Federal Reserve
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Business & Financial Letter

Curbing the Boom

Business statistics recently have been just about as overpowering as those of earlier months, so policy-makers acted to put further curbs on the boom with the announcement of a complex series of monetary measures last week. Among other things, the Federal Reserve Board of Governors shifted reserve requirements on Eurodollars and large certificates of deposit (CD's), and suspended interest-rate ceilings on the latter instruments. These Board actions were "designed to curb the rapid expansion in bank credit and help moderate inflationary pressures, and at the same time to assure the availability of credit on a reasonable scale." This week Federal Reserve Chairman Burns followed up with a letter to member banks requesting their cooperation in assuring that the rate of bank-credit extension "is appropriately disciplined."

Strength of the boom

The strength of real economic activity is apparent in the latest industrial-production index, which jumped 1.0 percent in April—a much larger gain even than the substantial increases reported in the several preceding months. Gains in output were not only strong, pushing the index 9.0 percent above the year-ago level, but were also widely distributed across the entire range of production.

Another sign of strength is a sharp first-quarter jump in corporate profits; during this period, after-tax profits reached a $62.3-billion annual rate, for a 26-percent year-to-year gain. The boom also brought about a sharp improvement in the Treasury's finances; last winter, the Treasury had forecast deficits of $25 billion for fiscal 1973 and $13 billion for fiscal 1974, but Secretary Shultz now suggests that the deficit will be "substantially less" than $20 billion this year and that the budget will be "moving strongly toward balance" in fiscal 1974.

Unfortunately, a substantial chunk of the growth in corporate profits and federal revenues happened as the result of continued inflation. During the first quarter, the general price index rose at a 6.6-percent annual rate—considerably higher than the preliminary 6.0-percent figure reported a month ago. That first-quarter figure was bad enough, but it was followed in April by another substantial increase in consumer prices and by the worst upsurge in wholesale industrial prices since the panic buying of the early Korean War days.

Headlong pace

Banking statistics continued to indicate the headlong pace of the credit-fed boom. During the January-February period, total loans of large commercial banks increased 2.4 percent, compared with a 2.2-percent gain in the comparable period of 1972. Then, in March and April, total loans increased 4.0 percent, as against a 1.0-percent gain in the year-ago period. Despite minor monthly fluctuations, all major lending categories were considerably stronger than in fast-paced 1972. In addition to a phenomenal

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business-loan pace, surprising strength was shown by mortgage and consumer loans, as well as loans to nonbank financial institutions.

Large banks continued to meet this very heavy loan demand in part by selling securities. After a 4.4-percent reduction in January and February, they reduced their holdings another 1.4 percent in March and April. (In the year-ago period, they actually added to their holdings, especially Treasury securities.) However "liability management" was by far the more important source of funds. Bidding for corporate funds with large CD's was brisk, and altogether, banks increased their outstanding CD's by 12.8 percent in January and February and by 11.0 percent more in March and April. Thus, through April of this year, large banks met their loan demand with a $4.8-billion reduction in security holdings and a $11.3-billion issuance of CD's.

From all indications, business borrowing will remain very strong as the year progresses. The latest plant-equipment spending survey (McGraw Hill) suggests that corporations will require substantial amounts of funds this year, both for modernization of existing facilities, and for new facilities to meet the capacity overload now evident in many industries. In addition, they will need funds to rebuild their inventories, since shelves are now being swept clean in many industries by the very rapid pace of consumer and business demand.

Countermeasures
In earlier attempts to counter the inflationary boom some months ago, the Federal Reserve tightened open-market policy. The flavor of these actions is reflected in the published minutes of the January and February meetings of the Federal Open Market Committee. In its latest actions, the System directed its attention to commercial-bank reliance on money-market sources of funds, such as CD's and Eurodollars.

To begin with, the Board of Governors imposed an 8-percent marginal reserve requirement—the regular 5 percent plus a supplemental 3 percent—on further increases in total outstanding funds obtained by a bank through the issuance of large CD's or through an affiliate's issuance of obligations subject to time-deposit reserve requirements. The Board also proposed including finance bills (working capital acceptances) as part of the total obligations subject to the 8-percent marginal reserve requirement. Those finance bills currently outstanding would be subject to a 5-percent reserve requirement, instead of zero as at present.

The Board also reduced, from 20 percent to 8 percent, the reserve requirement on certain foreign borrowings of U.S. banks, primarily Eurodollars, thus affording roughly parallel treatment with the marginal reserve requirement on large CD's and bank-related commercial paper. The Board also acted to

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eliminate gradually the reserve-free bases still held by some banks subject to this measure.

Federal Reserve Chairman Burns attempted to broaden the effectiveness of this reserve-requirement ruling by appealing to the largest nonmembers—about 190 banks—to adhere to the ruling affecting Federal Reserve member banks. "The reserve-requirement action was taken by the Board in an effort to restrain bank-credit as part of the nation's anti-inflationary program. The effectiveness of this proposal in the essential task of combating inflation would be enhanced if it applied generally throughout the banking community. Accordingly, I very much hope you will see fit to conform to the additional 3-percent marginal requirement."

Lifting ceilings

The Board also suspended interest-rate ceilings on large CD's maturing in 90 days or more, "in order to permit member commercial banks to maintain a balanced structure of deposits." Ceilings had been suspended almost three years ago on shorter maturities, but they had been kept in place on longer-maturity deposits of $100,000 and over, with a range of 6¾ to 7½ percent. "Because of recent advances in market rates, the ceiling rates on longer-maturity deposits now practically preclude banks from using long-term CD's, and the great bulk of large CD's being issued mature in less than 90 days. . . . With market interest rates relatively high, the suspension of ceilings across the board will enable banks to compete in all maturity sectors of the short-term market and thereby permit them to establish a balanced maturity structure for outstanding large certificates of deposit."

In parallel actions, the Federal Deposit Insurance Corporation suspended rate ceilings on large CD's for insured banks that aren't Federal Reserve members, and the Federal Home Loan Bank Board removed rate ceilings on large savings certificates ($100,000 and over) issued by member savings-and-loan associations. Both regulatory agencies, like the Federal Reserve, kept rate ceilings in place for all other types of deposits, such as passbook savings and "consumer type" certificates of less than $100,000.

These actions on rate ceilings show certain similarities to last month's action by the Committee on Interest and Dividends regarding business-loan rates. In each case, policymakers attempted to have the marketplace govern bank's dealings with large firms in regard to the rates banks charge big corporations for loans, and in regard to the rates they pay corporate treasurers for the use of funds. In addition, policymakers showed their intent to maintain rate stability for households and small businesses, with the rates charged such borrowers kept "under special restraint," and with the rates paid them for consumer-type deposits kept under rate ceilings.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 5/9/73	Change from 5/2/73	Change from year ago Dollar	Change from year ago Percent
Loans adjusted and investments*	72,690	+134	+9,801	+15.58
Loans adjusted—total*	55,033	+ 30	+9,799	+21.66
Commercial and industrial	19,997	—114	+3,244	+19.36
Real estate	15,897	+ 49	+2,614	+19.68
Consumer instalment	8,147	— 7	+1,366	+20.14
U.S. Treasury securities	6,190	— 72	— 487	— 7.29
Other securities	11,467	+176	+ 489	+ 4.45
Deposits (less cash items)—total*	70,668	+124	+8,587	+13.83
Demand deposits adjusted	20,486	+ 63	+1,364	+ 7.13
U.S. Government deposits	1,165	—192	— 5	— 0.43
Time deposits—total*	47,777	+436	+6,906	+16.90
Savings	17,981	+ 58	+ 13	+ 0.07
Other time I.P.C.	19,569	+444	+4,792	+32.43
State and political subdivisions	7,611	— 91	+1,162	+18.02
(Large negotiable CD's)	9,137	+355	+4,183	+84.44

Weekly Averages of Daily Figures	Week ended 5/9/73	Week ended 5/2/73	Comparable year-ago period
Member Bank Reserve Position			
Excess reserves	— 6	6	0
Borrowings	74	296	0
Net free (+) / Net borrowed (—)	— 80	—290	0
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions			
Net purchases (+) / Net sales (—)	+206	+433	—1,329
Transactions: U.S. securities dealers			
Net loans (+) / Net borrowings (—)	+ 79	+ 57	+ 50

*Includes items not shown separately.

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