity pattern existed for certificates issued by large Seventh District banks.

An interesting question arises whether changes in the relation between market rates of interest and the ceiling rates imposed by Regulation Q affect the maturity structure of CDs issued. Since market rates tend to increase as time to maturity lengthens, it might be expected that maturities would shorten as market rates approached ceiling rates and lengthen as the spread between market and ceiling rates widens. In the first quarter of 1964, market rates—which generally tend to be 30 to 40 hundredths of a percentage point above Treasury bills of comparable maturity—were near or above the 4 per cent ceiling rate banks are permitted to pay on certificates of three months or longer.<sup>2</sup> (The ceiling on one to three month maturities is 1 per cent, well below current market rates, effectively precluding banks from issuing CDs of less than three months.) At the end of March, most large banks were quoting interest rates of 4 per cent on new CDs of six months and over and about 3.9 per cent on three to six-month maturities. Smaller banks tended to quote 4 per cent across-the-board.

In April, market interest rates declined somewhat and rates quoted on new CDs of nine months or less backed away from the ceiling. This change gave banks an opportunity to sell longer-term maturities. A comparison of the maturity distribution at seven large District banks at the end of February and at the end of May indicates that these banks did respond to the easier money mar-

### Distribution of CDs outstanding at weekly reporting member banks

| Reserve District        | December 5, 1962 | July 1, 1964 |
|-------------------------|------------------|--------------|
|                         | (per cent)       |              |
| Boston . . . . .        | 2.5              | 4.4          |
| New York . . . . .      | 39.9             | 41.7         |
| Philadelphia . . . . .  | 2.2              | 3.5          |
| Cleveland . . . . .     | 8.8              | 7.4          |
| Richmond . . . . .      | 2.1              | 2.0          |
| Atlanta . . . . .       | 2.4              | 2.5          |
| Chicago . . . . .       | 14.6             | 12.6         |
| St. Louis . . . . .     | 1.9              | 2.8          |
| Minneapolis . . . . .   | 3.4              | 1.9          |
| Kansas City . . . . .   | 2.3              | 2.6          |
| Dallas . . . . .        | 9.0              | 7.9          |
| San Francisco . . . . . | 10.9             | 10.7         |
| <b>Total . . . . .</b>  | <b>100.0</b>     | <b>100.0</b> |

<sup>2</sup>Market rates on Treasury bills are computed as discounts from face value and tend to understate the rate of return in comparison with rates on CDs which are computed as interest yield on face value.

**Maturity distribution of CDs  
outstanding at seven large  
Seventh District banks**

| Maturity<br>(months) | Feb. 19,<br>1964 | May 20,<br>1964 |
|----------------------|------------------|-----------------|
|                      | (per cent)       |                 |
| Within 3 . . . . .   | 60               | 47              |
| 3- 6 . . . . .       | 24               | 36              |
| 6- 9 . . . . .       | 9                | 10              |
| 9-12 . . . . .       | 4                | 5               |
| Over 12 . . . . .    | 3                | 2               |
| <b>Total</b>         | <b>100</b>       | <b>100</b>      |

ket conditions by issuing longer term CDs. At the end of February, 60 per cent of the certificates issued and outstanding at these banks had three months or less to maturity. Three months later, this proportion had declined to 47 per cent while the proportion with maturities of three to six months had risen from 24 to 36 per cent. The proportion outstanding with maturities of over nine months remained small and largely unchanged.

Information permitting direct comparison of the maturity distribution of CDs in 1964 with those on earlier dates is not available. However, somewhat similar information on the initial maturity of CDs issued by the same seven banks and outstanding on December 5, 1962 suggests that banks have on the whole shortened maturities over the past 18 months, either by choice or because of the narrowing of the gap between market and ceiling rates.

### Seasonal patterns

Although the history of CDs is brief and dominated by a sharp rise in volume, some

seasonal patterns in the amount outstanding may already be observed. The most noticeable is the decline and subsequent rise in volume at quarterly corporate income tax dates. This pattern is clearly visible in the accompanying chart which shows the weekly volume outstanding at large New York City banks since May 1961.<sup>3</sup> CDs outstanding at these banks declined in nine of the 13 weeks that included tax dates and in all of the six most recent such weeks. In these six most recent "tax" weeks, the net decline averaged about 3 per cent. Because most banks usually sell new CDs to offset part of their decline in outstandings, this figure tends to understate the amount maturing in tax weeks. In all cases, the volume rose following the tax date and surpassed the pre-tax volume within six weeks. A similar pattern is observed for all banks and a small number of large Chicago banks in the periods for which such data are available.

The decline in CDs in corporate tax weeks may be attributed to the practice of many business firms of investing funds set aside for income tax payments in short-term securities. Because maturities are determined through negotiation between the issuing bank and the purchaser, CDs may easily be written to mature on tax dates and thus lend themselves nicely to use as investment outlets for corporate tax funds.

### Secondary market

Because of the secondary market, CDs resemble the short-term debt instruments issued by such other borrowers as the U. S. Treasury (Treasury bills) and business firms (commercial paper). The ability of holders to sell their CDs at any time prior to maturity and

<sup>3</sup>Weekly data for all weekly reporting member banks is available only since the beginning of this year.

regain possession of their funds distinguishes them from other types of commercial bank time deposits.<sup>4</sup>

The Federal Reserve has recently begun to collect data on the volume of CDs traded on the secondary market and on dealers' inventories on a regular weekly basis. Daily averages of weekly trading volume and dealers' inventories since October 1963 are shown in the chart on page 16. The lower half of

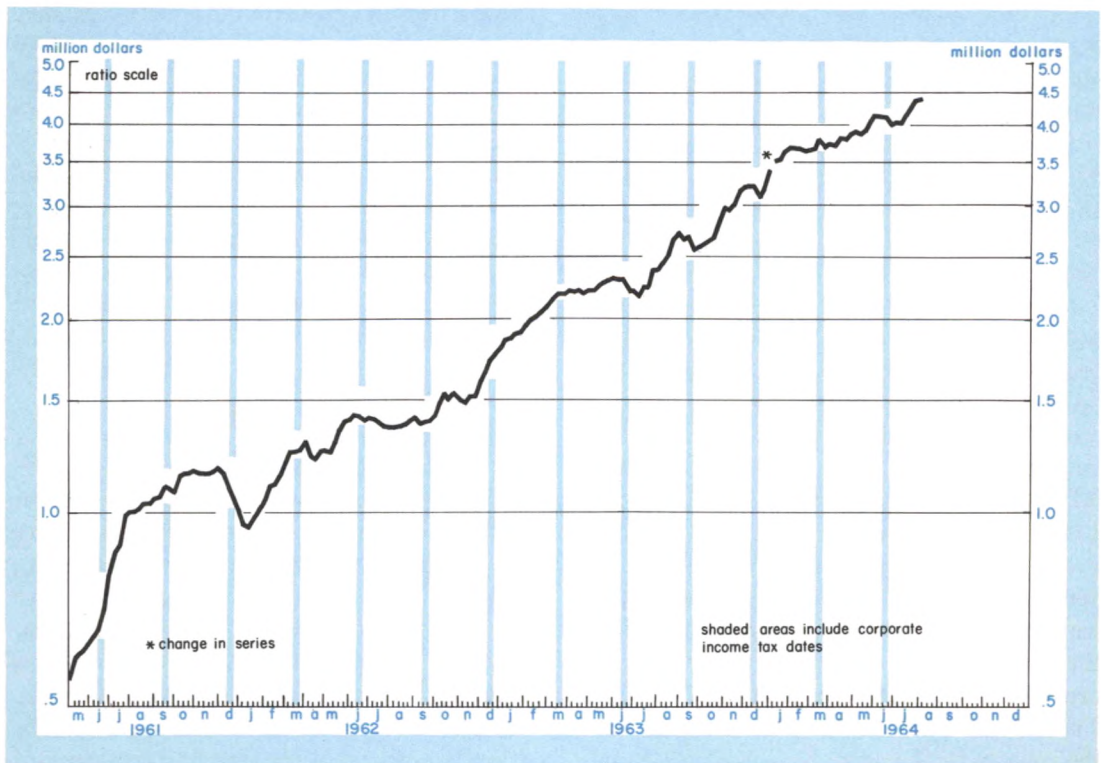
<sup>4</sup>Passbook savings may in practice be redeemed at any time, although the bank could legally require 30 days notice before withdrawal. Banks, however, are not permitted to accept such deposits from corporations.

the chart shows market rates on three-month CDs of major banks and on three-month Treasury bills.

Trading fluctuated between a low of 20 million dollars in early October 1963, and a high of 106 million dollars in the last week of 1963. The average daily volume of trade in the nine months from the end of September 1963 to the end of June 1964 was about 45 million dollars. Trading volume was somewhat higher in the first two quarters of 1964 than in the last quarter of 1963.

The lower volume of trading in the final three months of 1963 may have been a consequence of a sharp reduction in the spread

### CDs continue to rise rapidly at large New York City banks



between market yields obtainable on CDs and on Treasury bills in the third quarter of the year following a rise in the Federal Reserve discount rate in July. Although precise information is not available, the trading volume on the secondary market was reported to have been at very low levels during these months. After the spread widened in October, trading may have been slow to recover.

In the short run, dealer positions tend to vary more or less inversely with the volume of trading. When trading increased, dealer inventories have tended to fall and when trading declined, inventories have tended to rise. Inventories fluctuated between 102 million dollars in a week when trading volume was near its peak and 296 million dollars when trading volume was below average. While dealer inventories fluctuated widely from week to week, they varied only slightly from quarter to quarter and tended to average about four times the daily average volume of trade.

In volume of trading, the CD market is dwarfed by the Treasury securities market. In April 1964, trading volume averaged 1.9 billion dollars per day for all marketable Treasury securities including Treasury bills, 1.4 billion dollars for Treasury bills alone and only .07 billion dollars for CDs. The greater volume for Treasury securities in large part reflects the larger volume of these securities outstanding. At the end of April, the volume of Treasury securities, Treasury bills and CDs outstanding was 207, 51 and 11 billion dollars, respectively.

Activity in a market may be measured by comparing the dollar volume of transactions with the volume of securities outstanding. On this basis, activity on the CD market is approximately equal to the activity for all Treasury securities but considerably less than the activity for Treasury bills alone. In April,

trading volume was equal to 0.6 per cent of month-end CD volume outstanding, 0.9 per cent for Treasury securities and 2.8 per cent for Treasury bills.

Approximately the same results are obtained when the ratio of dealer inventory to volume outstanding is computed. The resulting ratios are 1.1, 1.2 and 4.0 per cent, respectively, for CDs, all Treasury securities and Treasury bills alone. These measures indicate the wide acceptance of CDs as a money market instrument. It is interesting to note that while bills comprise only one-fourth of all Treasury securities, they account for about three-fourths of the volume of all Treasury securities traded.

Although comprehensive information on the maturities of CDs traded on the secondary market is not available, some indications may be obtained from the quote sheets published by major dealers. These sheets list the CDs that dealers are offering for sale, specifying issuing bank, amount, maturity date, coupon rate and market yield. The great majority of CDs listed in recent months matured within three months of the offering date. These are the maturities banks are effectively precluded from selling by the 1 per cent interest rate ceiling imposed by Regulation Q and can be obtained only on the secondary market.

### Market yields

Market yields on CDs approximate those on prime commercial paper and bankers acceptances. Yields vary, however, with size and reputation of the issuing bank, being lowest for the country's 15 or so largest banks—called "prime" banks—and rising as size of bank diminishes. Although higher than Treasury bill yields, yields on CDs tend to vary directly with changes in the bill yield. The higher yields are attributable, in part, to the relative newness of the market, the name of a

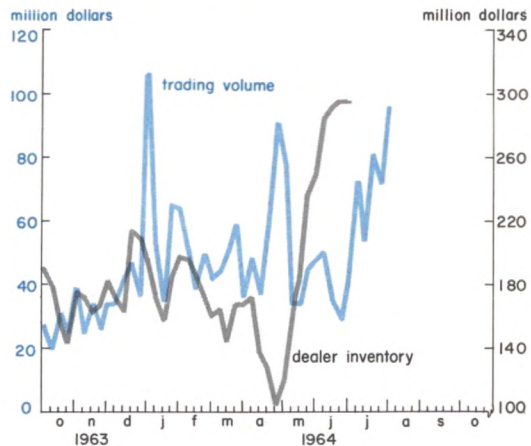
bank instead of the U. S. Government on the instrument and somewhat more limited marketability. While Treasury bills may be transferred by Federal Reserve telegraph for delivery in every city in which a Federal Reserve Bank or branch is located, CDs must be transferred through the mails which is both more costly and time consuming. As a consequence, almost all are physically issued, stored and redeemed in New York City.

Rising interest rates over the past year have made it difficult at times for all but the very largest banks to sell CDs of some maturities at rates below the ceiling. Some of these banks have resorted to the use of brokers and dealers in placing their CDs. These intermediaries generally have a larger area from which to draw customers. They obtain payment for their services either by charging more than they paid or by charging a "finders" fee.

On occasion, some of the finders fee is passed on to the purchaser either directly or indirectly through concession pricing. In the latter case, the finders fee compensates the intermediary for the loss on the sale. If such practices serve to raise the effective yield paid by the bank to the depositor above the ceiling rate, they are considered in violation of Regulation Q.

The Federal Home Loan Bank has recently acted to discourage savings and loan associations from investing heavily in CDs issued by any one commercial bank. Member associations may now include these certificates as part of their liquidity requirement only if "the deposit, together with all other time deposits of the association in the same bank does not exceed the greater of one-quarter of 1 per cent of such bank's total deposits as of the bank's last published statement of condition or \$10,000." In addition, member associations may not include CDs

### Trading volume and dealer inventory tend to move in opposite directions



whose acquisition involve payment from a third party in connection with the making of the deposit.

The recent unfortunate experience of a few small banks with CDs should not greatly affect their use as a money market instrument. The market for CDs issued by the country's largest and best known banks may be expected to prosper and expand.