APRIL 1962

BUSINESS REVIEW

Balance of Payments and Monetary Policy

The Long and the Short of It: Bankers are Reaching Out for Longer-Term Securities Again

FEDERAL RESERVE BANK OF PHILADELPHIA

BUSINESS REVIEW

is produced in the Department of Research. Clay J. Anderson was primarily responsible for the article "Balance of Payments and Monetary Policy" and J. C. Rothwell for "The Long and the Short of It." The authors will be glad to receive comments on their articles.

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BALANCE OF PAYMENTS AND MONETARY POLICY*

Spending, borrowing and lending, and investing are not confined within national boundary lines. Consumers and business firms in the United States buy goods and services from all over the world. We lend and invest in foreign countries; foreigners lend and invest here. We pay interest and dividends on foreign investments in this country and, in turn, receive income on funds invested abroad. We are spending large amounts for foreign travel—much more than foreign visitors spend here. Our Government makes large payments abroad; foreign governments make payments here. These are only a few illustrations of the multitude of transactions that crisscross national boundary lines. Some transactions result in receipts from, others in payments to foreign countries.

International transactions have not attracted as widespread interest here as in most foreign countries. This is not surprising. Exports account for less than 4 per cent of our total output of goods and services. But foreign trade is much more important to most countries. The United Kingdom and West Germany export about one-fourth and the Netherlands over one-half of their total output. Our growing concern about the balance of international payments has been aroused by a persistent deficit and, especially in the past few years, substantial losses of gold.

I am going to deal briefly with four questions:
What is the balance of payments?
Why has the United States been running a deficit?
What about the impact of the Common Market?
What are the implications of our balance-of-payments position for monetary policy?

* A talk by Clay J. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia, to the Second Post Graduate Seminar, Central States Graduate School of Banking, Chicago, Illinois, March 9, 1962.

BALANCE OF PAYMENTS

The balance of payments commonly refers to a summary statement showing a country's receipts from and payments to foreign countries during a given period of time. A country's international transactions are classified to show its main sources of receipts and principal types of payments. If payments are larger than receipts, a country has a deficit; if receipts are larger than payments, it has a surplus in its international transactions. (Of course, if transfers of gold and net changes in foreign assets and liabilities are included, receipts and payments are equal.) A simplified statement of the balance of payments of the United States in 1961 is given on page 4.

Receipts

Exports are by far our largest source of foreign receipts. Agricultural products, industrial supplies and materials, and capital equipment account for a large part of our exports. Transportation and other services, and earnings on investments abroad are other significant sources of receipts from foreign countries.

Payments

Our largest item of expenditure abroad is for imported goods. There are also substantial payments for a variety of services rendered by foreigners, and expenditures by United States tourists

UNITED STATES BALANCE OF PAYMENTS, 1961

(Billions of Dollars)

Receipts		
Exports		$19.9
Transportation, travel, and miscellaneous services		4.8
Income from investments abroad		3.6
Inflow of foreign private long-term capital		0.4
U. S. Government receipts		1.3
Total receipts		$30.0
Payments		
Imports		$14.5
Transportation, travel, and miscellaneous services		4.7
Interest, dividends on foreign investments in U. S.		0.9
Private remittances and other transfers		0.9
Outflow of private long-term capital		2.6
Direct investment	$1.6	
U. S. Government payments		7.1
Military expenditures	3.0	
Government grants, loans and aid	4.1	
Total payments		$30.6
Basic balance: deficit		$ 0.6
Net outflow of short-term capital		1.2
Unrecorded transactions, errors, and omissions		0.6
Over-all deficit		2.5

Note: Detail may not add to totals because of rounding.

traveling in foreign countries. In recent years, private long-term investments in foreign countries have averaged about $2.5 billion annually. Government payments to foreign countries, primarily military expenditures and economic aid, have been large throughout the postwar period.

The basic balance of payments, a term frequently used, includes international transactions in goods and services, private long-term capital movements, and Government transactions. It excludes short-term capital flows, which often reflect interest-rate differentials and other temporary forces rather than more fundamental economic conditions. In 1961 there was a deficit of $600 million in our basic balance of payments. A net outflow of short-term capital of $1.2 billion, and unrecorded transactions believed to be mainly short-term capital flows brought the over-all deficit to $2.5 billion. If debt prepayments by foreign governments are excluded, the total was $3.2 billion.

Payments mechanism

In domestic transactions only one monetary unit—the dollar—is involved in making payments and settling balances. Sales and other sources of receipts are in dollars, and dollars can be used in any type of payment.

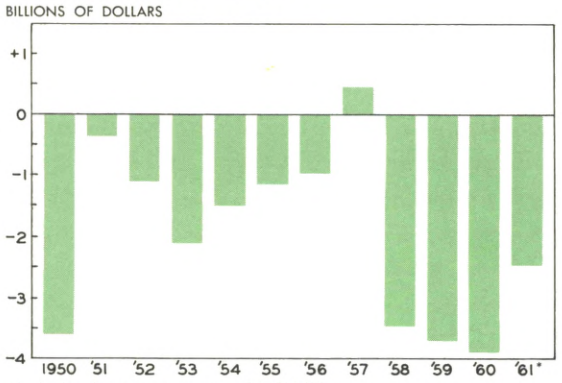
In foreign transactions there is no international monetary unit that is generally acceptable in payment of international transactions. There is a well-developed foreign exchange market, however, in international financial centers, such as New York, London, and Paris. Exporters and others with bills of exchange payable in foreign currencies can sell their bills to their bank or foreign exchange dealer. They receive dollars at the current rate of exchange. The buying banks and dealers send the bills abroad for collection and payment, thus building up their balances of foreign currencies. These balances enable banks and dealers to sell foreign currencies to importers and others needing to make payment abroad. In short, exports and other sources of receipts provide foreign currencies which can be used to pay for imports and other expenditures abroad. Through banks and other foreign exchange dealers, the bulk of international transactions is settled by transfers of credit instruments and debits and credits to the appropriate accounts.

WHY A DEFICIT?

A deficit in our balance of international payments is not something new. The United States has had a deficit every year, except 1957, since 1949. The "dollar shortage" and the "dollar gap," which attracted so much attention in the early postwar period, vanished in the fifties.

The annual deficit was not large until 1958. The small surplus in 1957 reflected primarily the surge in United States exports as a result of the Suez crisis. Beginning in 1958, the deficit soared

BALANCE OF PAYMENTS



*Includes debt prepayment of $0.7 billion.

and averaged nearly $3.5 billion during the past four years. There was some improvement last year but the amount was small if debt prepayments by foreign governments are excluded.

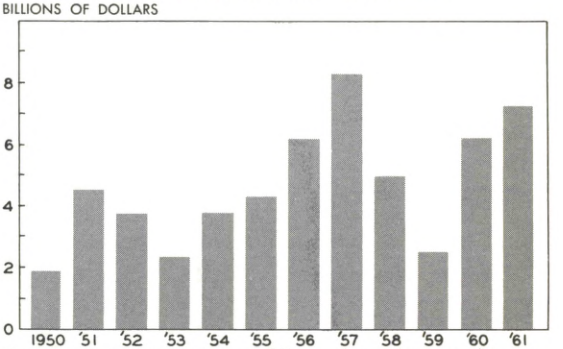
The causes of the persistent balance-of-payments deficit cannot be pinpointed. Both receipts and payments reflect the sum of a multitude of transactions. The deficit is the result of all transactions, not just a few. Nevertheless, it may be helpful to take a look at some major categories of international transactions to see where our strengths and weaknesses lie.

Surplus on goods and services

The United States has had a surplus on goods and services for many years. Receipts from sales of merchandise, services rendered foreigners, and income on foreign investments have substantially exceeded payments to foreigners for these purposes. The annual surplus on goods and services since 1949 has ranged from a low of about $2 billion to a high of over $8 billion. Last year the surplus exceeded $7 billion.

Merchandise has contributed the major part of the United States surplus on goods and services. The excess of merchandise exports over imports averaged around $4 billion during the past five years. During that time, we sold more goods than we bought in practically all major geographical sectors of the free world—Canada, Western Europe, Asia, and Africa. Trade with the Western Hemisphere other than Canada was about in balance—some years showing a small deficit and others a small surplus.

BALANCE OF GOODS AND SERVICES*

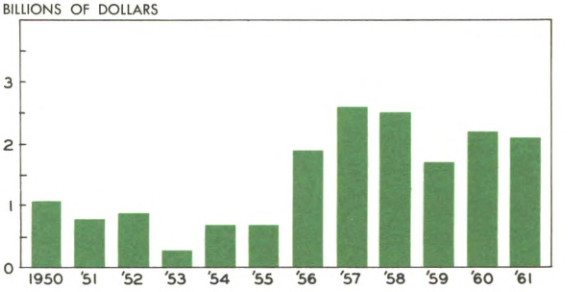


*Includes investment income, military sales, private remittances, and pensions.

Private long-term capital

Individuals and business firms lend and invest more abroad than foreigners lend and invest in the United States. The net outflow of private long-term capital has been considerably larger since the mid-fifties. The bulk of this outflow has been in the form of direct investments in plant and equipment. A part represents portfolio investment; that is, purchases of foreign securities.

NET OUTFLOW—PRIVATE LONG-TERM CAPITAL



New loans and investments abroad result in payments to foreign countries; however, they later build up a return flow of receipts in the form of interest, dividends, and debt repayment.

United States direct investments in foreign countries total close to $35 billion. The bulk of the investments is in manufacturing, petroleum, and mining. As to the geographical distribution, the largest amount is in Canada; but there are also substantial amounts in South American countries and in Europe. Direct investments in the Common Market countries total about $3 billion.

Government payments

Government payments abroad are much larger than receipts from foreign governments. Last year, payments exceeded receipts by nearly $6 billion, and the net outflow on Government account has averaged about this amount annually during the past five years.

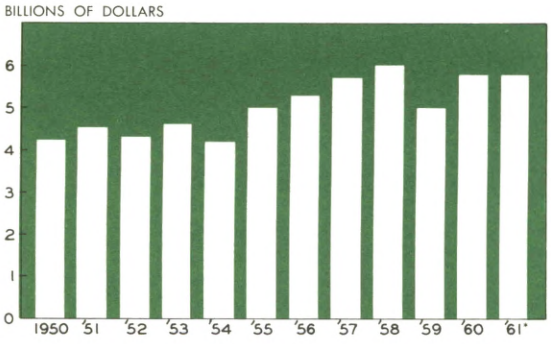
A large part of the Government's payments abroad is for maintenance of United States troops and bases in foreign countries. Military expenditures, which have been running about $3 billion a year, are an integral part of the nation's defense program.

Throughout the postwar period the United States has spent large sums aiding in the reconstruction and development of many foreign countries. In the early postwar years, Government loans and grants went primarily to European countries and Japan to assist in the reconstruction of war-devastated areas. Later, Government aid was shifted to help promote economic development in the underdeveloped countries. Net Government economic aid to foreign countries has averaged about $3 billion annually in recent years. These payments are directly related to our exports in that about 65 cents of every dollar paid out in Government loans and grants is used for the purchase of United States goods and services.

The deficit and gold

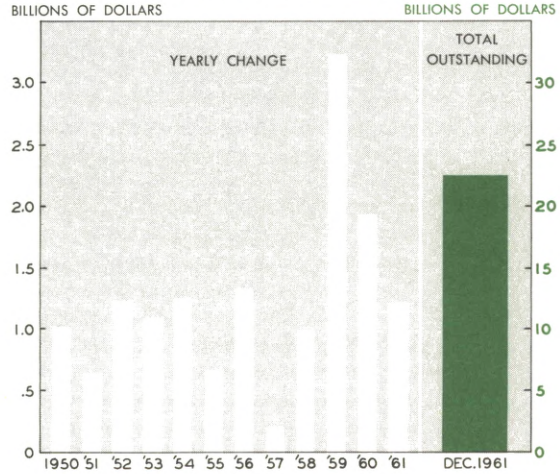
In international transactions, as in domestic, we can spend more than we receive only by going into debt, or by giving up something such as gold that foreign creditors are willing to accept in payment. The initial effect of our deficit is mainly to increase bank deposits in the United States owned by foreigners. Deposits in excess of minimum working balance needs are frequently invested in highly liquid earning assets such as

NET OUTFLOW—UNITED STATES GOVERNMENT PAYMENTS



*Includes debt prepayment of $0.7 billion.

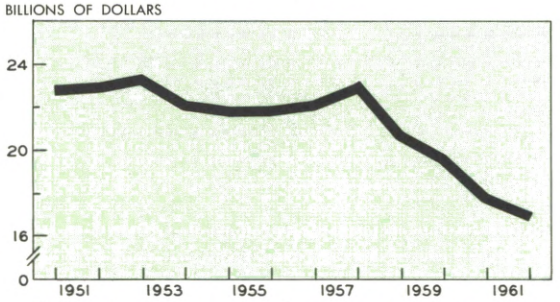
SHORT-TERM LIABILITIES TO FOREIGNERS



U. S. Treasury bills and other short-term securities and paper. Thus when foreigners accept dollars in payment of deficits, our liabilities to foreigners increase and they accumulate deposits and other short-term dollar assets in the United States.

Foreign holdings of short-term dollar assets total about $22.5 billion. The principal source of these foreign-owned dollar assets has been the deficits in the United States balance of payments. About 70 per cent of the combined deficit since 1949 has been settled in dollars and the remainder by a transfer of gold.

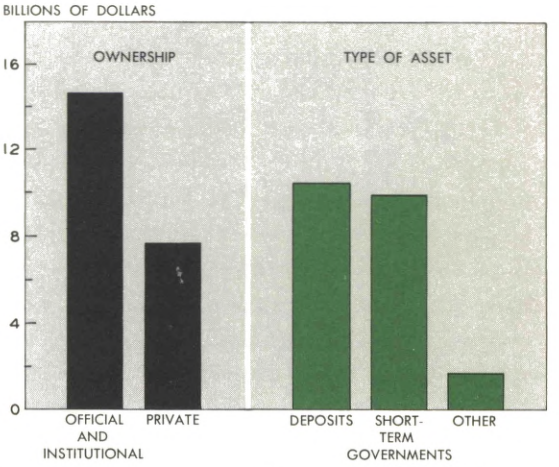
UNITED STATES GOLD STOCK



What determines whether our deficits are settled in dollars or gold? The choice rests with our foreign creditors. The largest part of our short-term liabilities to foreigners is to official institutions—central banks and governments—and to international institutions such as the International Monetary Fund. The fact that the dollar is a widely used medium of international payments, ability of foreign official institutions to convert dollars into gold for legitimate monetary purposes, and confidence that the United States will maintain the value of the dollar are important reasons why foreigners are willing to hold dollars. Many foreign central banks hold a part or all of their monetary reserves in dollars. Some invest a part of their dollar reserves in highly liquid earning assets such as Treasury bills and

SHORT-TERM DOLLAR ASSETS OWNED BY FOREIGNERS

December, 1961.



bankers' acceptances. Others hold practically all of their reserves in gold. When the latter acquire dollars a loss of gold is almost automatic.

Private institutions, which hold roughly one-third of foreign-owned short-term dollar assets, need dollar working balances in conducting international transactions. Willingness to hold an excess above a minimum working balance depends on their confidence in the future value of the dollar and on the interest rate they can earn on short-term investments compared with rates available on similar investments in other countries with stable currencies. Now that the major currencies are convertible, interest-rate differentials tend to generate a flow of short-term funds from international money centers with lower to those with higher short-term rates. Higher rates abroad, especially in Great Britain, have been an important reason for the net outflow of short-term capital from the United States in the past two years. Ordinarily, official institutions and international organizations do not shift balances from one center to another to take advantage of interest-rate differentials.

IMPACT OF THE COMMON MARKET

The possible impact of the Common Market on United States exports and imports and hence on our balance-of-payments position is another question of considerable current interest. The European Economic Community, usually referred to as the Common Market, includes six countries: France, Germany, Italy, the Netherlands, Belgium, and Luxembourg. The United Kingdom and Denmark have applied for admission; hence the number of members may be increased soon. One of the goals is the removal of tariff and trade barriers between member countries and establishment of a uniform external tariff on imports from outside the Common Market. Thus far, tariffs among Common Market countries have been reduced 40 per cent.

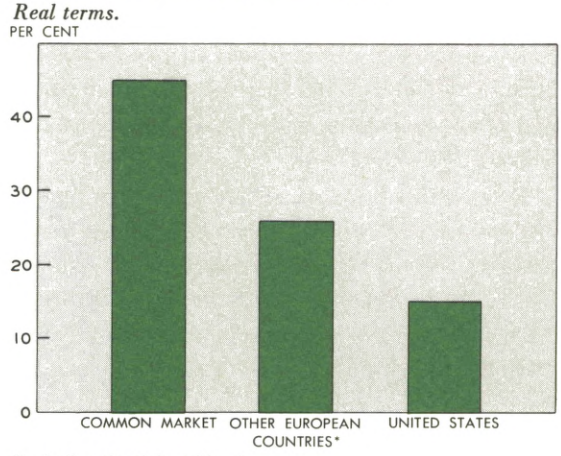
It is much too soon to have any clear idea of the influence of the Common Market on our balance of payments. For one thing, the effect will depend significantly on the trade program adopted by the United States and the Government's success in negotiating a reduction in the Common Market's external tariffs. It may be useful, however, to look at a few facts and some of the broader implications in order to put the problem in better perspective.

Geographically, the Common Market is much smaller than the United States, but it has nearly as large a population. Its total output and per capita income are only about one-third of ours, but its exports are about the same as ours and imports are considerably larger.

The Common Market countries have been experiencing an unusually rapid rate of growth. From 1953 to 1960, total output in real terms increased 45 per cent as compared with 26 per cent for the rest of Europe and 15 per cent for the United States. Common Market countries account for roughly one-sixth of our exports and

INCREASE IN G.N.P., 1953–1960

Real terms.

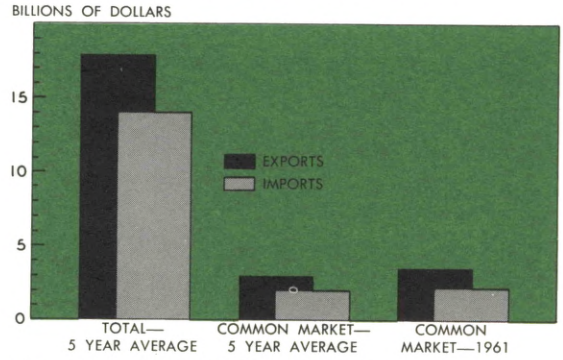


*Including the United Kingdom.

imports. In recent years, our exports to the Common Market have consistently exceeded our imports from these countries. The export surplus last year was $1.3 billion, as compared with an annual average of $1 billion for the past five years.

The Common Market is likely to have diverse influences on foreign receipts of the United States. Reduction and the eventual elimination of tariffs and other trade barriers within the Common Market are tending to give producers in those countries an increasing advantage in competing

UNITED STATES MERCHANDISE TRADE*



*Some exports were excluded from figures for security reasons.

with United States exporters. This advantage is an important reason for the provision in the recently proposed Trade Expansion Act that would give the President greater authority in negotiating broad reductions in tariffs between the Common Market and the United States.

Rapid growth in income and purchasing power in Common Market countries is creating an expanding market which will tend to offset adverse effects on United States exports. It is significant also that only a small percentage of the families in the Common Market countries own automobiles and major appliances such as refrigerators, freezers, and television sets. A largely untapped market for consumer durables could afford American producers an excellent opportunity to increase their exports.

There is a widespread impression that lower costs and a slower rate of rise, especially in wages, give Common Market producers an important competitive advantage. It is extremely difficult to get a reasonably accurate comparison of production costs in different countries; however, material recently prepared for the Joint Economic Committee of Congress does not indicate that our exporters are at a significant disadvantage in this respect. Total wage costs increased less in the United States from 1953–1959 than in four of the Common Market countries. The increase in France was slightly less than in the United States, and data were not given for Luxembourg. The 27 per cent increase in total wage costs in the United States was considerably below the increases in West Germany, Belgium, the Netherlands, and Italy, which ranged from a low of 37 per cent for Belgium to a high of 55 per cent for Germany. The United Kingdom had an increase of 48 per cent.

A more significant indicator from the standpoint of competition is wage cost per unit of output. During the period 1953–1959, wage costs per unit of output increased 12 per cent here as compared with increases of 20 per cent in the United Kingdom, 18 per cent in the Netherlands, 7 per cent in Germany, and decreases in Italy and in Belgium. Large productivity gains enabled Italy and Belgium to reduce wage costs per unit despite substantial increases in total wages. A recent survey by the National Industrial Conference Board of American manufacturers with plants abroad indicated that lower productivity and higher non-wage costs frequently offset or more than offset the lower money wage rates in foreign countries.

The other side of the coin is the effect of the Common Market on United States imports. A mutual reduction of tariff and trade barriers would tend to stimulate our exports to the Common Market, but it would also make it easier for Common Market producers to sell in the United States.

A large part of our imports is in tropical and semi-tropical products not produced here, and raw materials and other products used in further production. Imports that do compete with domestic industry often stimulate progress and the development of new products. The automobile industry is a recent example. A growing volume of imports spurred domestic manufacturers to bring out small cars to compete with the foreign compacts. Thus far, American compacts have been competing successfully with foreign cars of the same class.

A vital factor influencing our ability to compete with the Common Market, in addition to tariff negotiations, is the behavior of costs and prices. A rising cost-price spiral in the United States would tend to price our producers out of world markets, resulting in an increase in imports and a decrease in exports.

WHAT ARE THE IMPLICATIONS FOR MONETARY POLICY?

Finally, what are the implications of our balance-of-payments deficits for monetary policy?

Solving our balance-of-payments problem requires an over-all program of which monetary policy is only a part. The Government has taken a number of steps to try to bring foreign receipts and payments into balance. A broader program of export credit insurance, more information about sales opportunities abroad, greater emphasis on the need for holding the line on costs and prices to help keep American producers competitive are among the measures designed to encourage exports. Other steps have been taken to reduce foreign payments, such as lowering the duty-free allowance of returning United States tourists from $500 to $100, attempts to get other countries to assume a larger share of foreign aid, and increased emphasis that purchases required under our foreign aid programs be made in the United States.

Where does monetary policy fit into the over-all program? There are several things that monetary policy can do.

One implication is obvious. In using monetary policy to foster high levels of production and employment, and sustained growth we must be careful to avoid inflation. A rising cost-price spiral would have a double-edged effect on the balance-of-payments deficit; it would reduce our foreign receipts and increase payments.

A second and closely related implication for monetary policy derives from the large volume of short-term dollar assets held by foreigners. Willingness of foreigners to continue to hold reserves and working balances in dollars will depend on their faith and confidence in the future value and stability of the dollar. Loss of confidence could induce large-scale withdrawals of dollars and gold. If this embarrassment is to be avoided and if the dollar is to continue to serve as the world's leading international reserve currency, it is imperative that the value of the dollar be protected and foreign confidence preserved by sound monetary and fiscal policies.

A third implication, now that the major currencies are convertible, is that international interest-rate differentials, especially short-term rates, should be considered in formulating monetary policy. Short-term funds have become sensitive to differences in interest rates. Relatively low short-term rates in the United States during the past two years resulted in increases in foreign borrowing here and substantial outflows of short-term capital.

The Federal Reserve was thus confronted with objectives calling for conflicting actions—ample reserves and low interest rates to promote recovery and facilitate sustained growth, but relatively high short-term rates were needed to slow or at least not aggravate the outflow of short-term funds and loss of gold. In an attempt to achieve both objectives, the Fed pursued an easy money policy but supplied reserves in ways that would exert minimum downward pressure on short-term rates. Under legislative authority previously granted, member banks were permitted to count vault cash as reserves. The Fed also supplied a large volume of reserves by purchasing intermediate and longer maturities of Government securities, putting the direct downward pressure on intermediate- and long- rather than short-term rates.

Fortunately, the United States has a total gold stock of $16.7 billion, providing a $5 billion cushion of excess reserves. A cushion of excess reserves has enabled Federal Reserve authorities to direct monetary policy toward achievement of domestic economic goals even though techniques

employed in supplying reserves were adapted to the needs of the balance-of-payments situation.

CONCLUDING REMARKS

In closing, there are four points I should like to emphasize.

First, our balance-of-payments deficit persists because it springs from deepseated causes. The surplus on goods and services is not large enough to cover the net outflow of private long-term capital and Government payments required in the foreign military and economic aid programs.

Second, in our current economic environment, the deficit does not generate important self-correcting market forces. It can be eliminated only by discretionary action on a broad front. If steps already taken prove inadequate, more drastic action will be required.

Third, the Common Market is not just a strong competitor. It is an area of rapidly rising income; and let us hope our Government will be able to negotiate a trade program that will give our exporters reasonable access to this growing market.

Finally, in using monetary policy to help achieve sustained growth in output and employment, we should not overlook the importance of reasonable price stability. Rising prices would tend to price our products out of the world market, intensify our balance-of-payments problem and, if long continued, might undermine confidence in the dollar and lead to large withdrawals of dollars and gold.

THE LONG AND THE SHORT OF IT:

BANKERS ARE REACHING OUT FOR LONGER-TERM SECURITIES AGAIN

June 22, 1961—The banker settled back in his high leather chair and began to speak:

"We learned our lesson during the last two periods of business recession and early recovery—in 1953–1954 and 1957–1958. Loan demand was off and we started buying longer-term securities with higher interest rates. It was the only thing we could do to bolster sagging profit margins. Then—bam!—the business recovery got up a head of steam, interest rates rose, and we had to sell our long and intermediate securities at a discount in order to meet a rising loan demand. But we learned. During the 1960–1961 recession, we put most of our money in short-terms."

March 20, 1962—The banker tapped his ballpoint pen on the desk for emphasis:

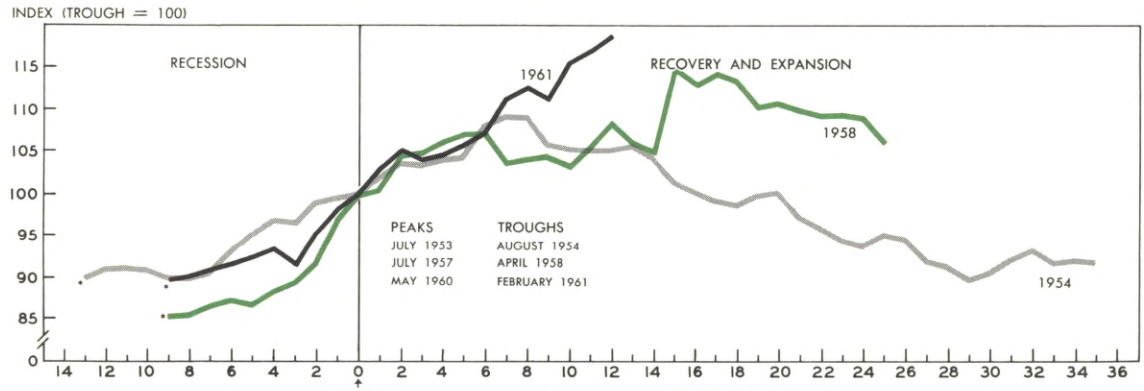
"Profit margins are under pressure again. Sagging loan demand and rising interest rates on time and savings deposits are forcing us to go after higher-yielding, longer-term securities. It's the only way we can meet higher costs and still make a decent report to stockholders at year's end."

The above are typical comments from typical bankers explaining the shift in investment policy which has occurred at many banks in the past few months. From an emphasis on shorter-term securities, manifest during the most recent business recession and for several months thereafter, bankers now are nodding more and more approvingly at intermediate- and longer-term issues.

This raises some interesting questions: (1) how do the timing and magnitude of the present portfolio adjustment compare with similar phases of past business cycles, (2) why the current interest in longer maturities, (3) will the present

CHART 1

"OTHER" SECURITIES—WEEKLY REPORTING MEMBER BANKS



*Business cycle peak.

effort to buy longer-term issues unduly impair bank liquidity?

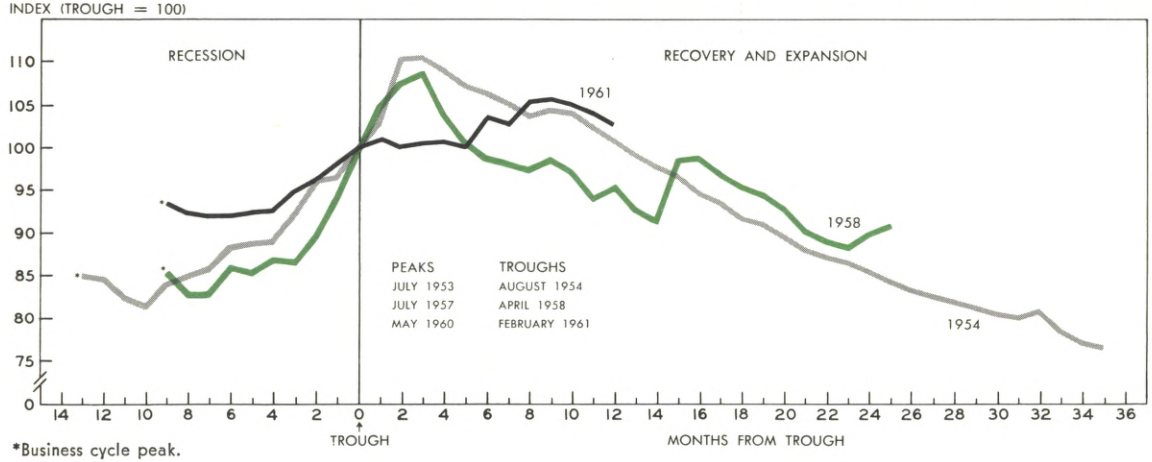
TIMING AND MAGNITUDE

In their efforts to increase yields, bankers* have concentrated especially on "other" securities—a classification consisting chiefly of municipals and corporates. As may be seen in Chart 1, banks accumulated these securities rapidly as the economy ebbed into the recessions of 1953–1954, 1957–1958, and 1960–1961. In the two earlier periods, holdings began to level off six to eight months after the recession trough at around 5 to 9 per cent above the trough level. In the 1961–1962 upturn, however, holdings of these securities are still rising at a rapid clip 12 months after the low point of the recession. Latest available data place

*The terms "bank" and "banker" are used throughout to mean weekly reporting banks, except as otherwise indicated.

CHART 2

UNITED STATES GOVERNMENT NOTES AND BONDS—WEEKLY REPORTING MEMBER BANKS

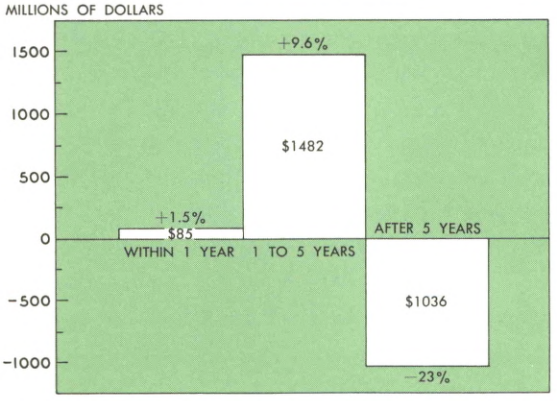


*Business cycle peak.

CHART 3

WEEKLY REPORTING MEMBER BANK HOLDINGS OF UNITED STATES TREASURY NOTES AND BONDS

Change from June 1961 to February 1962.



"other" securities 18.5 per cent above the 1961 recession trough.

Bank holdings of United States Treasury notes and bonds tell another story. These securities were added rapidly to bank portfolios during the two previous downturns, and a little less rapidly during the 1961 recession (as shown in Chart 2). During the 1953–1954 and 1957–1958 *upturns*, banks cut their holdings of notes and bonds sharply three months after the cycle trough. In the 1961–1962 upturn, on the other hand, banks kept their holdings of notes and bonds relatively stable for the first five months after the trough, then increased them sharply. In the past three months, note and bond holdings have begun to drift downward, but are still above levels associated with past recessions.

Chart 3 shows changes in the maturity distribution of bank holdings of notes and bonds during the period of rapid accumulation between June, 1961 and February, 1962. As may be seen, the accumulation was chiefly in the one- to five-year sector, the after-five-year area showing a marked decline. This would seem to indicate that bankers are not prepared to go too far out in the maturity spectrum, at least in their holdings of Governments.

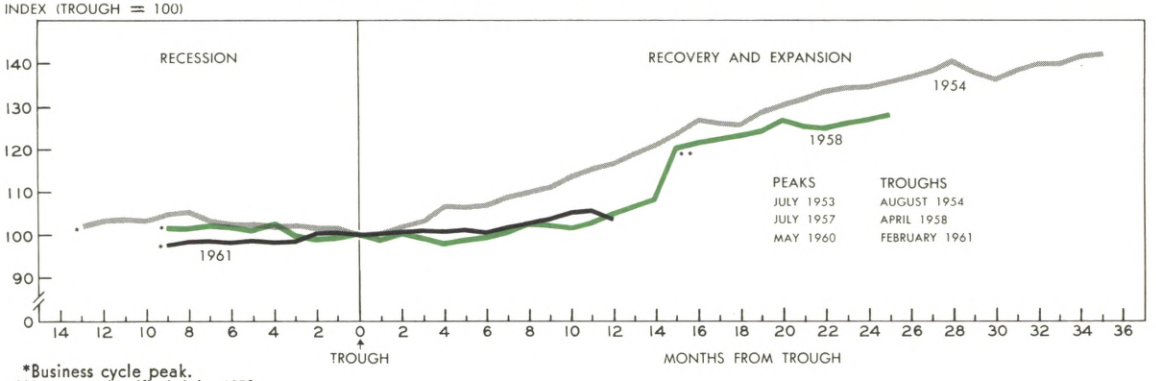
But why should banks be buying longer-term securities at this stage of the business upswing? The answer to this question may be found by examining several factors influencing the management of bank portfolios in recent months.

WHY THE INTEREST IN LONGER-TERM SECURITIES?

First of all, loan demand has not lived up to advance billing. As may be seen in Chart 4, loans

CHART 4

LOANS ADJUSTED—WEEKLY REPORTING MEMBER BANKS



*Business cycle peak.
**Loans reclassified July, 1959.

at weekly reporting member banks since the recession trough have held well below the 1954 level and are now about in line with the 1958 trend. This growth in loans has been slow relative to expectations and relative to the ability of the banking system to lend. Coupled with increasing costs, the slack demand for loans has put pressure on bank earnings. To relieve this pressure, many banks have purchased higher-yielding, longer-term securities.

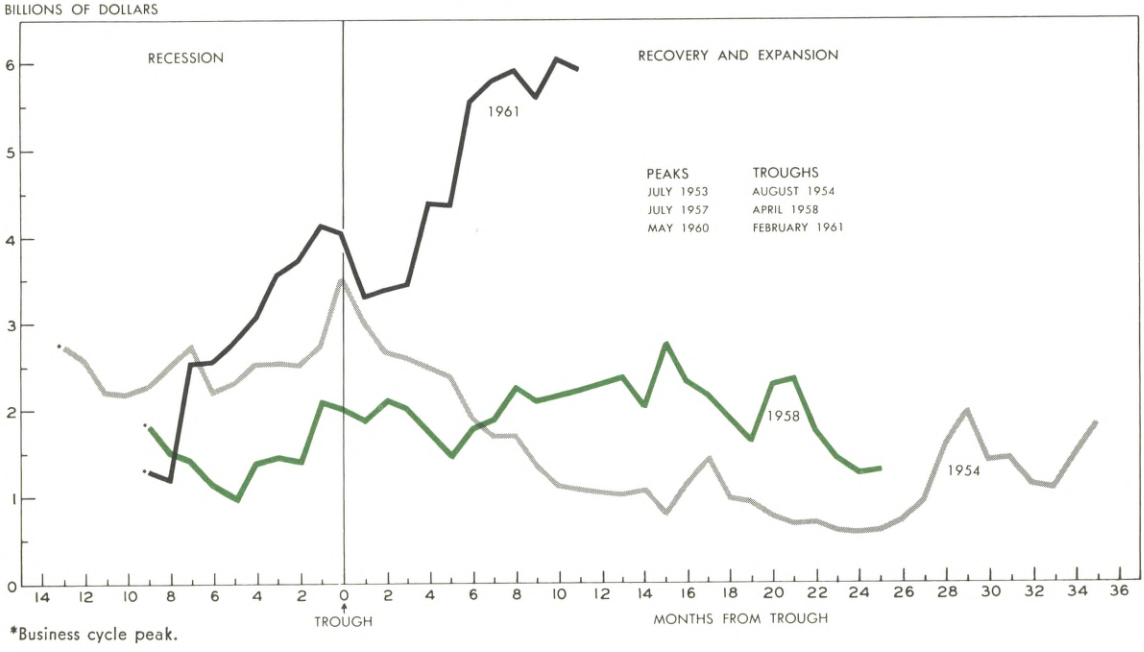
Another reason why banks have been buying longer-term issues concerns the recent revision of the Federal Reserve System's regulation on interest rates member banks may pay on time and saving deposits. Effective January 1, 1962, the rate ceiling was raised to 3½ per cent payable on savings deposits and on time deposits and certificates of at least six months, and 4 per cent on like deposits held for more than a year. Previously, the rate ceiling on all deposits was 3 per cent. Under this provision, many banks have raised rates. The additional expense incurred has encouraged banks to seek out higher-yielding, longer-term securities to add to their portfolios.

As a third factor, one might suspect that part of the emphasis on longer-term issues is in response to the forecast by some bankers that the present business expansion will not be sufficiently brisk to produce inflationary pressures. If this is the case, the reasoning goes, the supply of funds may be adequate to meet loan demand without any upward pressure on interest rates, with the consequence that bond prices might not decline much.

Another factor of importance in bank decisions to buy longer-term securities is the relatively large holding of liquid, though lower-yielding, short-term Treasury bills. As shown in Chart 5,

CHART 5

UNITED STATES TREASURY BILLS—WEEKLY REPORTING MEMBER BANKS



*Business cycle peak.

bank holdings of Treasury bills recently leveled off almost 50 per cent above the 1961 recession trough, much higher than in the two other periods shown. In fact, it is likely that, despite increased bank interest in longer-term issues during business recovery, holdings of Treasury bills rose more than enough to shorten the average maturity of bank investment portfolios. Very recently, the extensive purchases of municipals may have produced some lengthening in the average maturity.

In short, banks have relatively high holdings of short-term Governments. Many banks are experiencing rising costs and are disappointed in the trend of loan demand. Thus, they are willing to reach out for higher-yielding, longer-term securities to add to their investment portfolios. But one further question remains to be explored: Will the present efforts to buy longer-term securities unduly impair bank liquidity?

THE STATE OF BANK LIQUIDITY

An answer to the above question is subject to many imponderables. What will be the future demand for loans? What volume of reserves will be made available to the banking system in coming months?

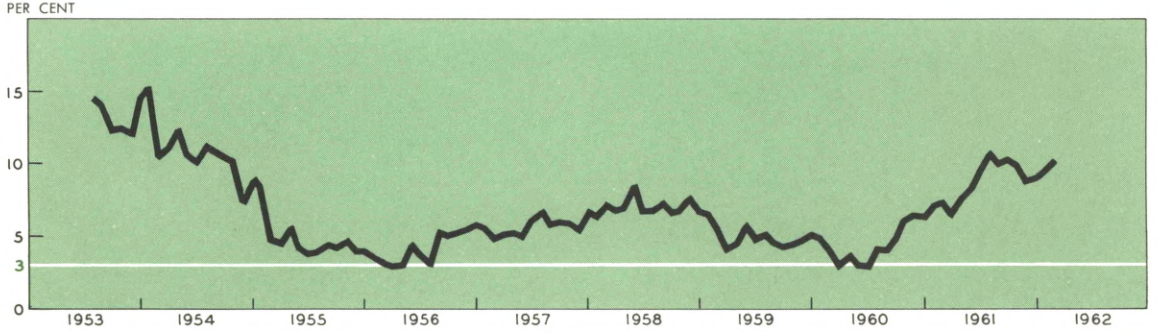
Such questions, of course, cannot be answered with any degree of certainty. Yet it is possible to get some idea of the relative vulnerability of banks to future liquidity pressures by taking a look at their present and past liquidity position.

Chart 6 shows an estimate of all member bank holdings of short-term Government securities as a percentage of total deposits during the period 1953–1962. The last point plotted (February, 1962, 12 months after the 1961 recession trough) shows that member banks held short-term Governments of over 10 per cent of their total deposits. Twelve months following the 1953–1954 and 1957–1958 recession troughs, all member banks had a short-term Government-total deposit ratio of less than 5 per cent, or one-half of the present figure.

Thus the liquidity position of member banks by this measure is high compared to recent years. If the many bankers who have forecast a relatively mild loan demand in future months are indeed correct, liquidity pressures might not even approach those felt in past business upturns. If they are wrong, as forecasters sometimes are, bankers may find themselves repeating the opening quotation in this article.

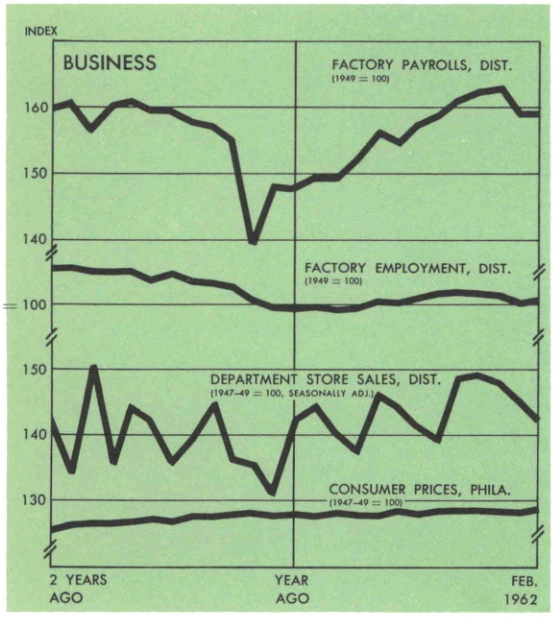
CHART 6

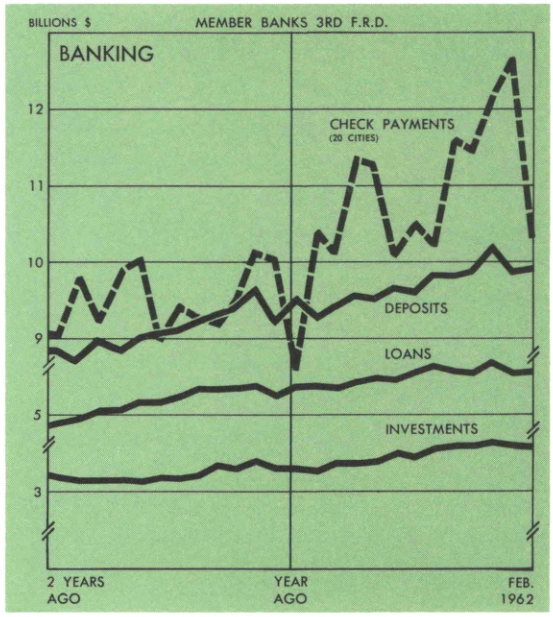
RATIO OF SHORT-TERM UNITED STATES GOVERNMENT SECURITIES* TO TOTAL DEPOSITS—ALL MEMBER BANKS 1953–1962



*Estimates, Federal Reserve Board.

FOR THE RECORD...





SUMMARY

	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	Feb. 1962 from		2 mos. 1962 from year ago	Feb. 1962 from		2 mos. 1962 from year ago
	mo. ago	year ago		mo. ago	year ago	
MANUFACTURING						
Production	....	....	....	+ 3	+14	+13
Electric power consumed	− 2	+15	+17	....	....	....
Man-hours, total*	0	+ 3	+ 3	....	....	....
Employment, total	0	+ 2	+ 1	0	+ 4	+ 3
Wage income*	0	+ 8	+ 8	....	....	....
CONSTRUCTION**	−19	0	+14	+ 3	+23	+14
COAL PRODUCTION	− 7	+ 6	+10	0	+ 8	+ 9
TRADE***						
Department store sales	− 2	− 1	+ 7	+ 1	+ 4	+ 6
Department store stocks	− 1	+ 8	....	− 1	+ 6	....
BANKING						
(All member banks)						
Deposits	0	+ 4	+ 5	0	+ 7	+ 8
Loans	+ 1	+ 3	+ 4	+ 1	+ 6	+ 7
Investments	− 1	+ 8	+ 8	− 1	+10	+11
U.S. Govt. securities	− 1	+10	+10	− 2	+ 8	+ 9
Other	0	+ 4	+ 4	+ 2	+16	+16
Check payments	−18†	+20†	+23†	−19	+ 8	+11
PRICES						
Wholesale	....	....	....	0	0	... 0
Consumer	0‡	+1‡	+ 1‡	0	+ 1	+ 1

*Production workers only.
**Value of contracts.
***Adjusted for seasonal variation.

†20 Cities
‡Philadelphia

LOCAL CHANGES

	Factory*				Department Store†				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change Feb. 1962 from									
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Lehigh Valley	+ 1	+ 5	+ 2	+16	....	....	....	....	−20	+14
Harrisburg	0	− 2	− 1	− 1	....	....	....	....	−17	+ 6
Lancaster	+ 2	+ 3	0	+10	− 5	0	−10	+ 6	−15	+12
Philadelphia	0	+ 1	− 1	+ 6	− 5	− 2	0	+12	−15	+19
Reading	0	+ 5	+ 1	+17	− 4	− 1	− 4	+ 7	−17	+14
Scranton	0	+ 2	+ 1	+10	− 6	− 2	− 3	− 4	−16	− 1
Trenton	− 1	+ 2	− 4	+12	+12	− 2	− 3	− 2	−14	+14
Wilkes-Barre	+ 1	+ 1	+ 3	+10	− 4	+ 4	− 3	− 5	−22	+11
Wilmington	0	− 1	− 2	+ 2	− 3	+ 5	− 8	+ 9	−35	+56
York	0	− 2	− 1	+ 3	+ 9	0	+ 7	+ 7	−14	+10

*Not restricted to corporate limits of cities but covers areas of one or more counties.
†Adjusted for seasonal variation.