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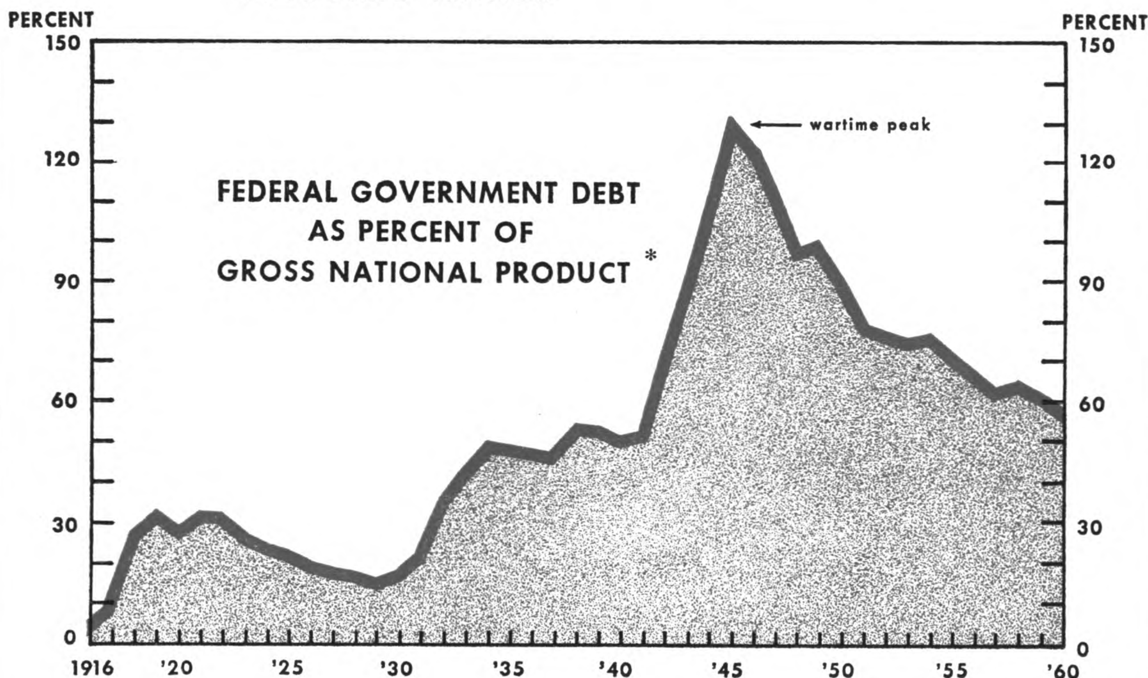
IN THIS ISSUE

The Federal Debt in Review 2

A Year of Cross Currents in Banking 8



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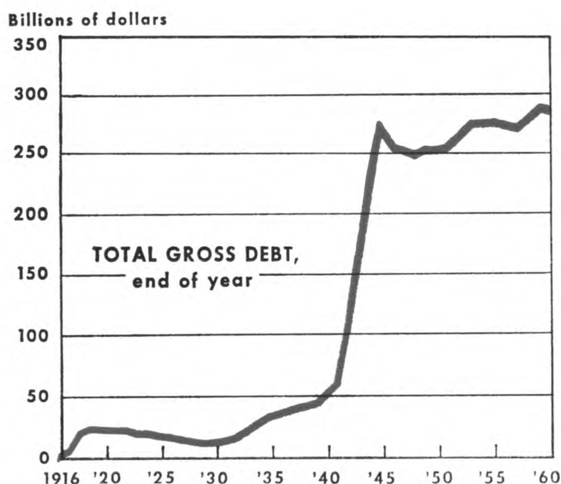
The Federal Debt in Review

FOLLOWING the sharp upswing during World War II, the total magnitude of the Federal Government debt has changed relatively little during the postwar period. The deviation in any one year from the wartime peak of $279 billion, reached in 1945, has amounted at most to only 9 percent (the decline to the postwar low in 1948).

While the rate of growth of the Federal debt has slowed down appreciably during the postwar period, the nation's ability to service the debt has increased markedly. This is revealed most clearly in the fact that the Gross National Product — the measure of the nation's current output of goods and services — has more than doubled since 1945 (partly due to rising prices), whereas the gross Federal debt has grown by only 4.2 percent. Consequently, the burden of the debt on the economy has become relatively smaller, so that at the end of 1960 such debt amounted to about 58 percent of GNP, as compared with 131 percent at the end of 1945.[1] Such a way of measuring the debt burden is depicted by the chart shown on the cover of this issue.



Since the wartime peak, the Federal debt has shown relatively little change in magnitude.

Composition of the Federal Debt

Although the magnitude of the Federal debt has shown relatively little change in the postwar period, since 1950 the portion of such debt consisting of securities that can be bought and sold in the market or that are convertible into marketable securities has increased. (See chart.) As a result, a larger relative amount of the gross debt is now subject to such influences as price variation and market demand. On the other hand, a portion of the debt not subject to market factors — special issues made available to Government investment accounts — has increased very slightly in the past decade.

Concurrently, two other segments of the gross debt have declined in size. Since 1950, "other" debt has become relatively less important; this grouping includes nonmarketable issues such as investment bonds, depositary bonds, non-interest-bearing debt, and debt not subject to the statutory limit set by Congress. In addition, the remaining portion of the gross Federal debt — the volume of nonmarketable savings bonds outstanding — has declined.

It is noteworthy that the general composition of the gross debt in 1960 showed little

(1) One factor that has contributed to holding down the total gross public debt is the statutory limit set by Congress. At present, the maximum aggregate debt is limited to a base of $285 billion; to this base has been added a temporary increase of $8 billion. (The temporary addition is in force until its authorization expires on June 30, 1961.) Thus the total debt limit is set currently at $293 billion. At the end of December 1960, the gross debt subject to the statutory limit amounted to $290.5 billion, leaving a margin of $2.5 billon of presently allowable debt.

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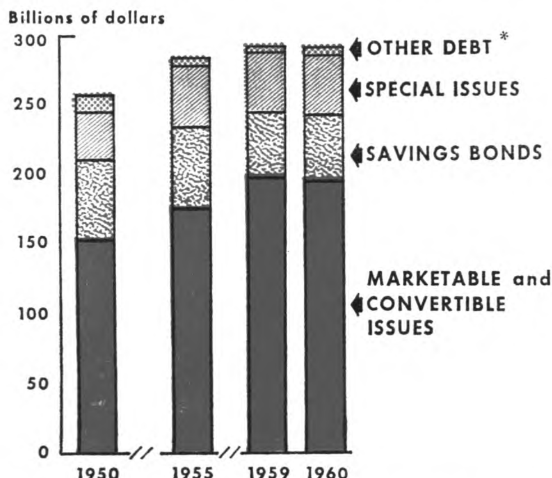
COMPOSITION OF THE FEDERAL GOVERNMENT DEBT by Type of Debt, for Selected Years



*Includes investment bonds, depositary bonds, non-interest-bearing debt, and debt not subject to the statutory limit

The marketable portion of the debt and the amount of special issues have increased since 1950, while the volume of savings bonds and other debt has declined.

change from the previous year. It may be suggested that the lack of change was not happenstance, but instead was the result of planned Treasury debt operations.

The savings bonds segment of the public debt in 1960 is an example of holding-the-line by type, especially since 1960 was preceded by a four-year period of steady and often substantial declines in the volumes of such securities outstanding. Savings bonds are tailored to fit the investment needs of individuals, with the Treasury hoping that the bonds will be held until maturity and, to the extent that they are not, that redemptions will be balanced by new sales. Beginning in 1955, however, more savings bonds have been redeemed for cash than have been sold as new issues.[2] To offset this development, the Treasury in 1959 increased the rate of interest paid on some savings bond issues. In addition, two advance refunding operations dealing with savings bonds were undertaken, one in 1959 and one in November 1960.

An advance refunding of this type can be best explained by an illustration. In November 1960, the owners of F and G savings bonds maturing in 1961 were allowed to exchange such issues for comparable amounts of marketable bonds maturing in 1969. (The 1969 bonds were an addition to the issue first sold in 1957.) By offering a nine-year bond in exchange, the Treasury was attempting to refund some of the savings bonds outstanding in advance of their maturity date, thereby lengthening the average maturity of the Federal debt. At the time, nearly $800 million of the F and G bonds were outstanding; of this amount, about 19 percent was exchanged under the terms of the offering. The owners of the savings issues who subscribed to the marketable issue not only increased their interest return but also extended the term length of their investment portfolios.

Maturity Structure of the Federal Debt

Problems in debt management often resolve around the maturity structure of the marketable portion of the Federal government debt. Although part of the debt must be in the form of short-term instruments, it is advantageous to have a substantial amount in long-term securities. A relatively large amount of long-term debt is desirable in that it (1) makes frequent market interruptions for refinancing unnecessary, especially when market demand may be unfavorable, (2) helps to stabilize interest costs, (3) prevents too much debt liquidity, and (4) provides an outlet for investors preferring a longer-term security.

In the past decade, the portion of marketable debt maturing within one year, i.e., the floating debt, has ranged, within narrow limits, around 40 percent of the total. There are clear indications that the debt managers feel that the economy needs this relatively large amount of highly liquid securities for its everyday business. Issues such as Treas-

(2) It should be pointed out that only two issues of outstanding savings bonds, i.e., E and H, are currently being sold. The remaining issues are being redeemed as they mature or approach maturity, to be replaced by the E and H savings bonds or by marketable securities.

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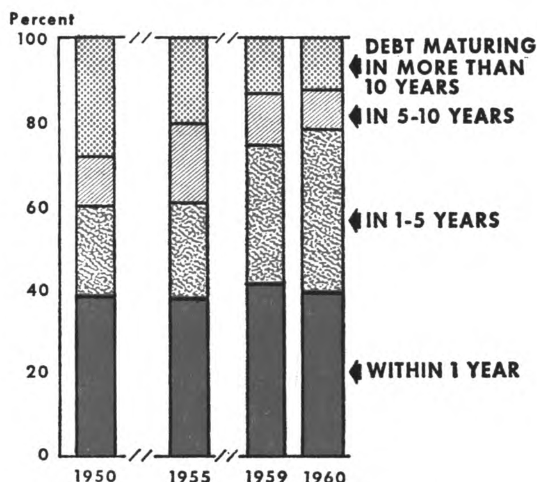
ury bills and certificates, as well as notes and bonds maturing within a year, are used by corporations for investing temporarily excess funds without the danger of possible large capital losses; they are also used in some circumstances as security for short-term bank loans, especially in connection with Federal funds transactions and with loans to Government securities dealers. Moreover, a special type of Treasury bill has been developed as a short-term investment that can be used by corporations to meet quarterly income tax payments.

The proportion of the debt which takes the form of intermediate-term or long-term issues has often represented a problem for debt management. Since 1950, long-term issues, defined as debt maturing in more than five years, have declined from 40 percent of the total marketable issues outstanding to only 23 percent of the total. (See chart.) Concomitantly, the intermediate segment has increased in size. The process of declining maturity takes place automatically, unless it is prevented from doing so by some counter measures, because long-term securities with stated maturities become "younger" as maturity dates approach; sequentially, a long-term bond thus becomes first an intermediate bond, and then a short-term issue and part of the floating debt. The declining age of the marketable debt is brought out in an accompanying chart, where the average maturity can be seen to have declined from nearly 100 months at the end of 1950 to about half as much at the end of 1959.

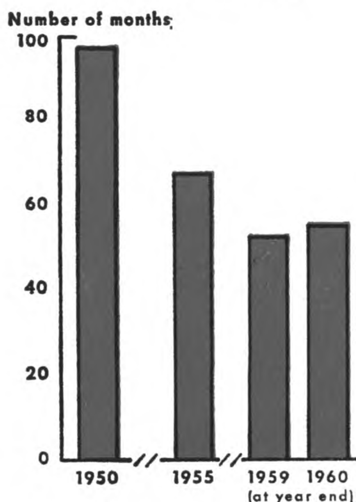
During 1960, the Treasury was able to extend slightly the average maturity of the debt. Although by the end of September the average maturity had dropped to 50 months (the lowest level in many years), an advance refunding operation in October boosted the average to 55 months. The extension of average maturity was not reflected in a larger share of debt maturing in more than 5 years, however. Instead, the intermediate segment of the debt during 1960 increased in size at the expense of all the other maturity classes, as is shown in a chart.

MATURITY DISTRIBUTION OF THE MARKETABLE DEBT
Percentage Distribution, for Selected Years



The portion of the Federal debt maturing in 1-5 years has been increasing at the expense of debt maturing in more than 5 years.

AVERAGE MATURITY OF THE MARKETABLE DEBT
Selected Years



The average maturity of the marketable debt has declined from 97 months at the end of 1950 to 55 months at the end of 1960.

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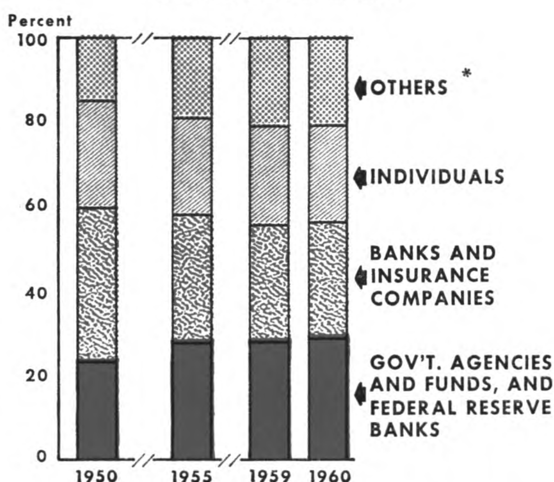
Ownership of the Federal Debt

Another continuing problem which is faced in the management of the Federal government debt is that of the pattern of ownership, in relation to potential effects on the money supply. Some kinds of debt ownership have a greater inflationary potential than others. As a case in point, the Treasury often prefers to place as many securities as possible outside the portfolios of commercial banks because of the "money-creating" aspects of bank operations. The ability of the commercial banking system to create demand deposits, and thus in turn to influence the money supply, tends to increase the inflationary potential of bank-held Federal debt. Also, owners of the Federal debt who look upon such investments as temporary outlets for idle funds might be inclined to sell their "governments" very quickly if a need for funds arises or if another more profitable, but still dependable, investment form appears. These investors might also be less inclined to reinvest automatically in Government securities when their present holdings mature.

Some of the changes that have occurred in the distribution of debt ownership in the past decade have contributed clearly to facilitating the management of the existing debt. For one thing, the relative share of the gross debt held by commercial banks has declined, due in large part to the heavy demand for bank loans in recent years. Many banks, in order to meet loan demand, have liquidated some of their investments, transferring the released funds into their loan portfolios. As a result, the inflationary potential of the debt has been lessened because the share held by the banks has been reduced.

On the other hand, holdings of Government securities by insurance companies have tended to decline. Since the insurance companies are usually long-term investors, this turn of events has *not* helped the Treasury to keep maturities stretched out to the point desired. Holdings of individuals as a percentage share of the gross debt have also declined slightly since 1950, again reducing the amount of debt in long-term ownership.

OWNERSHIP OF THE FEDERAL DEBT
Percentage Distribution, for Selected Years



*Includes nonfinancial corporations, state and local governments, pension funds, savings and loan associations, and securities dealers

In the past decade, public agencies have increased their share of the ownership of the Federal debt, while the shares held by individuals, banks, and insurance companies have decreased.

Two groups of debt owners have increased in relative importance in recent years. In 1950, Government agencies and trust funds and the Federal Reserve banks held 23 percent of the public debt; by 1959 the combined share had grown to nearly 28 percent. The Government agencies and trust funds, (in particular the social security trust funds) have become a more important outlet for securities. Another group, shown on the chart as "other" investors, is made up of nonfinancial corporations, state and local governments, pension funds, savings and loan associations, and securities dealers. Such owners increased their share of the total debt from 15 percent in 1950 to 22 percent in 1959; some are long-term investors (pension funds) while others (securities dealers) employ their funds only temporarily.

During calendar year 1960, the change from the the previous year in the distribution

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of debt ownership was nominal. Fractional gains in the share of the debt held by Government funds and agencies and Federal Reserve banks, in the share held by commercial banks, and the share held by insurance companies were offset by corresponding declines in the shares of the debt held by individuals and "other" investors. The increase in the holdings of Government securities by the Federal Reserve banks resulted from open market operations in 1960. Commercial banks enlarged their investment portfolios in reaction to a declining loan demand during the year. On the other hand, nonfinancial corporations moderately reduced their investment in Government securities, thus providing a counterbalancing effect to the increases in debt ownership by the other groups.

Debt Operations in 1960

It is clear that during 1960 the Treasury held the composition of the Federal debt fairly steady, and was able, at least temporarily, to slow the net decline in the dollar amount of savings bonds outstanding. In addition, the average maturity of the marketable debt was extended slightly while the ownership pattern of the debt was relatively unchanged.

In the course of 1960, the Treasury redeemed in cash nearly $17 billion of maturing bills and notes. Most of the cash redemptions occurred in the first half of the year. In addition, in the process of turning over the volume of Treasury bills issued on a regular weekly basis, about $800 million more in bills were redeemed than were reissued. Total cash redemptions of marketable Government securities therefore amounted to $17.4 billion, an amount slightly less than new cash borrowing in 1960, which totaled $18.2 billion.

The new borrowing took three forms: (1) $6.5 billion in one-year Treasury bills, which were issued on a quarterly basis in January, April, July, and October and were actually a rollover of a larger volume of maturing bills; (2) $9 billion in three separate issues of tax anticipation bills sold in January, July, and October, with maturities of 6-9 months; and (3) a somewhat longer-term offering in April amounting to $2.7 billion. The latter borrowing took the form of a Treasury note due in 25 months and a long-term bond due in slightly more than 25 years. It is significant that the bond was the first long-term security offered by the Treasury in a year.

The other debt actions carried out by the Treasury in 1960 involved two advance refundings and four refinancing operations. A refinancing takes place when the owners of maturing securities are offered the opportunity to convert their holdings *at maturity* into new issues. The refinancings occurred in February, May, August, and November, involving a total of $38.4 billion of maturing securities that were mainly certificates and notes. The new exchange issues were also predominantly certificates and notes.

In any refinancing, the owners of the maturing issues also have the option of converting their holdings into cash; this conversion results in "attrition". The attrition on the refinancing operations in 1960 was generally quite moderate, ranging from 4 percent to 9 percent, if the special refinancing in August is excluded. As a result, the maturing securities were replaced with $33 billion of new debt with maturities ranging from approximately one to eight years.

Special Techniques

To bring about the favorable changes in the structure and composition of the Federal debt in 1960, the Treasury employed some special techniques or types of financing. One important technique was that of advance refunding. In addition to the refunding of the F and G savings bonds already mentioned, the Treasury in June undertook to refund in advance a portion of $11.2 billion of Government bonds due to mature in late 1961. It was announced that offers of up to $5 billion for either a 4-year note or an 8-year bond would be accepted by the Treasury. About $4.2 billion, or 38 percent, of the 1961 bonds were exchanged, mainly into the Treasury note that was offered. In this operation, the Treasury was trying not so much

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to lengthen the debt as to prevent an unusually heavy concentration of securities from maturing in late 1961. This debt operation has been described as a "junior" advance refunding, with intermediate debt being exchanged for short-term debt.

The June experience, in effect, served as a trial run for a larger advance refunding operation that took place in September and October. At that time, the owners of four separate issues of bonds originally sold during World War II were offered an exchange of three new bond issues maturing from 1980 to 1998. The Treasury's announced purposes were to lengthen the average maturity of the debt as well as to supply the needs of long-term investors. The advance refunding was aided by the fact that declining interest rates enabled the new bonds to be attractively priced; it was also aided by a change in the tax law with the result that no capital gains or losses are charged at the time of an exchange of an old security issue for a new one.

The response of the owners of the bonds, or "tap" issues as they were called, was quite favorable, considering the fact that about one-fourth of the holders were commercial banks whose interest in the exchange was limited. About $3.4 billion of the tap issues, or a little less than half of the amount held by financial institutions and individual investors, was exchanged. In addition, the small portion held by Government accounts was wholly refunded. Since the tap bonds would not have matured until 1967-1969, the operation constituted a "senior" advance refunding, with intermediate debt being replaced by long-term debt. The operation lengthened the average maturity of the Federal debt by five months. (See chart.)

Another special technique employed by the Treasury in 1960 was that of "cash refunding." New securities issued by the Government to replace maturing securities usually have been available only to owners of the maturing debt. In other words, the previous owners have pre-emptive rights for the new issues. In August, the Treasury departed from tradition when an issue of notes amounting to $9.6 billion matured. In effect, the notes were redeemed for cash, and the new exchange issue of a Treasury certificate and a re-opened bond were available for cash purchase by any interested party, not just by the owners of the maturing notes. The owners of $5.8 billion of the notes used their cash refunds to purchase the new issues. In addition, $3.1 billion of the new issues were purchased by other "outside" investors.

There are many advantages to the Treasury in this type of cash refunding. Speculation in new Government issues is discouraged because of the cash payment required. The allotment of the new issues can be controlled in terms of both the type of ownership and the dollar amount of each issue making up the total offer. An exact amount of funds can be raised, and no allowance has to be made for the possible attrition of an ordinary refinancing. Finally, a cash refunding might attract additional investors who otherwise would be closed out because they were unable to acquire the rights of maturing issues.

The new techniques used by the Treasury in 1960 will probably not replace the older methods of Government borrowing. Rather, they will serve, as they were intended to serve, as supplementary techniques that are appropriate because of special market conditions.

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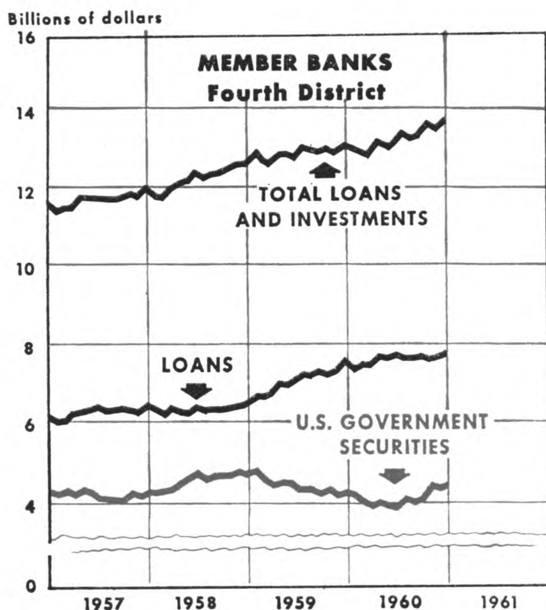
A Year of Cross Currents in Banking

(Fourth District)

THE COURSE of banking activity during 1960 was shaped by general business conditions, which showed substantial strength during the first half of the year and subsequent slackening during the second half. Banking activity during the past year was also affected by the fact that the Federal budget showed a surplus for the calendar year, which was in marked contrast to the relatively large deficits incurred in both 1958 and 1959. Another factor bearing on the course of banking activity during 1960 was the easier monetary policy of the Federal Reserve System which evolved as the year progressed. The interaction of the above developments contributed to a downtrend in interest rates from the peaks reached early in the year.

Let us see how these developments were reflected in Fourth District banking activity.

An expansion in loans during the first half of 1960 was offset by a reduction of investment holdings. In the second half, loans remained practically unchanged, while holdings of securities were enlarged appreciably.



Total Bank Credit Rose

During 1960, as shown in the accompanying chart, total loans and investments of member banks in the Fourth District advanced $580 million, or slightly more than 4 percent, which was about in line with the trend at all member banks in the nation. The growth of bank credit in the District in 1960 showed the largest annual percentage increase of the past six years, except for 1958.

Reflecting changes in business and financial conditions, the increase in bank credit during 1960 occurred entirely in the second half of the year. During the January-June period, the total of bank credit extended by the District member banks remained unchanged, as a normal seasonal decline in the first quarter was offset by a corresponding increase in the second quarter. At the end of June, total loans and investments of District banks had returned to the 1959 year-end level of $13.2 billion.

Although most of the credit expansion at commercial banks usually takes place during the last half of the year, it was the first time in recent years that total credit of District banks failed to move up in the first half. A $275-million expansion in loan portfolios was offset by a nearly similar reduction in the amount of investment holdings. Consequently, while total loans expanded in the January-June period to a new high, holdings of government securities fell under the $4-billion

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mark, the lowest level for Fourth District banks in the postwar period.

Responding to a number of Federal Reserve actions designed to promote easier credit conditions in the economy, total bank credit extended at District member banks in the second half of 1960 rose by about 4.5 percent from the midyear level.[1] The rise in the second half of the year, which was larger than corresponding increases in any other recent year, showed up in enlarged bank holdings of investments. While holdings of securities of all member banks in the District rose $580 million during the second half of the year, total loans remained unchanged. On the other hand, for the year as a whole, the advance of bank credit included both an expansion in loans and a rise in security holdings, with each sharing about equally in the increase.

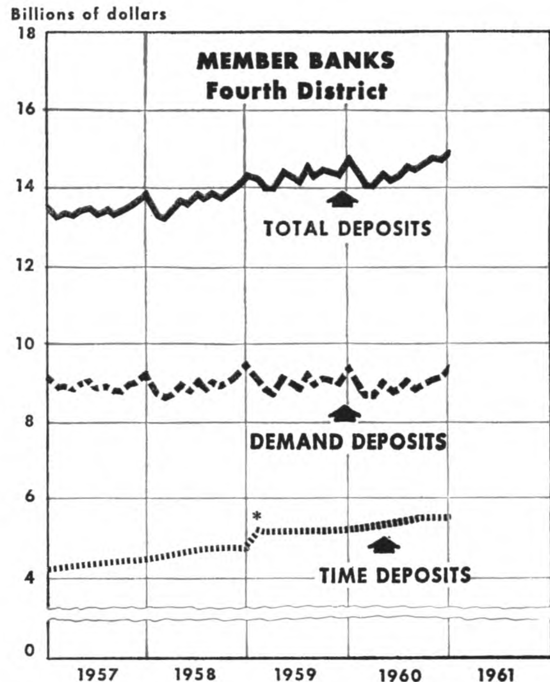
Deposits Up Slightly

Total deposits at member banks in the Fourth District at the end of 1960 were only a shade above the year-ago level. The increase of less than 2 percent compares with a 3-percent increase in 1959 and an increase of nearly 4 percent in 1958.

Indicative of deposit developments in 1960 was the fact that a larger-than-seasonal decline in deposits which took place during the first two months of the year was not made up until the end of October. The slight increase in deposit balances for the year as a whole resulted chiefly from the growth of time deposits. In fact, the rate of growth in time deposits during the last half of the year was larger than in any other like period in the postwar era.

Demand deposits at all member banks in the District fell for the second straight year, and at the end of 1960 were about 1 percent below the 1959 year-end level. Increases in demand deposits during the latter part of the year were not sufficient to offset the more-than-seasonal decline during the first half. The decline of demand deposits at District member banks, however, was accompanied by a sharp rise in deposit turnover. In the first six months of 1960, the amount of checks written against demand deposits, other than those of U. S. Government and interbank balances, was about 11 percent greater than in the corresponding previous-year period. In the second half of 1960, the rate of deposit turnover declined somewhat but still remained substantially above a year ago.

The slight increase in deposit balances for the year as a whole resulted chiefly from the growth of time deposits.



*Addition of large new member bank

Loan Trends Mixed

The $275-million upswing in loans by District banks in 1960 was the smallest annual increase since 1954, with the exception of

(1) The easing actions included: (1) lowering the discount rate in June from 4 percent to 3½ percent, and then in August and September to 3 percent, at all Federal Reserve Banks; (2) reducing the percentage of reserves required against demand deposits for banks in New York and Chicago; and (3) liberalizing vault cash requirements in two steps, so that beginning November 24 member banks were permitted to count all vault cash in meeting reserve requirements. At country banks, which hold the largest amounts of vault cash, the counting of all cash was partly offset by an increase of reserve requirements from 11 to 12 percent.

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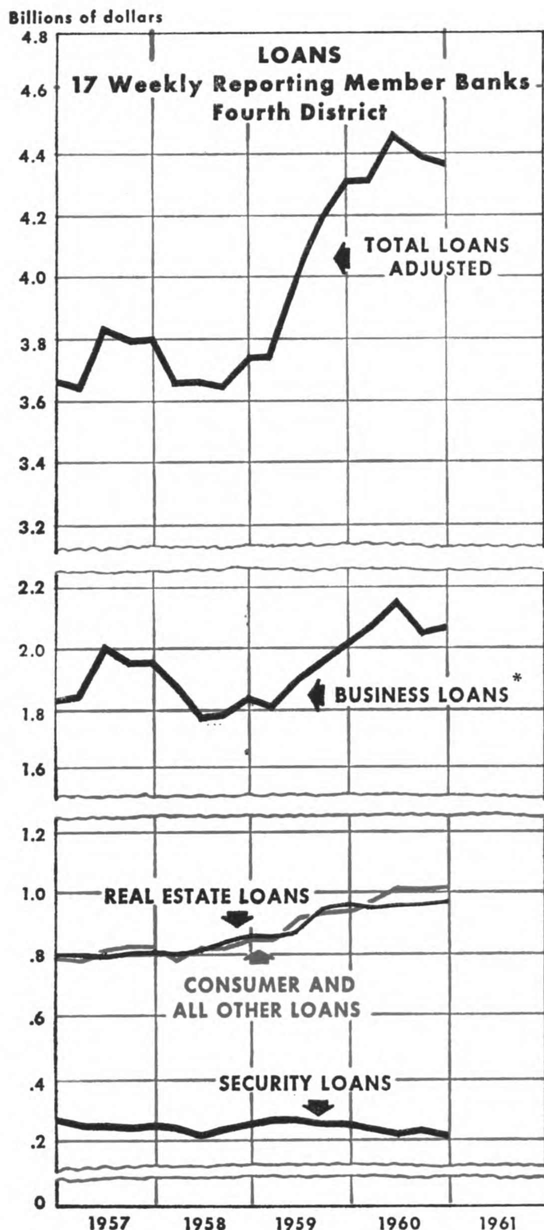
Following midyear, the demand for bank loans tended to slacken.



*Includes commercial and industrial loans, agricultural loans, and loans to sales finance companies

1958. The rise in total loans conceals, however, the divergent movements in various types of loans which occurred during the course of the year. Detailed information on loans is available from a sample of 17 large weekly reporting member banks, and is shown in an accompanying chart.[2] These highlights of bank lending in the District give some insight into the shifting nature of the forces at work in 1960.

During the first half of 1960, the trend of bank lending in the Fourth District reflected expansionary influences. Following the usual seasonal decline after the turn of the year, total loans adjusted[3] turned upward in February and continued a steady rise, reaching a record high of nearly $4.5 billion by the end of June. The net increase during the first six months amounted to $170 million. All loan categories except security loans shared in the increase.

The largest loan expansion by type occurred in commercial and industrial loans. Such loans outstanding at the end of the first half of the year amounted to $2,173 million, which was $144 million above the 1959 year-end level and $258 million above the 1959 midyear position.

The use of bank credit in the January-June period was especially heavy among the metals and metal products industries, in response to an inventory buildup. Between the end of 1959 and midyear 1960, the metals and metal products group increased its borrowing (at the fourteen District banks which report the distribution of loans by type of business) by $104 million, or to about two-and-one-half times borrowings in the same period of 1959.

Manufacturers of petroleum, coal, chemicals, and rubber products also increased their borrowing during the first half of 1960, while borrowing by trade firms and manufacturers of textiles, apparel, and leather goods was somewhat less than in the same period of 1959.

In expected seasonal fashion, commodity dealers and food processors reduced their

(2) These banks, located in 6 cities, hold about 62 percent of the total resources of all member banks in the district.
(3) Exclusive of loans to banks

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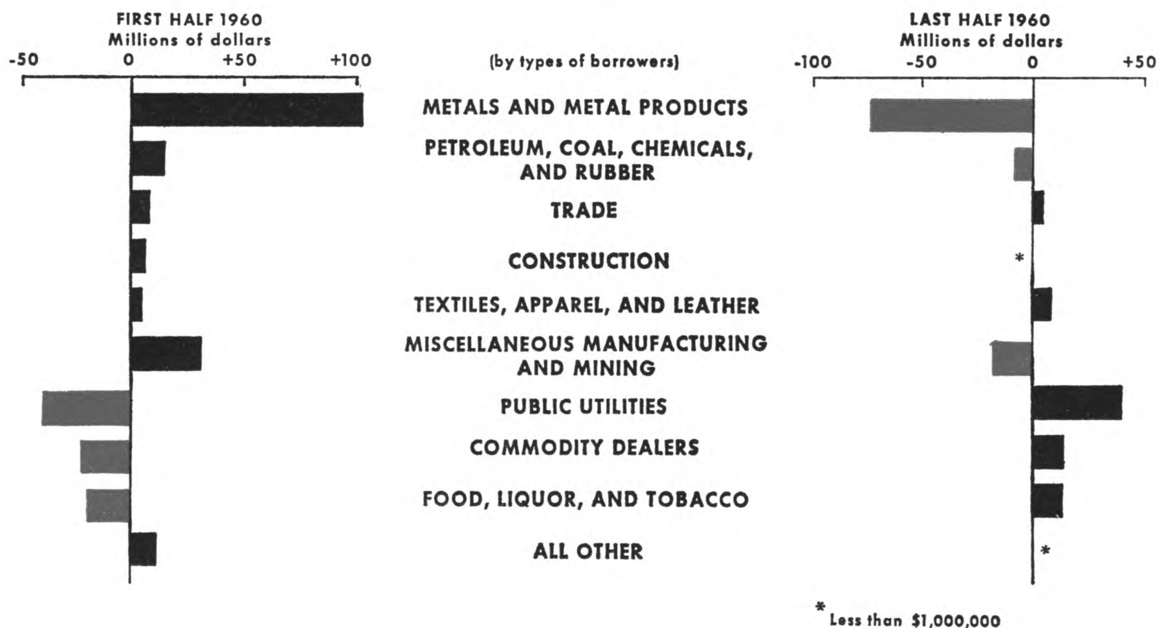

bank debt during the first six months of the year, although the reduction was larger than in other recent years. On the other hand, net repayments of bank loans by public utilities were about the same as in the first half of the preceding year.

By and large, the Fourth District pattern of borrowing by business groups during the first half of 1960 paralleled the national pattern.

After midyear, the demand for bank loans slackened for most categories of borrowers. Although the second half of the year is a period when bank loans are expected to pick up, total loans at the 17 weekly reporting banks by the end of December were $109 million below the midyear level.

Business loans fell in the third quarter, and recouped only part of the drop in the fourth quarter. In contrast to the national showing, business borrowings at weekly reporting banks in the Fourth District over the September tax payment period were the smallest in recent years. In addition, some of the business groups which had been borrowers in the first half of the year made substantial repayments in the second half. As a case in point, cumulative net repayments of loans by the metals and metal products group amounted to $73 million in the second half of 1960. That was the largest net reduction of bank loans outstanding by this group for any six-month period since the first half of 1954 and it stood in sharp contrast to the corresponding $13-million increase in the last half of 1959. The debt reduction stemmed from the relatively low rate of steel mill activity as well as substantial liquidation of steel inventories.

Among other business groups, loans to food processors, commodity dealers, and public utilities increased in the second half of the year about in line with seasonal expectations,

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while loans to trade concerns did not rise as would be seasonally expected. Other loan categories, which include security loans, loans to nonbank financial institutions, and consumer and all other loans, declined in the July-December period; only real estate loans increased in the second half of the year, although only half as much as in 1959.

Bank Investments Down, Then Up

Member banks in the Fourth District, as elsewhere in the nation, on balance, liquidated some of their holdings of government securities during the first six months of the year, mainly in order to finance expansion of loan portfolios. Holdings of U. S. Government securities of all member banks in the District at the end of June were down by nearly $320 million from the 1959 year-end level, or about one-third less than the liquidation in the same period in 1959. The largest decline in investment holdings of banks was in U. S. Government short-term issues. The spread between the market yields on such issues and the discount rate which prevailed during much of the period tended to favor liquidation of such securities as compared with borrowing from the Federal Reserve bank.

The liquidation of holdings of U. S. Government securities in the first half of the year was followed by a substantial expansion of such holdings in the second half, as previously mentioned, with large increases concentrated in the second week of July and in the last two weeks of October. At year-end 1960, total holdings of U. S. Government securities by the member banks in the District had reached $4,466 million, or $513 million above the midyear figure. Usually holdings of such securities decline or increase only slightly during the last half of the year.

Nearly all of the increase in holdings of Governments by weekly reporting banks in the second half of 1960 took place in Treasury bills and other short-term issues. As a result, such short-term issues comprised more than one-fourth of total bank holdings of U. S. Government securities at year end as compared with one-eighth of the total at midyear.

Holdings of "other securities," such as municipal and corporate securities, by Fourth District member banks rose appreciably more than in other recent years. A net increase of $110 million, or 8 percent, in such holdings was the largest since 1954, accounting for about one-third of the increase in investment holdings in 1960.

Bank Liquidity Improved In the Second Half

The expansion of bank loans in the first half of the year, coupled with a reduction of investment holdings and a decline in deposits, tended to reduce appreciably the liquidity position of member banks in the Fourth District. The reverse trend which set in after midyear, however, as loans fell while investments rose, soon brought about an improvement in liquidity positions. The ratio of short-term assets (less borrowings) to total deposits (less cash items and reserves) at weekly reporting member banks, which at the end of May was down to 8.9 percent, was up to 16.7 percent by year end. Conversely, the ratio of loans to deposits for all District member banks, which is an inverse measure of bank liquidity, after rising steadily from mid-1958, declined from a high of 59.6 percent at midyear 1960 to 56.8 percent by the end of 1960.

Reserve Position Eased Substantially

A concomitant of easier monetary policy in 1960 was a gradual downtrend in member bank borrowings at the Federal Reserve bank. Borrowing by the District member banks continued to be substantially below that of the preceding year, while excess reserves, after declining somewhat in the first half of the year, moved up sharply after midyear to the highest level since 1954. Throughout the entire year, member banks in the District, on balance, were in a net free reserve position. In fact, net free reserves of all member banks increased from about $30 million in the second biweekly period in December 1959 to $64 million in the similar period of December 1960.

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