

Corporate Liquidity and
Creditworthiness:
A Problem for '71?

A Ceiling That Should Be
Razed

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Corporate Liquidity and Creditworthiness: A Problem for '71?

by Edward G. Boehne

Corporate treasurers are counting heavily on a whopping big boost in profits in 1971 to bolster their inadequate liquidity positions. That, in a nutshell, is the result of our nationwide poll of treasurers of large corporations. But if profits turn out to be less bullish than expected next year, as seems likely, corporations will have to rely more heavily on external funds than they now anticipate.

For firms with top-quality credit ratings, substituting external funds for a shortfall in profits appears manageable. Those firms with less than top-quality credit ratings, however, may find this kind of substitution more difficult. And, as a consequence, less creditworthy firms may find themselves in somewhat of a liquidity bind for '71.

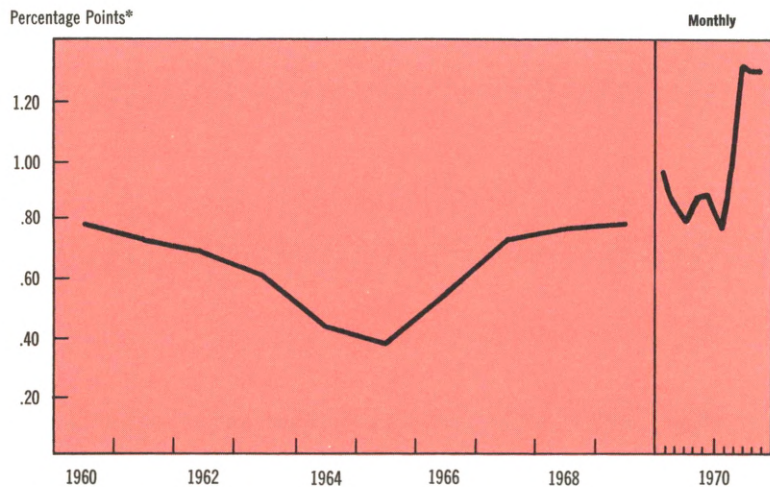
CONTINUING FOCUS ON LIQUIDITY

Overreliance on short-term financing during 1968 and 1969 threw corporate debt structures out of balance. As a result, treasurers have been under considerable pressure in 1970 to reduce large amounts of short-term bank loans, commercial paper, and finance company loans. Much of this reduction in short-term liabilities, however, has had to be done with external funds because of the slump in profits. The result has been record and near-record calendars of corporate bond offerings throughout 1970. So far this year, the cumulative borrowing through public offerings is double the level of 1969.

In addition, the financial community in general became jittery earlier in the year about the ability of some major corporations to refinance their large holdings of short-term liabilities as they became due. As a consequence, there has been a strong emphasis placed on the creditworthiness of borrowers in 1970. The percentage of lower quality bonds sold in the capital

CHART 1

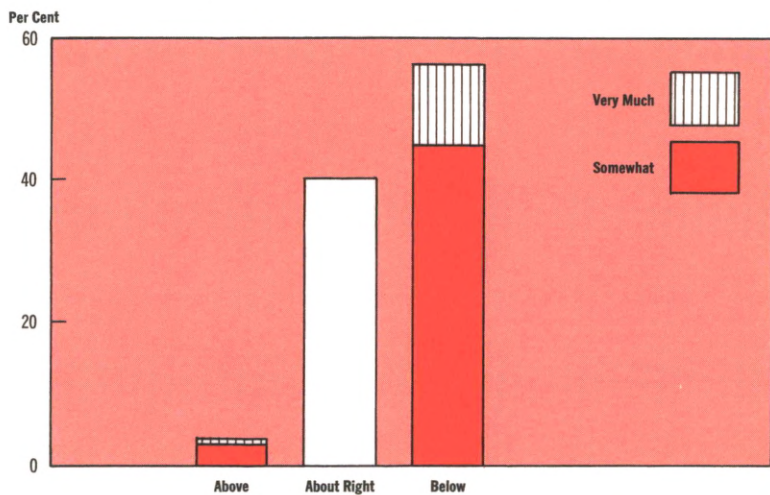
AS LENDERS BECAME MORE CONSCIOUS OF CREDITWORTHINESS IN 1970, THE SPREAD BETWEEN AAA AND BAA BONDS WIDENED SUBSTANTIALLY.



*The rate of interest on BAA bonds minus the rate on AAA bonds.

CHART 2

LIQUIDITY IS STILL BELOW WHAT IT OUGHT TO BE, ACCORDING TO MOST TREASURERS.



markets, for example, has shrunk from 20 per cent in 1969 to 10 per cent this year.¹ Another sign of the emphasis on creditworthiness is the yield spread between AAA and BAA bonds. As shown in Chart 1, the yield spread has jumped remarkably in 1970, rising nearly 50 basis points since June. The existing spread is the highest since 1942 and represents a substantial premium for quality.

Against this background of a major attempt on the part of corporations to improve their debt structures, we asked treasurers how they feel about their liquidity as 1970 ends. Although 40 per cent say their liquidity is adequate, as shown in Chart 2, over one-half

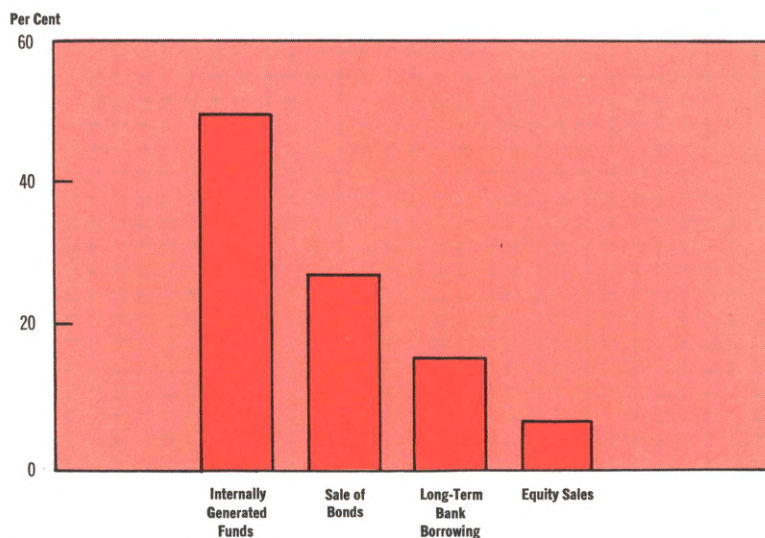
¹ Lower quality bonds refer to issues rated BAA or below. High-quality bonds are those issues rated A and above.

replied that their liquidity positions are below what they ought to be. Nearly one-fifth of those who say liquidity is inadequate say it is very inadequate. Further, a higher proportion of lower quality borrowers have inadequate liquidity compared to higher quality borrowers. For the treasurers who replied that their liquidity is very much below what it should be, nearly two out of three are from firms with lower quality credit ratings.

Improving Liquidity in '71. Treasurers with deficient liquidity positions indicate that they plan further reductions in short-term liabilities to bring their debt structures back into better balance. But, in sharp contrast to 1970, treasurers with inadequate liquidity positions say they will rely more heavily on internal funds

CHART 3

ABOUT ONE-HALF OF THE TREASURERS WITH INADEQUATE LIQUIDITY ARE COUNTING ON INTERNALLY GENERATED FUNDS TO REDUCE SHORT-TERM LIABILITIES IN 1971.



and less on external funds to reduce short-term liabilities next year.

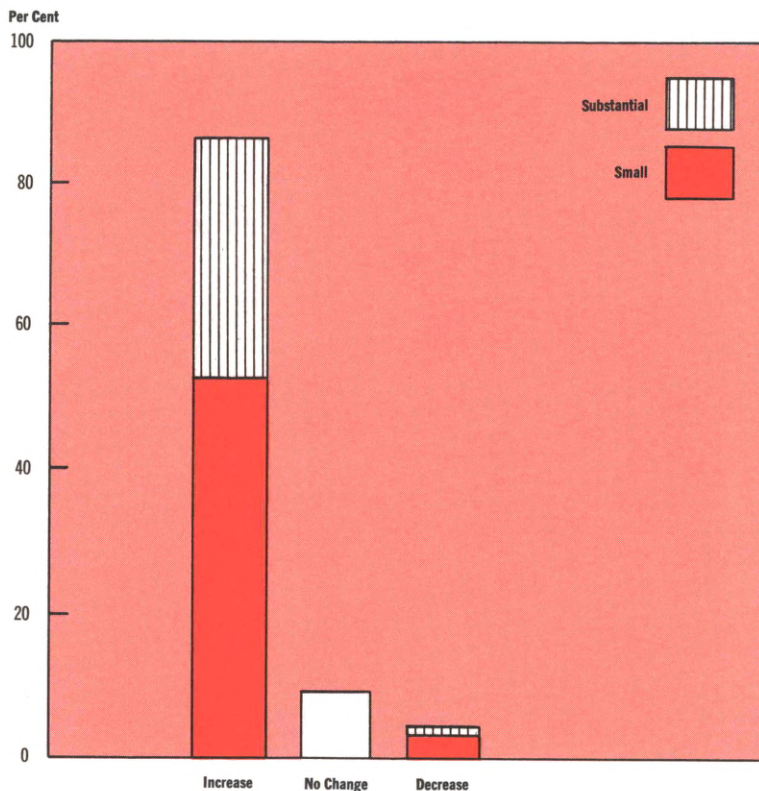
As shown in Chart 3, one-half of these treasurers say they will use internally generated funds to pay off short-term liabilities in '71, while only slightly more than one-quarter plan to go into the bond market, and fewer still plan equity sales. Realistically, lower quality borrowers plan to utilize capital markets less next year than firms with high-quality credit

ratings. But because they are shying away more from bonds than top-quality borrowers, lower quality borrowers are counting more heavily on a larger flow of internal funds to trim their holdings of short-term liabilities in 1971.

Counting on Profits. The increased flow of internal funds, say the treasurers, will come from improved profits next year. An overwhelming majority of all treasurers, as shown

CHART 4

MOST TREASURERS ANTICIPATE A STEP-UP IN PROFITS NEXT YEAR. NEARLY ONE OUT OF THREE EXPECTS A SUBSTANTIAL INCREASE.



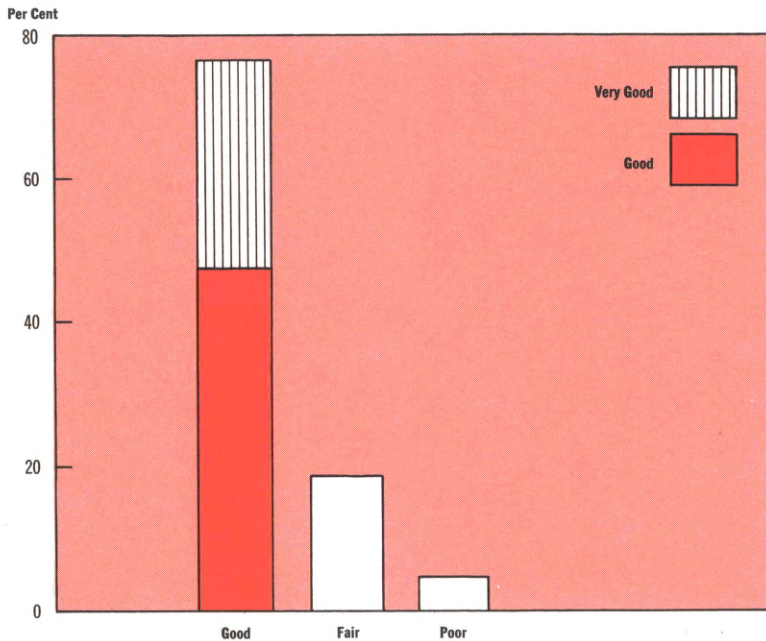
in Chart 4, expects a recovery in after-tax corporate profits in 1971. And nearly one-third of the total respondents anticipates a substantial boost in profits next year. Further, firms with lower credit ratings tend to be more optimistic about substantial increases in profits than firms with high credit ratings. When treasurers were asked to quantify their profit expectations for '71, they replied, on the average, that they anticipate a whopping 18 per cent leap in profits for next year.

A significant improvement in profits seems entirely reasonable next year. The economy has

been sluggish throughout 1970, and strikes have cut into profits in some industries. But an 18 per cent jump in profits for '71 appears questionable. With business spending on new plant and equipment a definite drag on the economy next year and consumer spending shaping up as only little more than a passive sector, it is difficult to envision a sales volume sufficiently large to generate an 18 per cent boost in profits. In addition, despite rising productivity, profit margins are not likely to swell in '71 because of rising labor costs. And the lack of robust demand, along with slack capacity in

CHART 5

NEARLY 80 PER CENT OF THE TREASURERS WHO NEED ADDITIONAL LIQUIDITY IN 1971 RATE THEIR CHANCES AS "GOOD" FOR OBTAINING IT.



most industries, will make price hikes a less attractive remedy than during boom years.

Nonetheless, treasurers are overwhelmingly optimistic about their chances of becoming more liquid by the end of 1971. Just under 80 per cent rate their chances "good" for obtaining more liquidity, as shown in Chart 5. Of these, 30 per cent rate their chances as "very good." In addition, firms with lower quality credit ratings are as confident as higher rated firms about obtaining more liquidity, mainly because they are hoping a greater profit flow will keep them out of the capital markets.

Outlook for Liquidity in '71. If the internal flow of funds falls short of their optimistic expectations, as seems likely, treasurers will be faced with essentially three alternatives: one, they can cut back on their plans to trim short-term liabilities; two, they can curtail spending in other areas, for example, plant and equipment spending; and three, they can rely more on external sources of funds.

A reasonable expectation is that treasurers would opt for all three alternatives in varying degrees. For firms with high credit ratings, a less-than-hoped-for flow of internal funds very probably would be manageable. On the whole, they have made more progress than firms with lower credit ratings in reducing short-term liabilities during 1970. So, they are in a better position to slow the pace of further reductions next year. Also, high-quality borrowers are in a stronger position to substitute external funds if a shortfall in profits develops.

But the lot of less creditworthy firms may not be so fortunate if profit expectations go unrealized. On the one hand, they have a more urgent need to reduce short-term liabilities in 1971 because they had less access to capital

markets for funding in 1970. On the other hand, if profits do fall short of expectations, they may not have any more access in 1971 to quality-conscious lenders in the capital market than they did in 1970. Less-than-top-quality borrowers could turn to the banks to supply them with funds. However, even with sluggish loan demand, banks are quality-conscious as well. So, while liquidity needs in general seem to be manageable in 1971, the survey does indicate that firms with less-than-top-quality credit ratings may find the going somewhat slippery next year.

INVESTMENT STEADY

The bullishness that dominated last year's spending plans for plant and equipment has all but disappeared. As shown in Chart 6, treasurers indicate almost no change in outlays for 1971. Sluggish sales, climbing costs, sagging profits, excess capacity, and pressing liquidity needs have all diminished the anticipated flow of funds to investment. And less-than-expected profits next year again could cause a further rollback in spending plans, particularly if liquidity needs remain pressing.

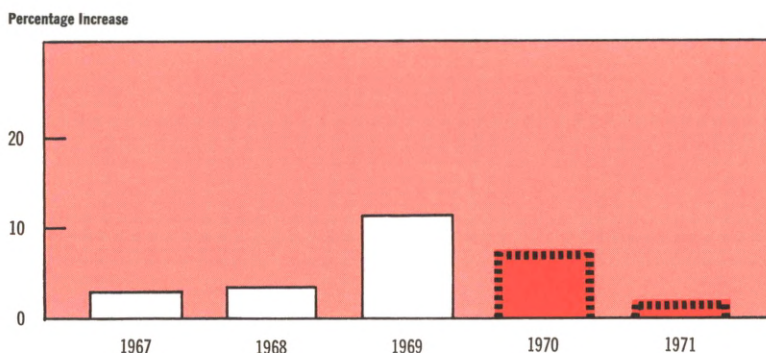
In real terms—after adjusting for inflation—the outlook for investment outlays is even more bearish. The majority of treasurers expects average price increases of 5 to 6 per cent for plant and equipment next year. So, in physical terms, investment is headed for what appears to be a significant decline next year. As a result, business investment will be a major drag on employment and real growth for the overall economy in '71.

INTEREST RATES

Financial markets are affected, of course, by influences other than those generated in the

CHART 6

PLANT AND EQUIPMENT SPENDING WILL RISE ONLY SLIGHTLY NEXT YEAR, SAY CORPORATE TREASURERS.



corporate sector. For example, the impact of the government and mortgage sectors, actions of the Federal Reserve, and inflationary expectations are all important. Nevertheless, treasurers see their own actions as having some impact on money and capital markets in 1971. Because of less reliance on external funds next year, treasurers do anticipate a decline in long-term rates in the coming months, as shown in Chart 7. However, with strong demand for funds from other sectors and expectations of continuing inflation, treasurers forecast only a slight decline in bond rates. Also, the spread between AAA and BAA is expected to narrow only slightly. And treasurers from firms with lower quality credit ratings are somewhat more optimistic about a narrowing of the spread than their counterparts in top-rated firms.

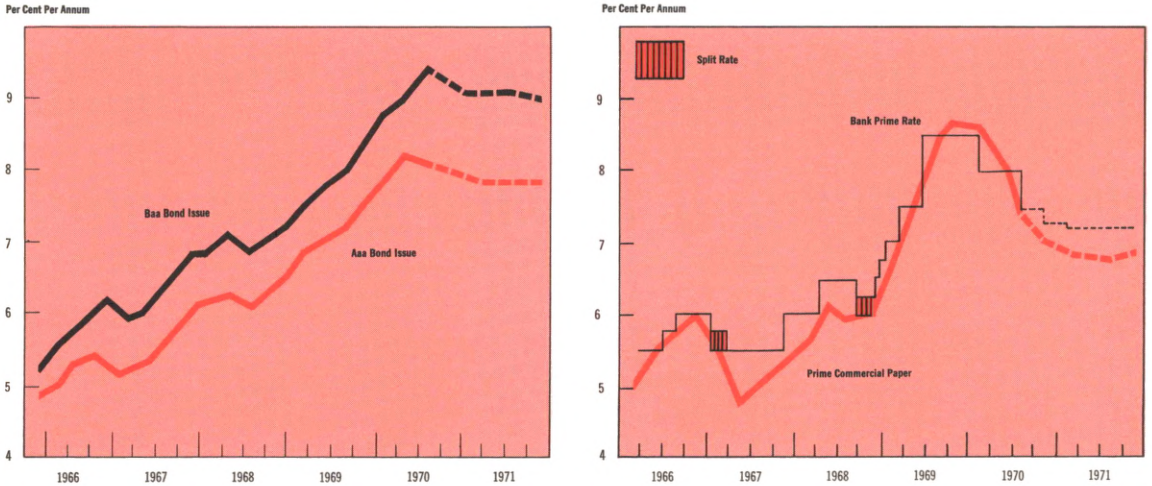
Since treasurers answered the survey questionnaires in October, short-term rates have dropped substantially. Back in October, as

shown in Chart 7, treasurers had expected short-term rates to move down from 50 to 75 basis points through the first quarter of '71 and then level off for the rest of the year. However, the economy has been weaker than expected since October, partly because of the General Motors strike and partly because of more basic deficiencies in demand. The result has been very sluggish demand for business loans. Also, actions of the Federal Reserve have tended to have a depressing effect on the short-term rates. As a consequence, money market rates have fallen much further in recent weeks than treasurers had anticipated.

Still, despite the imprecision of rate projections in the money market, the main message of the treasurers is that reduced reliance on external financing should take some pressures off the financial markets next year. And, although treasurers are aware of noncorporate influences on the money and capital markets,

CHART 7

CORPORATE TREASURERS EXPECT SOME MODEST DECLINE IN INTEREST RATES IN THE COMING MONTHS.



they do not believe that these will be enough to offset what they see basically as some easing in interest rates for 1971. All bets are off, of course, if profits do fall short of expectations and more reliance than now anticipated has to be placed on external funds to meet spending needs.

CONCLUSION

A year ago, corporations were bullish about spending plans for plant and equipment in 1970. But these plans were suspect because they depended on rising profits at a time when the economy was headed downward.

This year, corporate treasurers again have big plans. They are optimistic about improving liquidity in '71 by further reducing short-term liabilities. Again, as in 1970, treasurers are counting heavily on rising profits to meet their objectives. And again, the treasurers' plans have to be questioned. Profits almost certainly will rise in '71. But a jump of 18 per cent, as the treasurers forecast, appears inconsistent with the gradual economic recovery that is beginning to emerge on the 1971 horizon. And because their options for funds are fewer, less creditworthy firms likely will bear the brunt of any shortfall in profits.

ABOUT THE SURVEY

In early October, questionnaires were sent to treasurers of corporations included in *Fortune's* compilation of the largest 500 manufacturing and 200 nonmanufacturing firms. The overall response rate was 63 per cent, with no question answered by less than 40 per cent of the sample.

Although surveys for business outlays on plant and equipment are well known, this survey is the only large-scale attempt to determine the financial feasibility of total corporate spending plans. Since firms responding to our survey account for a large share of the corporate sector, a reading of their financial expectations can give us a clue to the general firmness of overall spending plans for next year.

Two caveats should be noted, however. The survey is limited to the largest firms in the country. No attempt was made to ascertain if expectations of smaller firms might differ. Second, probing expectations of the corporate financial mind on a comprehensive basis is relatively new and must be regarded as experimental. The survey is too new, for example, to attempt to remove systematically biases in the answers of respondents.

Nevertheless, previous surveys of corporate treasurers have shed some light on the year ahead. The 1968 survey, for example, indicated that after-tax profits in 1969 would be about the level of 1968. And they were. Last year's survey demonstrated how vulnerable business investment plans would be to declining profits in 1970. Over a year later, depressed profit levels are indeed turning out to be the achilles' heel of capital spending plans. So, there is reason to look closely at what treasurers tell us about the corporate sector of the economy.

FORECASTS FOR 1971 NOW AVAILABLE

The Department of Research has compiled and analyzed a number of predictions for 1971 made by businessmen, economists, and Government officials. This compilation includes a summary of forecasts for the economy as a whole as well as for particular sectors of the economy. The more important indicators are presented in chart form.

Copies of this release are available upon request from Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

A Ceiling That Should Be Razed

by Warren J. Gustus

Few things are less popular than high interest rates and few people less likely candidates for public sympathy than investors who hold bonds in substantial amounts. This may be one reason why since 1918 all attempts to raise the ceiling on marketable Federal long-term debt above 4¼ per cent have failed. However, as market rates have pierced this ceiling, there have been undesirable consequences for the management of the Federal debt. Furthermore, it is unlikely that there are any offsets to these effects, such as lowered debt costs or lower interest rates in general.

Congressional inaction on repeated requests to remove the ceiling—the most recent of these from the Nixon Administration last year—has resulted in a more rapid increase in short-term debt than otherwise would have occurred. One consequence of this is that the ability to use debt and monetary management in a manner consistent with sound principles is complicated unnecessarily. With over \$120 billion of the debt maturing in the next year, and with the Treasury having to raise substantial amounts of new cash, repeal of this legislation is long overdue.

WHY AND WHEN THE CEILING BEGAN

Before World War I, Congress passed on each new issue of Government securities. It determined the interest rate, maturity, and other characteristics of the debt, and then authorized the Treasury to borrow on an issue-by-issue basis. However, during World War I, because of the necessity of issuing a large number of Government securities, Congress gave the Treasury authority to set the general terms of bonds issued. Congress reserved some control by providing both a ceiling on the amount of public debt that could be issued and a ceiling on interest rates for Treasury bonds.

In 1917, Congress authorized the Treasury to issue a specified amount of marketable bonds at interest rates not in excess of 4 per cent. But sooner or later, interest-rate ceilings have a way of decreasing the supply of funds rather than making them available at some fixed rate. And, by 1918, it was clear that because of the 4 per cent rate, the Treasury could not obtain longer term funds. So, Congress increased the amount which could be borrowed and raised the interest ceiling to $4\frac{1}{4}$ per cent.

Since then, under the pressure of Treasury financing needs, one relaxation of the ceiling has occurred. In 1967, notes which have always been exempt from the ceiling were redefined to be securities with a maximum maturity of seven years instead of five. But in spite of this relaxation by indirection, by 1970, only 27 per cent of the publicly held marketable debt had an original maturity of more than seven years, and 33 per cent had a maturity of one year or less.

MINIMIZATION OF TREASURY DEBT COSTS

One reason given repeatedly by hostile Congressmen for maintaining the interest ceiling is that otherwise Government expenditures would be increased. Most of the time, short-term debt can be sold at a lower interest rate than long; thus, the argument goes, if the Treasury were free to sell longer term debt, costs of the debt to taxpayers would be increased.

However, even if the Treasury had sold long-term debt instead of short, and even if long-term rates had been consistently above short, a policy of lengthening the maturity of the debt would have reduced interest costs substantially below what they are now because of the escalation of all interest rates since 1951. For example, in 1960, yields on long-term Governments aver-

aged 4.01 per cent, which was cheap compared to the yield in 1970 on 3 to 5 year issues, which was about 7.5 per cent. Moreover, this type of comparison tends to understate somewhat how ineffective the ceiling has been in minimizing the cost of the debt.

One reason is that it has been possible at some cost to circumvent the restrictions of the ceiling by use of Agency issues. The growth of Agency issues is in part explained as a device to avoid the restrictions that the ceiling interest rate on debt imposes; the ceiling rate does not apply to Agencies.¹ But since the market usually requires a higher rate on an Agency issue than on a direct Treasury obligation, a long-term Agency issue carries a higher rate than a direct obligation with the same maturity.

Another reason is that interest payments are only part of the costs of the debt. Any Treasury financing is costly in terms of the time required of specialists both inside and outside the Treasury in doing such things as setting the terms, floating the issue, and collecting the funds. Shorter maturities mean more frequent refundings, and the larger the number of issues, the greater the hidden costs of the debt.

DEBT MANAGEMENT AND STABILIZATION

Even if financing long-term were to result in higher total interest payments, this still would be a poor reason for maintaining the ceiling. Minimization of interest costs is not an appropriate goal of debt management when central governments are involved. It is always possible for a government to eliminate interest payments entirely by issuing noninterest bearing obliga-

¹ Another probably more important reason is that Agency issues are not counted in the total debt subject to the debt ceiling.

tions, that is, money. And even under present laws and institutional arrangements, the Treasury and the Federal Reserve could do this if they choose. For example, the Treasury could sell securities to the public. Then, the Federal Reserve could purchase an equivalent amount of securities in the market with newly created funds. The Treasury would pay interest on this debt to the Federal Reserve, which, in due course, would return it to the Treasury as excess earnings. Net outlays of interest by the Treasury for the new debt would be zero, and interest costs of the debt would be reduced. Such a policy carried far enough could eliminate all Federal interest costs. But this policy is undesirable, of course, because it would mean loss of monetary control and inflation.

The Treasury should try to raise funds as efficiently as possible. But this is not the same thing as saying that minimization of interest costs is *the* appropriate criterion for determining how deficits and refundings should be financed if price stability is a policy goal, as most people believe it should be. And it may be that using such a criterion would increase costs above what they otherwise might have been.

Suppose, for example, short-term debt is a closer substitute for money than long-term. However, because of a rate ceiling, any increase in the Federal deficit has to be financed with short-term debt. This would require monetary policy to be more restrictive than it otherwise would be to keep prices stable. Therefore, the central bank would have to sell securities to the public to offset the inflationary impact of the short-term debt. This would tend to increase the costs of the debt because debt publicly held would be increased and along with it interest payments to the holders of the

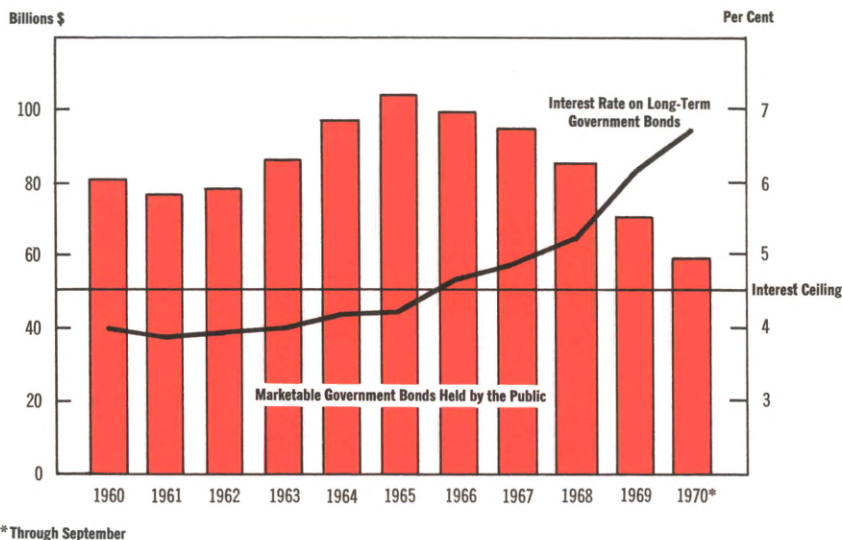
securities.² What the actual costs to the Treasury of alternative debt structures would be is unknown. Nevertheless, it is clear that the question is a complex one and that an interest-minimization criterion, while superficially attractive, may be very misleading.

In addition to longer term considerations about debt maturities and total interest costs, there is also the consideration of debt management as a tool for cyclical stabilization purposes. One component of total spending is the quantity of money; another is the desired income velocity of money or the number of times it turns over. Some believe that by varying the volume of near-moneys, such as short-term Government debt, it is possible to affect the velocity of money or the rate at which people spend. This has led to the suggestion that the maturity of the debt be lengthened during cyclical upturns to dampen liquidity and discourage spending, and shortened during cyclical downturns to increase liquidity and encourage spending.

As it turns out, and as Chart 1 indicates, some of the time since the end of World War II, the ceiling on long-term debt has been no hindrance to the use of debt management as a stabilization tool. This is because the ceiling was above market rates. However, since 1965, the Treasury has been unable to sell marketable bonds because long-term interest rates have exceeded 4.25 per cent. The 1967 revision in the law redefining rates to have a maximum maturity of seven years instead of five provided some relief. Nevertheless, further declines in the average maturity of the debt have occurred.

² This assumes that the marginal tax rate applicable to the public is lower than the marginal rate applicable to the central bank. This assumption is true for the U.S.

CHART 1
INTEREST RATE ON AND OUTSTANDINGS
OF GOVERNMENT BONDS



By August of 1970, average maturity of the publicly held portion of the marketable debt was down to three years, eleven months. The volume of publicly held bonds has declined from about \$110 billion in 1965 to below \$60 billion at present.

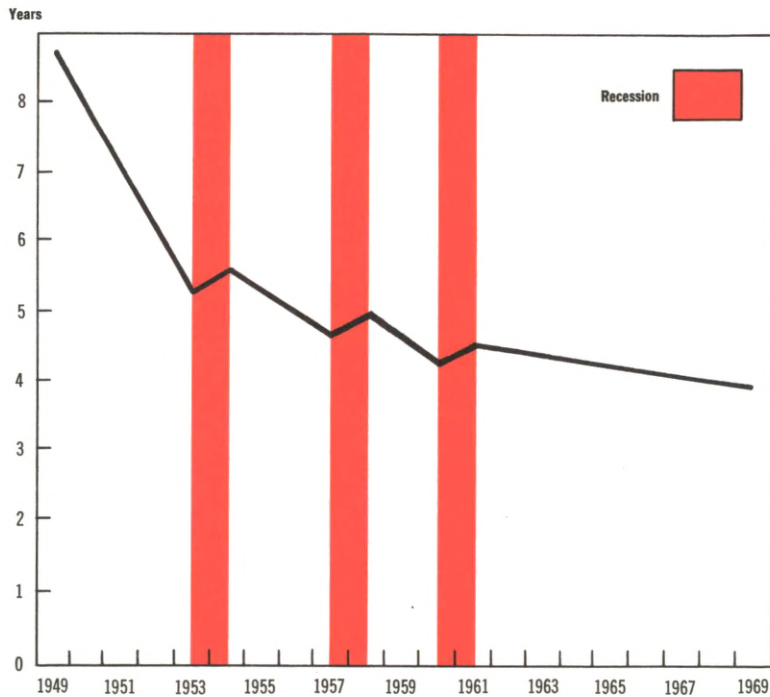
Chart 2 shows that during the 1950's and early 1960's, when the ceiling rate was above market rates, average maturity of the debt tended to decline during cyclical upturns and to increase during cyclical downturns. This is opposite to what a stabilization policy involving changes in the maturities structure would require. Since then, because of the rise in market rates above the ceiling, the Treasury has not had the option of financing long, so it is impossible to tell what it would have done.

Economists disagree about the short-term relation between changes in maturity of the debt and spendings decisions. It may be true, as some claim, that the influence of minor changes in maturity on economic activity is slight. Lengthening maturities during cyclical upturns by making holders of the securities less liquid may not persuade them to spend less. Shortening maturities during cyclical downturns by making holders more liquid may not persuade them to spend more.

Even if changes in the maturity structure would at times have a significant impact, the Treasury might be reluctant to use such changes as a tool of stabilization policy. The pressures might be too strong for the Treasury to borrow short during both cyclical ups and downs—

CHART 2

CYCLICAL BEHAVIOR OF AVERAGE DEBT MATURITIES
(MARKETABLE INTEREST-BEARING PUBLIC DEBT)



Source: Treasury Department

during upturns to minimize interest costs, and during downturns for fear of the impact on investment decisions of increases in long-term rates.

Consequently, the ceiling may be innocuous because spending decisions are insensitive to changes in the maturity of the debt or because the Treasury may be unwilling to manipulate debt maturities in its absence. Even so, it is a bad law and should be repealed. This is because it complicates Treasury housekeeping opera-

tions and, more important, interferes with the implementation of monetary policy.

HOUSEKEEPING OPERATIONS

At the minimum, the ceiling deprives the Treasury of flexibility in its housekeeping operations with respect to the debt. Last year, when the Administration requested that Congress repeal the law, Secretary of the Treasury Kennedy stated that because of the ceiling, \$21 billion in maturing shorter term bills and notes had to

Table
**Average Maturity of Publicly
Held Federal Marketable Debt**

	Years	Months
June 1946	10	3
1960	4	8
1965	5	9
1969	4	2
August 1970	3	11 ³

³ Excluding bills, the average maturities would be higher than this. Nevertheless, even excluding bills, declines would have been substantial since the end of World War II. Average maturity was ten years, five months in 1946, and five years, ten months in 1970.

be refinanced during fiscal 1969 compared with \$14 billion in 1966. These pressures are even larger now.

One consequence of the 4¼ per cent ceiling during a period when total Federal debt has been increasing and when frequent refinancings of maturing debt have been taking place is that sharp declines in the average maturity of the debt have occurred. Thus, at the end of World War II, average maturity of the Federal marketable debt was ten years and three months. By 1965, average maturity had declined to five years, nine months. Since then, when long-term interest rates have been consistently above the ceiling, average maturity has again declined sharply.

Because of the shortening of the debt's maturity, refinancings are more of a potential problem than they used to be. By 1970, with the need for continuing monetary restraint, life would be simpler for monetary policymakers if Treasury financings were less frequent than they have been.

The exact size of Treasury cash needs in the coming months is still not known, since it hinges on budget uncertainties both on the spendings and receipts sides. However, with

hints of an estimated deficit for fiscal 1971 of \$15 billion, it is clear that substantial amounts of new money will have to be raised during the first half of 1971. And added to this are refundings, which during the first quarter of next year will include \$6 billion publicly held debt plus the routine rollover of maturing Treasury bills.

Financings of these amounts, running as they do into many billions of dollars, raise urgent questions about management of debt operations and how they might be improved. Moreover, the potential for interference with monetary policy, which all economists agree is an important tool of stabilization policy, is growing.

MONETARY MANAGEMENT AND EVEN KEEL

Ordinarily, during a Treasury financing, whether for new money or to refinance an old issue, the Federal Reserve commits itself to a neutral monetary policy. Under most circumstances, this even keel means no change in the discount rate and no change in reserve requirements, because these moves are visible evidence of a policy shift. It generally means, too, that the Federal Open Market Committee will adopt neither a more nor a less restrictive policy and that actual operations will be conducted in such

a way to suggest no policy change to the market.

The purpose of even keel is to facilitate Treasury financings. There are relatively few dealers in Government securities, all of them operating with slender equity-to-total funds ratios and handling very large flotations of securities. Without even keel, they might suffer windfall profits or losses as a result of shifts in monetary policy during Treasury financings. For example, if an increase in monetary restraint and an increase in interest rates were to occur before dealers had distributed an issue to investors, the markdown in their holdings could cause them serious financial difficulties, as well as make them reluctant to underwrite succeeding issues. An ill-timed policy change under existing market arrangements could even cause the failure of a financing.

The problems that can arise are illustrated by the Treasury financing in May of this year. At that time, money stock and bank credit appeared to be running significantly above levels consistent with the Federal Open Market Committee's target growth rates for the second quarter. Nevertheless, a Treasury financing was in its final stages, and, in view of the very sensitive state of the securities market, no effort was made to obtain the degree of firmness in money market conditions that might have been required to restore the monetary aggregates to the target growth path. Thus, in late April and early May, when it appeared that the disturbed conditions in securities markets were jeopardizing the Treasury's May financing, the System supplied reserves through open market operations more readily than it otherwise would have done.

Of course, the Federal Reserve can attempt

to make compensatory changes in monetary policy outside of even keel periods. For example, if a slowdown in growth of money and credit has to be postponed for, say, three weeks, policy can concentrate the desired changes at the end of the even keel period. If Treasury financings are infrequent, this may not be much of a problem. Sometimes this is the case. But when the Federal Reserve wishes to pursue a gradually more restrictive policy, sustained or frequent periods of even keel make it more difficult to compensate later for inaction. If the Treasury had more freedom to structure the debt, better coordination of debt management and monetary policy could be achieved.

SUMMING UP

It perhaps is too strong a statement that the debt ceiling always has been a policy drag. During some of its life, market rates have been below the ceiling so that it has been innocuous. Such developments as Agency issues have softened somewhat the impact the ceiling might have had when market rates of interest rose above it. But shortening the maturity of the debt has increased the liquidity of the economy at times when decreases might have been more appropriate. And the ceiling may have increased the direct and indirect costs of the debt above what they otherwise would have been. Furthermore, monetary management has been more difficult than it need be.

Periodically, since the end of World War I, attempts to eliminate the ceiling have been defeated because of practical political considerations. But, hopefully, reassessment in Congress next year will show that the costs of the ceiling are too high.

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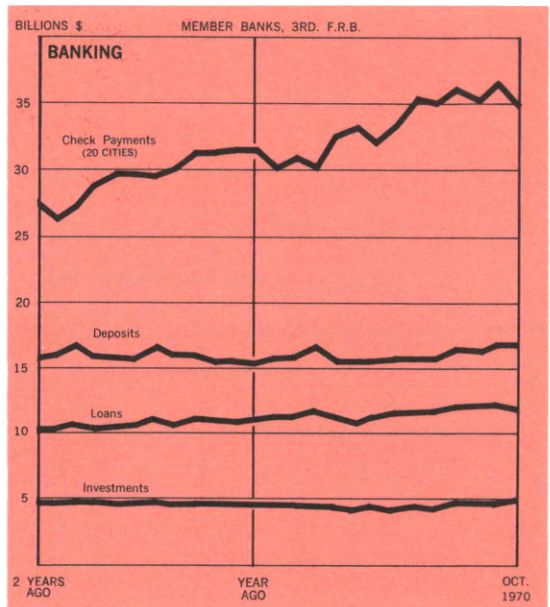
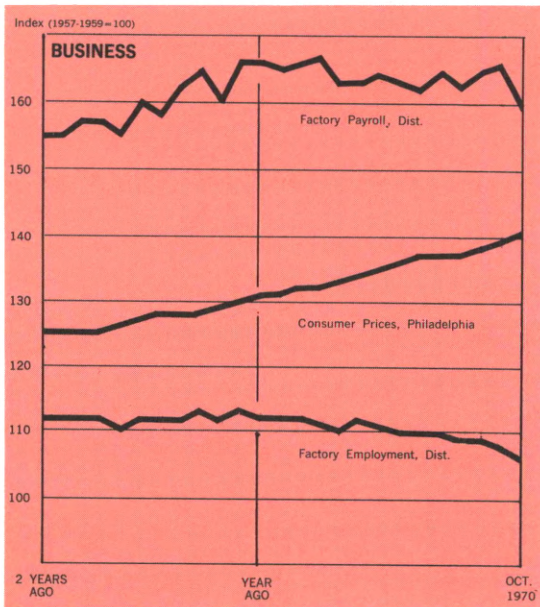
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FOR THE RECORD...



SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	October 1970 from		10 mos. 1970 from	October 1970 from		10 mos. 1970 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
MANUFACTURING						
Production .....	.....	.....	.....	- 2	- 8	- 3
Electric power consumed	- 2	- 2	+ 2	.....	.....	.....
Man-hours, total*	- 2	- 9	- 4	.....	.....	.....
Employment, total	- 2	- 5	+ 1	.....	.....	.....
Wage income*	- 3	- 4	+ 1	.....	.....	.....
CONSTRUCTION**	-12	-25	+20	+ 1	-12	- 1
COAL PRODUCTION	+ 4	+ 3	- 1	- 4	+ 5	+ 7
BANKING						
(All member banks)						
Deposits	- 1	+ 8	+ 1	- 2	+ 7	+ 2
Loans	0	+ 8	+ 7	0	+ 5	+ 5
Investments	+ 2	+ 7	- 4	+ 2	+11	0
U.S. Govt. securities	+ 2	+ 1	- 9	+ 3	+ 5	- 6
Other	+ 2	+11	- 1	+ 2	+14	+ 4
Check payments***	- 6†	+15†	+14†	+ 2	+13	+11
PRICES						
Wholesale .....	.....	.....	.....	0	+ 3	+ 4
Consumer	+ 1†	+ 7†	+ 7†	+ 1	+ 6	+ 6

LOCAL CHANGES	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
	Per cent change October 1970 from		Per cent change October 1970 from		Per cent change October 1970 from		Per cent change October 1970 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Standard Metropolitan Statistical Areas*								
Wilmington ..	- 6	- 9	-15	- 7	+ 2	+ 3	- 6	- 1
Atlantic City .	.....	.....	.....	.....	- 4	+ 9	- 3	+17
Trenton	- 8	-10	- 8	- 8	- 9	+ 9	- 1	+20
Altoona	- 1	- 3	0	- 4	- 4	+ 7	+ 2	+11
Harrisburg ...	- 2	- 2	- 3	0	- 4	+ 7	0	+46
Johnstown ...	- 4	-10	-13	-13	- 1	+ 9	+ 1	+13
Lancaster	- 2	- 2	+ 2	+ 1	- 5	+ 9	0	- 4
Lehigh Valley.	- 1	- 3	- 2	0	- 3	+ 2	- 1	+31
Philadelphia .	- 1	- 8	- 1	- 5	- 8	+20	- 1	+11
Reading	- 3	- 6	- 5	- 4	+ 2	+18	+ 1	+13
Scranton	0	- 6	+ 2	- 4	+ 6	+ 3	+ 1	+11
Wilkes-Barre .	- 2	- 4	- 2	+ 1	- 4	+ 3	0	+ 4
York	0	- 1	- 1	- 3	- 8	+ 5	- 1	- 5

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

†15 SMSA's
‡Philadelphia

*Not restricted to corporate limits of cities but covers areas of one or more counties.
**All commercial banks. Adjusted for seasonal variation.
***Member banks only. Last Wednesday of the month.