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Of Credit and Business Conditions

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MONEY MARKET IN JULY

Pressures in the money market remained relatively steady during July, despite the sizable flows of funds associated with the Fourth of July holiday and unusually wide and erratic fluctuations in float. The effective rate for Federal funds remained almost steadily at 2¾ per cent throughout the month, although some trading at lower rates took place from time to time. The over-all reserve position of member banks fluctuated rather widely during the month, and on the whole was somewhat easier than expected, mainly because of a high average amount of float caused by an unusually heavy volume of checks and delays in their collection. Reserve positions of New York central reserve city banks, however, tended to be tighter than in the preceding month, and the rates charged by New York banks on call loans to dealers in Government securities were generally at or above those which prevailed in June. The general trend of longer-term interest rates was upward, while short-term rates tended to decline until the latter part of the month.

Federal Reserve System holdings of Government securities showed a net decline over the four weeks from June 27 to July 25 of 155 million dollars, including a net reduction of 125 million in outright holdings and a 30 million decline in repurchase agreements with Government securities dealers. During the week ended July 4 when member bank reserves were subject to a heavy drain caused by the seasonal outflow of currency, outright holdings rose by 348 million dollars, but this rise was more than offset by sales and redemptions of 473 million dollars during the three succeeding weeks.

The market for Government notes and bonds, which had shown mixed movements in June, was marked by declining prices during most of July. The growing market opinion that a renewal of economic expansion after the end of the steel strike would result in heavy demands for funds and tighter credit conditions, as well as the large current volume of corporate security flotations at relatively attractive yields, tended to depress the prices of longer-term Government securities. At the shorter end of the market, attention focused on the refunding of 12,388 million dollars of 2 per cent Treasury notes due August 15 and of 550 million of 1½ per cent notes due October 1. The exchange offering of a new 2¾ per cent note to mature August 1, 1957 met with a favorable initial response and the "rights" and "when-issued" securities were quoted briefly at a premium. Price quotations slipped below par during the exchange period, when it became apparent that a number of holders of the maturing 2 per cent notes intended to sell their securities or present them for cash redemption. Attrition, according to the final Treasury report, amounted to 882 million dollars.

In sharp contrast, the market for Treasury bills tended to be buoyant during most of July; the average issuing rate moved down and in the middle of the month reached the lowest level since March. In part the decline early in July reflected the influence of large System purchases, but the strength of nonbank demand was such as to carry bill rates even lower during the second and third weeks of the month despite sales from the System's holdings. The demand for bills diminished subsequently, however, and yields rose moderately.

The corporate and municipal markets exhibited a heavy tone during July, partly because of an overhang of unsold issues from the previous month and partly because of a large volume of new corporate flotations. In addition, these

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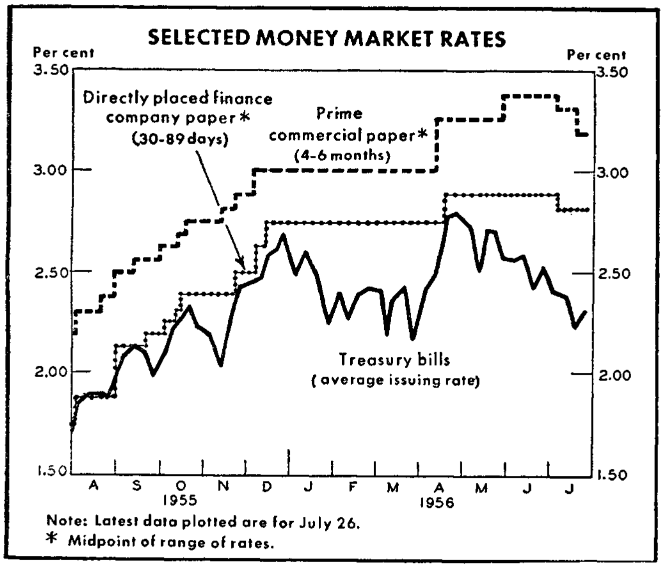


markets were influenced by the same anticipations of tighter credit conditions that depressed the Government bond market. Yields on outstanding corporate and municipal issues tended upward over the month, several proposed offerings were postponed, and the breaking-up of underwriting syndicates was frequently marked by price concessions to make slowly moving issues more attractive.

The strength of the Treasury bill market was a factor in the decline in several closely related short-term money market rates during the month (see chart). On July 5 a number of the finance companies that place their paper directly with investors reduced by ⅛ per cent their rates on paper with maturities up to 240 days, thus bringing the range of rates on 30 to 89-day paper to 2¾-2⅞ per cent from a flat 2⅞ per cent. At the same time some dealers in commercial paper reduced the rates on prime four to six-month commercial paper by ⅛ per cent, and a further reduction of ⅛ per cent became effective July 20; the range of rates is now 3⅛-3¼ per cent as compared with a flat 3⅜ per cent at the start of the month. In each case these were the first general declines in rates on either type of paper since mid-1954. In contrast, rates on bankers' acceptances, which had been reduced by ⅛ per cent in mid-June, were raised an equivalent amount on July 19, bringing the offering rate on unindorsed 90-day acceptances to 2½ per cent.

Member Bank Reserve Positions

Net borrowed reserves averaged 140 million dollars during the four weeks ended July 25, down by 67 million dollars from the average in the preceding four weeks, as float remained at unusually high levels throughout the month. However, until the statement week ended July 25, average net borrowed reserves remained close to the levels that prevailed in the last two weeks in June. Average member bank borrowings from Federal Reserve Banks amounted to 736 million dollars over the four weeks, 53 million below the average for the four statement weeks ended in June.

Early in the month, banks lost reserves as the result of the increase of currency in circulation associated with the Fourth of July holiday, as well as from a lower average level of float—which did not, however, decline as much as is usual at this time of the year. At the same time holdings of Government securities by the Federal Reserve Banks rose sharply, thereby releasing reserves to the banking system. On balance, average net borrowed reserves were almost unchanged between the final statement week of June and the first statement week of July, and declined only slightly in the succeeding week.

During the remainder of the month, market factors tended on balance to add to the reserves of member banks, and Federal Reserve security holdings were reduced substantially. However, member bank reserve positions fluctuated rather widely, reflecting the large midmonth increase and subsequent decline in float, the return flow of currency from circulation in the wake of the Fourth of July holiday, and changes in Treasury balances at the Federal Reserve

Table I

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, July 1956

(In millions of dollars; (+) denotes increase, (—) decrease in excess reserves)

Factor	Daily averages—week ended				Net changes
	July 4	July 11	July 18	July 25	
Operating transactions					
Treasury operations*	+ 81	+ 61	−156	+ 35	+ 21
Federal Reserve float	−138	− 62	+243	− 19	+ 24
Currency in circulation	−278	−160	+115	+176	−147
Gold and foreign account	+ 6	+ 9	− 10	+ 33	+ 38
Other deposits, etc	− 1	+ 11	+ 15	+ 4	+ 29
Total	−329	−143	+206	+232	− 34
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+296	+ 78	−339	− 79	− 44
Held under repurchase agreements	+ 17	− 33	− 7	− 3	− 26
Loans, discounts, and advances:					
Member bank borrowings	−113	+236	− 30	−276	−183
Other	—	+ 1	− 1	—	—
Bankers' acceptances:					
Bought outright	+ 1	− 1	—	+ 1	+ 1
Under repurchase agreements	—	—	—	—	—
Total	+201	+281	−377	−357	−252
Total reserves	−128	+138	−171	−125	−286
Effect of change in required reserves†	+ 8	+146	+ 37	+ 36	+227
Excess reserves†	−120	+284	−134	− 89	− 59
Daily average level of member bank:					
Borrowings from Reserve Banks	643	879	849	573	736‡
Excess reserves†	472	756	622	533	596‡

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† These figures are estimated.
‡ Average for four weeks ended July 25.

Banks. System holdings of Government securities on an outright basis were reduced by 473 million dollars between July 4 and July 25, the cumulative effect being to counteract the easing tendencies stemming from other factors.

Government Securities Market

Following temporary advances at the beginning of July, the prices of Government notes and bonds declined almost without interruption. The rally at the beginning of the month was partly connected with the onset of the steel strike which suggested that economic activity and demands for bank credit might temporarily slacken; in addition, large purchases of Treasury bills by the Federal Reserve System were interpreted as confirmation of the willingness of the System to assist the banks in meeting regular seasonal pressures on their reserves. After July 5, however, prices turned down and market sentiment became increasingly bearish over the rest of the month. The wide spread between yields on long-term Government securities and yields on newly offered corporate bonds was one factor tending to depress the Government securities market, as was the continued large volume of new corporate security flotations. Market opinion veered toward the view that, once the steel strike was terminated, a vigorous economic expansion—perhaps with an inflationary potential—would develop, and that in consequence credit policy might become more restrictive. In this environment, offerings of intermediate and longer-term Government securities by insurance companies, trust accounts, and savings banks switching into higher yielding corporate securities met with only limited demand. Over the month as a whole most issues maturing after 1961 declined by between 1²¹⁄₃₂ and 1²⁶⁄₃₂ points and shorter issues by between ⁴⁄₃₂ and 1⁶⁄₃₂. The two longest bonds declined by over 2½ points.

On July 12 the Treasury announced the refunding terms for 12,388 million dollars of 2 per cent notes due August 15 and 550 million dollars of 1½ per cent notes due October 1. Holders were offered in exchange for these notes a new 2¾ per cent note maturing August 1, 1957. The new notes were dated July 16 with interest adjustments as of that date, thus providing an immediate increase in the interest return to holders choosing to make the exchange. The subscription books were open July 16 through July 18, and the physical exchange was effected on July 25.

Since the bulk of the maturing 1½ per cent notes was held by the Federal Reserve Banks, interest centered on the terms of the exchange of the 2 per cent notes, of which about 5 billion was held outside the Federal Reserve Banks and Government investment accounts. Initial response was generally favorable, and the 2 per cent "rights" rose above par bid on the day after the exchange was announced. After the week end, offerings of both rights and the "when-issued" 2¾ per cent notes reached the market in some size at or just above par from investors who had apparently been holding the 2 per cent notes with a view to meeting early cash needs. Since offsetting demand was light, the bid price on both rights and when-issued securities declined as much as ¹⁄₃₂ of a point below par, at which level sellers tended to hold off. Of that portion of the two maturing issues held outside the Federal Reserve Banks and the Government investment accounts, 882 million dollars was retained for cash redemption, a rate of attrition of about 18 per cent; the total subscription to the new issue amounted to 12,056 million dollars. The new notes were bid at ¹⁄₃₂ below par on a when-issued basis through July 23, but later moved down to ³⁄₃₂ below par bid in line with the general decline in Government security prices.

In contrast to the upward trend in yields on Government notes and bonds, Treasury bill rates generally moved downward during the first three weeks of July, following a month of near stability. Early in the month the market was strongly influenced by the substantial outright purchases of bills by the Federal Reserve System, as well as by the temporary advance in the prices of other Government securities. In the July 2 auction the average issuing rate dropped to 2.409 per cent from 2.535 per cent in late June. Substantial demands from investors who had apparently missed in the auction drove the rate on the longest outstanding bill down to 2.29 per cent (bid) by the close of July 5, the lowest level since March. Even though System holdings of bills were reduced by over 350 million dollars in the two weeks ended July 18, the average issuing rate continued to move down, in part influenced by the investment of the proceeds of corporate security flotations, falling to 2.387 per cent in the July 9 auction and to 2.237 per cent in the subsequent week. In the two succeeding auctions, however, as nonbank demand tapered off somewhat and dealers became more cautious over the outlook for interest rates, the average issuing rate moved up, first to 2.303 per cent and then to 2.378 per cent.

Other Securities Markets

The markets for corporate and municipal bonds were marked by a somewhat heavier tone during most of July, as the volume of current and prospective flotations continued to be large. Conditions in these markets also reflected the spreading opinion that a renewed upsurge of business activity would develop following the termination of the steel strike. The reception accorded to new issues was mixed and, in a number of instances, the breaking-up of underwriting syndicates led to markups in yields. Average yields on outstanding corporate issues, as reflected in Moody's Aaa-rated corporate bond index, rose by 7 basis-points during July, following near stability throughout

June; yields on similarly rated long-term municipal bonds also advanced by 7 basis-points, almost offsetting the decline in the previous month. In each instance the upturn in yields on outstanding issues represented a reversal from the downward trend that had prevailed since early May.

The estimated volume of publicly offered corporate bonds for new capital rose to 565 million dollars, more than twice as much as in June. Most investors held off early in the month awaiting the test of the market that occurred on July 10, when a 250 million dollar issue of Aa-rated American Telephone and Telegraph Company debentures was offered to yield 3.73 per cent. The good reception accorded this issue led to some display of strength, and prices of many outstanding issues advanced temporarily. Subsequently, however, markets were again under pressure and several proposed issues were deferred.

Public offerings of municipal bonds amounted to an estimated 260 million dollars in July, compared with the unusually large offerings of over 600 million dollars in June. Dealer inventories remained at high levels throughout the month, partly in consequence of the heavy June offerings, and in a number of cases price concessions were made with a view to speeding the sale of slowly moving issues. The resistance of investors also led to the postponement of two sizable highway bond flotations that had been announced earlier. Despite the tapering-off of new issues, the municipal market remained sluggish toward the end of the month.

Member Bank Credit

Total loans and investments of weekly reporting member banks declined 1.4 billion dollars during the four weeks ended July 18, following an expansion of 1.2 billion dollars in the preceding four weeks. Loans dipped by 479 million dollars and investments decreased by 955 million.

About half of the decline in total loans was accounted for by a drop in business loans (including agricultural loans) of 259 million dollars, which was considerably larger than the 4 million dollar decline in the comparable period of 1955. Aside, however, from loans to sales finance companies, the chief categories of business loans showed relatively small changes, of about the same size as a year ago. Sales finance companies, which had borrowed heavily from banks prior to the June tax date, made net repayments of 245 million dollars, more than offsetting their borrowing during the week ended June 20; last year, repayments by sales finance companies in the comparable four-week period after the tax date were markedly smaller. Repayments by metal and metal products companies, whose borrowings have been so marked a feature of the year thus far, amounted to 63 million dollars, compared with net borrowings of 207 million in the four preceding weeks.

In addition to the decline in business loans, security loans registered a major drop, largely concentrated in the week ended June 27 and for the most part reflecting repayment of loans made by New York banks to dealers in Government securities during the preceding week. Consumer loans declined by 23 million dollars over the four-week period ended July 18, in contrast to increases in recent months, and real estate loans, which rose 45 million, advanced much less rapidly than earlier this year.

Over half of the nearly 1 billion dollar decline in the investment portfolios of weekly reporting member banks was attributable to a reduction of 535 million dollars in holdings of Government securities other than Treasury bills, partly reflecting the redemption of maturing tax anticipation certificates on June 22. Holdings of Treasury bills declined by 258 million and holdings of non-Government securities by 162 million.

Table II

Weekly Changes in Principal Assets and Liabilities of the Weekly Reporting Member Banks
(In millions of dollars)

Item	Statement weeks ended				Change from Dec. 28, 1955 to July 18, 1956p
	June 27	July 4	July 11	July 18p	
Assets					
Loans and investments:					
Loans:					
Commercial and industrial loans	− 64	− 8	− 106	− 80	+1,950 (commercial and industrial and agricultural loans)
Agricultural loans	− 7	+ 6	− 3	+ 3	
Security loans	−216	+ 25	− 71	+ 21	− 497
Real estate loans	+ 24	− 15	+ 28	+ 8	+ 480
All other loans (largely consumer)	+ 53	− 50	− 22	− 4	+ 664
Total loans adjusted*	−210	− 47	− 175	− 47	+2,485
Investments:					
U.S. Government securities:					
Treasury bills	−113	+ 5	− 105	− 45	− 997
Other	−360	− 28	− 105	− 42	−2,863
Total	−473	− 23	− 210	− 87	−3,860
Other securities	− 31	− 31	− 4	− 96	− 459
Total investments	−504	− 54	− 214	−183	−4,319
Total loans and investments adjusted*	−714	−101	− 389	−230	−1,834
Loans to banks	+177	—	− 133	+ 48	+ 246
Loans adjusted* and "other" securities	−241	− 78	− 179	−143	+2,026
Liabilities					
Demand deposits adjusted	−695	−962	+ 98	+424	−3,112
Time deposits except Government	+ 80	− 26	− 72	− 46	+ 209
U. S. Government deposits	+303	+194	−1,129	−144	+ 74
Interbank demand deposits:					
Domestic	−164	+806	+ 217	−273	− 136
Foreign	+ 5	+ 28	− 5	+ 45	+ 45

p Preliminary.
* Exclusive of loans to banks and after deduction of valuation reserves; figures for the individual loan classifications are shown gross and may not, therefore, add to the total shown.

INTERNATIONAL MONETARY DEVELOPMENTS

Monetary Trends and Policies

In the United Kingdom, the Chancellor of the Exchequer late last month urged on the banking community that a policy of credit contraction be "resolutely pursued". According to the latest statement of the London clearing banks, advances rose by 65 million pounds during the six weeks ended June 30, as against only some 0.8 million during the preceding four-week period. The latest increase, which is attributable in part to the semiannual inclusion of a number of extraneous items, leaves advances still almost 10 per cent below the mid-1955 level. At the same time the banks' liquidity position has improved, with the liquidity ratio on June 30 standing at 33.6 per cent, as against 33.2 in mid-May and 30.1 on June 30, 1955.

The British Building Societies' Association, in the face of continued heavy demand for mortgage credit, recommended to its members that they increase their lending and borrowing rates; these increases, to which six of the largest societies already have agreed, involve rises to 6 from 5½ per cent in the minimum rate on new loans, to 3½ from 3 per cent in interest paid on fully paid shares, and to 3 from 2½ per cent in interest on deposits. In response to the Treasury's offer of 4½ per cent Conversion Stock of 1962 in exchange for 824 million pounds of 2½ per cent National War Bonds maturing in mid-August, about 80 per cent of the old issue was tendered (the bulk reportedly coming from official portfolios); this leaves about 167 million to be paid off in cash. Yields of gilt-edged securities declined somewhat in the first half of July; the yield of 2½ per cent Consols fell to 4.74 per cent on July 9, but rose again to 4.83 on July 31. The average tender rate for three months' Treasury bills, which had stood at 5.13 per cent at the last June tender, declined to 4.98 at the last July tender.

The French National Credit Council last month took its first action, since the beginning of the current boom in Western Europe, to restrain the growing French inflationary pressures. First, the council tightened the instalment-credit terms for finance companies by raising minimum downpayments to 25 from 20 per cent and reducing the lending capacity of such companies to eight from ten times their combined capital and reserves. Secondly, it set commercial bank security-reserve requirements at a minimum of 25 per cent of their demand liabilities; heretofore, these requirements (which date back to 1948) had called for reserves of 20 per cent against *increases* in deposits. The 25 per cent requirement will, in effect, alleviate the Treasury's cash position, since it is expected to net the government some 80 billion francs through bank purchases of short-term Treasury securities.

Recent Canadian monetary and banking developments to the midyear are discussed elsewhere in this *Review*. During July the chartered banks' liquidation of government bonds, which had accelerated this spring, slowed down considerably. Business loans, while continuing the upward trend evident since early 1955, last month advanced less rapidly and on July 18 were 28.0 per cent above a year earlier, as against 29.5 per cent at the end of June and 30.5 per cent at the end of May. At the same time, the banks' indebtedness to the Bank of Canada continued, and even increased. Security yields, which generally had declined during May and June, last month moved upward once more, with the three months' Treasury bill tender rate rising to 2.65 per cent on July 26 from the year's low of 2.40 on July 5. The chartered banks, after having raised their loan rates in April, in July increased the interest rate on savings deposits to 2¼ from 2 per cent, i. e., to the highest level since the early thirties.

The Chilean authorities, following up the credit restrictions set for the first half of 1956 (which had provided, among other measures, for a diminishing rate of monthly credit expansion), now have announced rates that will allow an over-all July-December credit expansion of 11 per cent, as against 15 per cent in the first half. In Colombia, the 60 per cent supplementary-reserve requirement against increases in deposits imposed in April was abolished as of July 1; however, the more restrictive discount regulations also put into force in April have apparently remained unchanged. At the same time, commercial bank reserve requirements were reduced to 14 from 18 per cent for sight and to 5 from 8 per cent for all other deposits.

Exchange Rates

Sterling rates during the first half of July fluctuated within fairly narrow limits in a rather quiet market undistinguished by any noteworthy pressures. American-account sterling eased during the first week of July, moving as low as $2.79 15/32 on July 6. The market was not noticeably affected, either by the July 3 announcement that Britain's gold and dollar reserves had risen 16 million dollars in June or by the information that Britain had run a 25.2 million dollar deficit with the EPU. After noon on July 6 the rate moved upward, remaining stronger at about $2.79⅝ until midmonth, as commercial demand in New York (primarily on the part of oil companies) along with small offerings of dollars in London lent some firmness to the rate.

A lack of substantial activity also characterized the market for other types of sterling during the first half of July. Sterling for three and six months' delivery remained virtually unchanged at discounts of about $1\frac{9}{16}$ and $2\frac{31}{32}$ cents. The transferable-sterling market also appeared to be rather narrow and quiet, with the rate fluctuating between $2.7720 and $2.7745. Securities sterling continued to weaken and dropped as low as $2.67¾.

After midmonth, however, sterling came under increasing pressure. Good demand for dollars in London, particularly on the part of oil and tobacco interests, along with substantial sales of sterling in New York lowered the rate to $\$2.79\frac{9}{32}$ on July 24. Such pressures continued subsequently and, with the development of uncertainties in the Middle East, sterling declined further, to as low as $\$2.78\frac{11}{32}$ on July 30 and 31. At the same time, the discounts on sterling for forward delivery tended to narrow somewhat, with three and six months' sterling quoted at 1½ and 2⅞ cents discount on July 31. Transferable sterling was under slightly less pressure but nevertheless declined to $2.7610, while securities sterling moved erratically between $2.69½ and $2.66½, with the lower quotation at the month's end.

The Canadian dollar met with good investment demand from London and New York as well as commercial demand in New York and moved as high as $1.02¼ early in July. Subsequently the rate remained quite firm, although there was some tendency for it to ease in a smaller market in the closing days of the month; on July 31 the Canadian dollar was quoted at $\$1.01\frac{29}{32}$.

The West German "liberalized capital" mark continued to reflect good investment interest and moved substantially above the rate for the freely convertible mark, with the rate quoted as high as 24.62 cents on July 27.

SECURITIES MARKETS IN THE FIRST HALF OF 1956

The heavy demand for capital funds during the first half of 1956 placed pressure upon the securities markets and was reflected in an upward adjustment in the level of borrowing costs. Changing views concerning the future course of economic activity, together with recurrent uncertainty in political affairs, led to frequent reappraisals by investors and underwriters of the prospects for long-term interest rates and to relatively large and frequent swings in prices and yields of bonds and stocks during the period.

Flotations of both corporate securities and State and local government issues were larger in the first half of this year than in the same period of 1955. While seasonal net redemptions of Treasury securities also were greater than in 1955, a substantial part of these redemptions represented securities turned in for tax payments and thus did not release funds for reinvestment in other securities or for private debt repayment.

Market reception of the heavy volume of bond offerings was highly selective during most of the first half, and underwriters often encountered difficulty in distributing new issues at their original offering prices. Sluggishness in the bond markets was particularly pronounced during March and April, despite widespread price concessions and increasingly attractive yields in that period. A temporary improvement in buying interest during May and June brought about a decline in market yields on high-grade bonds. At midyear, long-term interest rates resumed their upward movement.

Volume of Offerings

The gross proceeds of corporate securities offered for cash in the first half of 1956 totaled approximately 5.3 billion dollars, the largest amount in any first six months on record. As shown in the table, corporate flotations for financing plant and equipment expenditures were higher than in the first half of 1955, reflecting the continued uptrend in business capital outlays this year. A more substantial increase over 1955 occurred in offerings to raise additional working capital, which was needed mainly because of rising inventories and record income tax payments. On the other hand, the rise in borrowing costs made it less attractive for corporations to refinance outstanding securities, with the result that the volume of refunding issues declined markedly from the first six months of 1954 and of 1955.

A noticeable shift in the types of securities offered by corporations to investors occurred during the past half year; issues of common stock declined both in absolute

Corporate Securities Offered for Cash
(In millions of dollars)

Offerings	1953	1954	1955			1956 Jan.-June
			Total	Jan.-June	July-Dec.	
Type of security:						
Common stock	1,326	1,213	2,185	1,320	865	1,000
Preferred stock	489	816	635	319	317	400
Bonds and notes	7,083	7,488	7,420	3,305	4,116	3,900
Total gross proceeds	8,898	9,516	10,240	4,944	5,298	5,300
Purpose of offering:						
Plant and equipment	5,647	5,110	5,333	2,488	2,846	2,700
Working capital	2,313	1,670	2,624	1,314	1,310	1,800
Retirement of securities	260	1,875	1,227	627	600	300
Other purposes	535	709	864	415	449	400
Total net proceeds	8,755	9,365	10,049	4,844	5,206	5,200

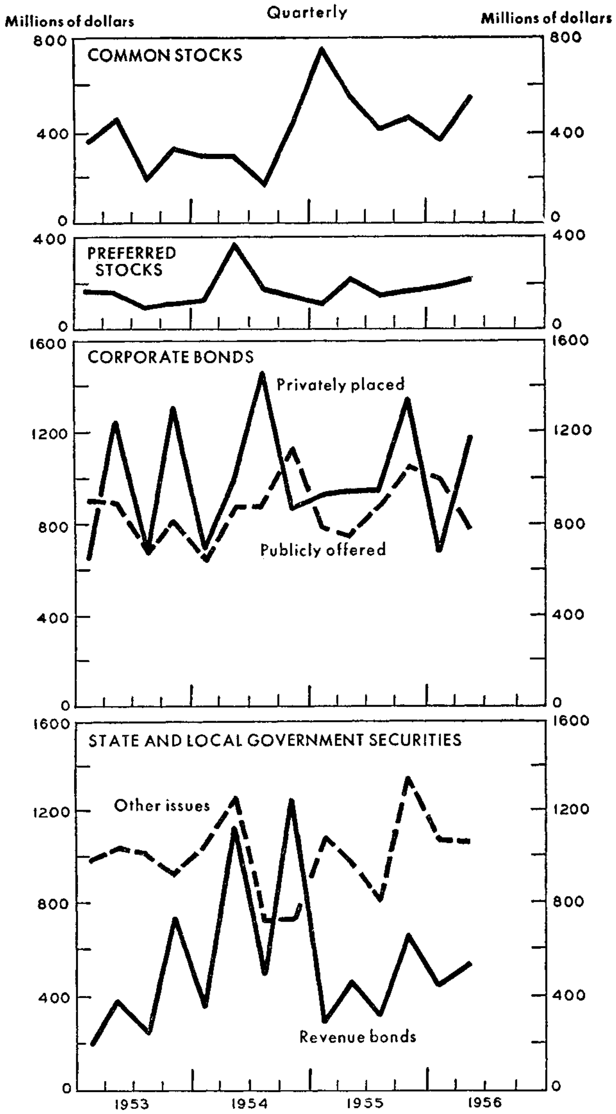
Note: Because of rounding, details may not add to totals shown.
Sources: Securities and Exchange Commission; 1956 partly estimated by the Federal Reserve Bank of New York.

amount and in relative importance, compared with the exceptionally large volume of such offerings during the comparable period of last year, while flotations of bonds and preferred stocks gained in importance over the first six months of 1955. A somewhat larger proportion of this year's corporate bond issues has been privately placed than in the corresponding periods of 1954 and 1955.

State and local governments floated 3.1 billion dollars of long-term bonds during the first half of 1956, an increase over the 2.8 billion raised during the same period of last year but substantially less than the record 3.8 billion in the first six months of 1954. Revenue bond issues were a somewhat higher proportion of total municipal offerings during the recent half year than in the first half of 1955, but were still considerably less important than during late 1953 and calendar year 1954 (see Chart I).

Net cash redemptions of Federal Government securities amounted to 10.0 billion dollars during the first six months of this year. This amount was twice as much as a year ago, since tax receipts were higher this year, while Federal outlays rose only slightly from the first half of 1955. Treasury security offerings in this period were confined to relatively short-term issues, in contrast to the first half of 1955, when Federal flotations included a forty-year 3 per cent bond.

Chart I
GROSS PROCEEDS OF NEW SECURITY ISSUES
Quarterly



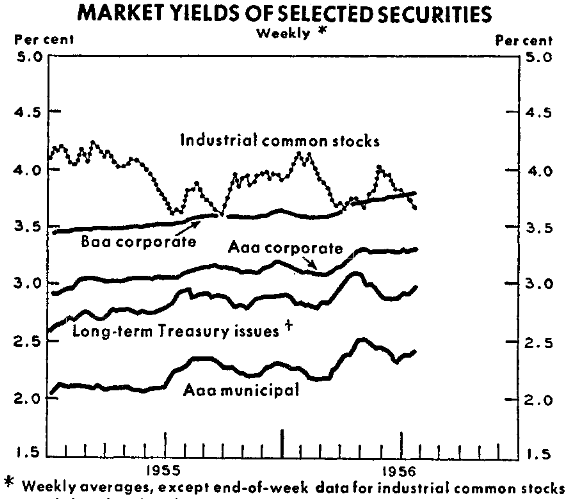
Sources: Securities and Exchange Commission and Bond Buyer; 1956 partly estimated by Federal Reserve Bank of New York.

The Cost of Borrowing

Borrowing costs and market receptivity to new issues were subject to rapidly changing influences during the initial six months of this year. Broadly speaking, the securities markets went through three phases, each one lasting about two months. The separate phases are clearly apparent in Chart II, which illustrates the movements in market yields for seasoned corporate, municipal, and Government bonds and for industrial common stocks.

During the first phase, roughly from the beginning of the year to the latter part of February, market yields on long-term bonds tended downward. The belief appeared to be widespread at the time that a peak in economic activity had probably been reached and that a subsequent downturn might bring lower interest rates in the future. Moreover, uncertainty over the President's intentions as a candidate for re-election had an unsettling effect on investment

Chart II
MARKET YIELDS OF SELECTED SECURITIES
Weekly *



* Weekly averages, except end-of-week data for industrial common stocks and Thursday close for municipal bonds.
\+ Old series.
Sources: Federal Reserve Bulletin and Moody's Investors Service.

markets. The volume of new corporate security issues during these months was relatively light, and was generally well received despite the economic and political uncertainties. However, there was an upsurge in State and local government borrowing during February, and the slow distribution of the new offerings left large unsold balances in the hands of municipal bond dealers.

In late February and early March, a change in market climate took place as investors found it necessary to reappraise the economic and political outlook. The President's decision to seek re-election cleared the air of this uncertainty, while the Federal Reserve survey of consumer finances gave evidence of consumers' intentions to maintain a high level of expenditures during 1956. Moreover, the joint Department of Commerce and Securities and Exchange Commission survey of business plans for capital outlays in 1956 imparted an improved tone to the business outlook, and gave rise to expectations of enlarged demands for capital funds particularly on the part of public utilities companies.

The markets for new issues of corporate and municipal bonds were characterized by congested conditions during the months of March and April. Despite higher yields on new issues and substantial price concessions on recent issues following the termination of some underwriting syndicates, many investors preferred to remain on the sidelines to await still more attractive yields. With large unsold balances of municipal bonds in their portfolios, underwriters bid cautiously for new security offerings, and the cost of borrowing rose to the highest level since 1953.

During this period of market congestion, average yields on long-term municipal bonds rated Aaa by Moody's Investors Service rose 34 basis-points from 2.17 per cent in late February to a peak of 2.51 per cent in early May. The advance in high-grade seasoned corporate bond yields was from 3.07 per cent to 3.31 per cent, while the yields on new issues rose even more sharply. In the Government securities market, the yield on the "bellwether" forty-year bonds rose by 13 basis-points between mid-February and early April; following the raising of discount rates by the Federal Reserve Banks in mid-April, there was a further rise of 3 basis-points in yields on the longest Government bond to a peak of 3.13 per cent on April 17.

In general, short-term Treasury bill rates moved up faster than long-term Government yields in this period; consequently, the trend toward a flattening of the yield curve which had developed during the second half of 1955 became even more marked. On April 19, there was a spread of 36 basis-points between the yields on the longest Treasury bill issue outstanding and the longest Government bond, compared with a spread of 49 basis-points at the end of 1955. Moreover, the yields on some intermediate-term Treasury issues rose temporarily above those on longer bonds, producing a "bulge" in the yield curve; for example, on April 16 the bid yield on the 2⅞ per cent notes of June 1958 stood 18 basis-points higher than the yield on the 3 per cent bonds of 1995.

The securities markets entered a third phase in early May, when indications of a slackening of demand for automobiles and other consumers' durable goods created the expectation among many large investors that at least a temporary decline in business activity might be in prospect, and that no further credit tightening was in the offing. Buying interest in both new and recent corporate securities showed a marked recovery beginning in May, and dealers were able to reduce their swollen inventories. As shown in Chart II, the decline in yields during this phase was centered mostly in Federal securities and municipal bonds. By the end of June, average yields on high-grade, seasoned municipal issues registered a decline of 17 basis-points from the peak in early May, while the longest-term Government bond fell off 12 basis-points in yield from the earlier high. In contrast, average yields on Aaa corporate bonds declined early in May by only 4 basis-points from the peak and then remained stable through the end of June, while average yields on Baa corporate bonds continued to edge upward during May and June.

In the stock market, dividends-price ratios on industrial common stocks tended to move in inverse relationship to bond yields in each of the phases described above. Generally speaking, the factors which generated caution among investors in fixed-yield obligations caused investors in equities to become more optimistic; similarly, when debt issues rose in investors' favor, equities tended to decline in attractiveness.

In the early weeks of the year, common stock prices sagged, while bond prices firmed. Then, stock prices began a strong upward climb, moving into new high ground at about the same time that bond prices reached their 1956 lows. A relatively sharp setback in stock prices occurred during May, but a recovery got under way in June.

As shown in Chart II, the dividends-price ratio for industrial common stocks (Moody's series) declined from a peak of 4.13 per cent in late January to a low of 3.65 per cent in early April when stock prices attained their highs for the first half of 1956. In early May, and again during July, common stock yields declined slightly below the market yields available on Baa corporate bonds.

Near the end of June, the bond markets took on a heavier tone and long-term yields began once more to rise. The large volume of June offerings of State and local government bonds encountered stiffened investor resistance to prevailing yields, and dealers' attempts to reduce their heavy inventories by cutting prices during July met with little success. Market yields continued to rise despite a decline in the volume of municipal offerings, and two highway bond issues scheduled for mid-July were deferred. In the corporate bond market, the calendar of new issues was heavily weighted by a 250 million dollar offering of debentures by the American Telephone and Telegraph Company and by several other sizable flotations. At the end of July, average yields on high-grade corporate bonds reached 3.33 per cent, a new high for the year, while yields on long-term Governments were close to their previous peaks.

Underlying these recent changes in the tone of the bond markets was the growing market expectation that a renewal of economic expansion and possibly of inflationary pressures might follow the settlement of the steel strike, and that demands for capital and credit financing would increase in the months ahead.

MONETARY AND BANKING DEVELOPMENTS IN CANADA

The Canadian monetary and banking scene during the past two years has been active indeed. A series of institutional and legal changes have broadened the money market. At the same time, credit policy has assumed a new importance in the fostering of balanced economic growth, in contrast to the earlier postwar years when greater reliance was placed on fiscal policy. These changes in the financial framework reflect in large measure the increasing maturity of the Canadian economy, which has shown a remarkable growth in recent years.[1]

With the rapid upsurge in production and employment after the mild 1953-54 recession, monetary conditions have gradually changed from ease to tightness. Severe inflationary strains, however, have remained absent; accordingly the primary aim of monetary policy has not been to prevent a credit expansion, but rather to match available funds to the growth of available resources. In pursuing this aim, monetary policy has gained flexibility and strength from the new money market and from the increased scope that it has given for central bank action.

Broadening of the Money Market

Throughout the postwar period the absence of a developed money market handicapped open market and discount rate policy in Canada. The issuing of Treasury bills at regular fortnightly tenders, it is true, had begun as early as the mid-1930's, but the bills were largely held within the banking system and their volume remained relatively small. In the absence of a broad bill market, the Bank of Canada found itself the principal buyer of Treasury bills from the banks, taking all offerings at a rate closely related to the latest average tender rate. Canada's commercial banks (the so-called chartered banks) not only made use of Treasury bills to adjust their reserve positions, but also maintained ample cash reserves in excess of the then 5 per cent statutory reserve requirement. Thus the banks seldom found it necessary to borrow at the Bank of Canada, with the result that the discount rate remained inoperative; moreover, central bank open market operations lacked a firm fulcrum, in the form of a stable cash reserve ratio, against which to exert an effective leverage.

The Canadian monetary authorities had long sought to encourage the growth of a short-term market, and beginning in 1953 they took a number of major steps in this direction. The government changed its regular issue of Treasury bills from a fortnightly to a weekly tender and began issuing nine months' as well as three months' bills, increasing both the total volume of bills and the number of maturities available to the market. The Bank of Canada then made its credit available, through repurchase agreements, to government securities dealers willing to take positions in the short-term market. To encourage further the development of market intermediaries the Bank of Canada, in its market transactions in Treasury bills, progressively widened the spread between its buying and selling levels, instituted a minimum for its individual buying transactions, and discontinued making payment in immediately available funds for bills purchased from banks, paying instead in clearing house funds. Moreover, the Bank of Canada opened its wire transfer facilities to dealers to help them avoid the costs of transferring bills between cities.

In mid-1954 two more important changes were made. First, the minimum required reserves of the chartered banks—consisting of notes as well as Bank of Canada deposits—were altered, as part of a revision of the banking legislation, from a daily ratio of 5 per cent to a monthly average of 8 per cent. Secondly, the chartered banks were encouraged to start making day-to-day loans to those government securities dealers that were carrying inventories of short-term government securities.

The Money Market Arrangements

The Canadian money market, unlike those in the United States and Britain, is not centered in one city but instead has two main centers, Toronto and Montreal; in other respects, it combines certain New York and London features. The core of the market consists of twelve jobbers

[1] For a discussion of the Canadian banking system, see *Monthly Review,* December 1954.

who, alone among Canadian government securities dealers, maintain continuous quotations in all maturities of Treasury bills and other government securities up to three years, hold portfolios of these money market securities, obtain day-to-day loans from the chartered banks, and have access to Bank of Canada credit in the form of repurchase agreements. The chartered banks' day-to-day loans, made against the pledge of Treasury bills and government bonds maturing within three years, are the primary source of funds for the financing of the jobbers' portfolios. The rates on these loans are determined through over-the-counter negotiations, and are kept competitive with the help of two special "brokers" who serve on a salaried basis as an information center for the banks. The banks report to these "brokers" the rate on each new loan, or any revised rate on an outstanding loan, of one million dollars or more. The "brokers" inform all the other banks accordingly but themselves do nothing about matching up supply and demand. The day-to-day loan rate from its inception has generally been below the tender rate for three months' Treasury bills, thus enabling the jobbers to earn a small profit on their carry.

The total outstanding volume of day-to-day loans extended by the chartered banks to the jobbers may not exceed a maximum determined by the borrowing limits of each jobber. These individual limits take in not only the jobber's day-to-day loans from the banks but also his borrowing facilities in the form of repurchase agreements with the Bank of Canada. Outside these limits, the jobbers also obtain financing from nonbank sources in the form of either short-term loans or repurchase agreements.

The day-to-day loan arrangements are of course intended to provide the banks with an interest-earning asset through which they can easily adjust their positions, as well as to provide a source of funds to finance the jobbers' inventories. A bank desiring to replenish its cash reserves may call part or all of its day-to-day loans by noon for payment that day; and, when the borrower replaces this loan by a loan from another bank, deposits at the Bank of Canada are transferred to the bank short of reserves from the one with ample reserves. The day-to-day loan market in Canada thus resembles that in London, and also has a function similar to the Federal funds market in the United States. The day-to-day loan market, moreover, offers a cushion for the entire commercial banking system: when the banking system as a whole is under pressure, it can transfer this pressure onto the jobbers to the extent that the jobbers borrow from the Bank of Canada and thus replenish the reserves of the banking system.

The Bank of Canada repurchase agreements with the jobbers differ from those in this country, but resemble the Bank of England advances to the discount houses, in that every jobber to whom this facility is extended may draw upon it at his own initiative. The Canadian jobbers, however, must stay within their borrowing limits. The repurchase agreements are made at the Bank of Canada discount rate, and are applicable to Treasury bills and other government securities with maturities up to three years; they run up to thirty days, but the jobber may terminate them at any time. Since the bank rate is as a rule higher than the day-to-day loan rate, a jobber whose day-to-day loan has been called by one bank and who is unable to replace it by a loan from another bank will not turn to the Bank of Canada until he has exhausted every possibility of obtaining nonbank funds. Central bank accommodation is also available to the banks as in this country but in contrast to the practice in England, where the discount houses and not the banks borrow from the Bank of England. The borrowing takes the form of seven-day secured advances, which means that seven days' interest would be charged even if the loan were repaid earlier, and that after seven days the advance has to be renewed.

With the broadening of the money market, the volume of private paper has increased substantially and today forms an important part of the market. This paper is issued by finance companies and by large nonfinancial corporations, and has maturities ranging generally from three months to one year. The notes are placed either directly or through dealers, and the purchasers are mostly corporations with temporary surpluses of funds. At the end of 1955 there was believed to be about 200 million Canadian dollars of finance company paper and about 50 million of other corporation paper outstanding.

The volume of Treasury bills, however, continues to be more important; on July 4 the total outstanding was 1,690 million dollars, as against 650 million at the end of June 1954 and 425 million at the end of January 1953. Of the current total, some 500 million is held outside the banking system, compared with less than 100 million at the end of June 1954. The Treasury bills are at present mostly three months' bills, the tender for nine months' bills having been discontinued last November. The weekly tenders are all on a competitive basis, and are open only to primary distributors—that is, to the banks, the jobbers, and the other 300-odd securities dealers who take part in the initial distribution of government securities.

Bank Credit Trends

The day-to-day loan market was started during a period of monetary ease when the Canadian economy was going through a mild recession, and the climate thus was favorable to a broadening of the money market. Nonbank investors had ample funds to invest in short-term securities. The jobbers were anxious to enlarge their portfolios, on which they could earn a profit with what they considered to be a minimum risk of falling prices. The banks, due to a slack demand for loans, were interested in expanding their other interest-earning assets. Moreover, the banks had ample excess reserves even following the introduction of the 8 per cent statutory reserve requirement. The new money market continued to operate relatively smoothly even after monetary conditions tightened, although there was some decline in the volume of the chartered banks' day-to-day loans.

The changes in the banks' other assets, however, were much more marked as the downturn in business activity gave way to a strong upturn. The 1955 economic upsurge did not at first give rise to an expansion of inventories, and bank loans resumed their growth only in April 1955. Thereafter the rise in general loans (i.e., excluding loans to local governments and certain other special categories) accelerated. The increase over a year previous amounted to 6 per cent at the end of the second quarter of 1955, and 12, 23, and 30 per cent at the end of the following three quarters. The expansion slowed down somewhat in June, and on July 18 general loans were 28 per cent above a year previous.

As the banks expanded their loans, an increasing part of their lending took the form of "capital loans"—that is, term loans to corporations, with a duration of more than one year, and acquisitions of corporate securities directly from the issuer rather than in the market. In November 1955 the chartered banks agreed with the Bank of Canada to cease making new commitments for such loans, after a survey revealed that existing commitments were in excess of 400 million dollars and that new commitments were being made at a rate of 50 million dollars a month. Along with the expansion in general loans came a rapid rise in the banks' holdings of insured residential mortgages, which the banks were permitted to acquire under the revision of the general banking legislation in mid-1954.

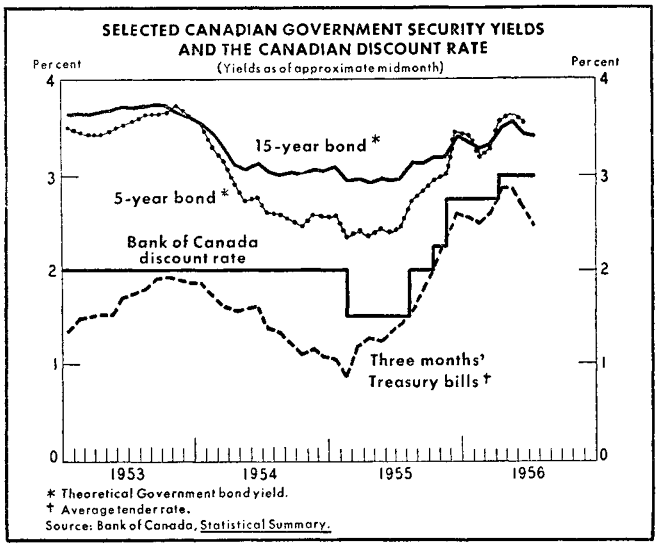
During the early part of the 1955 loan increase, the chartered banks were able to continue the expansion of their government bond holdings that had been under way since mid-1954, but in the summer months of 1955 this rise leveled off and in August came to a halt. Since August 1955 the banks, in order to satisfy the growing demand for loans, have been net sellers of bonds in practically every week. About the same time that the banks began unloading their holdings of government bonds, they also started reducing their portfolios of Treasury bills. In November, however, they began to rebuild their Treasury bill holdings in line with their agreement with the Bank of Canada discussed below; by mid-July 1956 their bill portfolios were some 300 million dollars above the August 1955 level. The banks' liquidation of government bonds, however, continued through July 1956. Altogether, the banks reduced their government bond holdings from August 24, 1955 to July 18, 1956 by 1,380 million dollars, or 42 per cent.

The reduction in the banks' holdings of government securities was in part reflected in purchases by other holders. From late August 1955 to July 18, 1956 the public's holdings of marketable government securities rose by 330 million dollars, while holdings by government accounts rose by 59 million and holdings of the Bank of Canada by 60 million. The larger part of the decline in the banks' government securities portfolios, however, found its counterpart in a 620 million fall in the total marketable government debt (the increase in Treasury bills being more than offset by the retirement of short-term notes and other issues), since securities purchased by the government accounts were subsequently retired. The reduction in the marketable government debt was made possible by the government's strong cash position, arising from large budget revenues and net sales of savings bonds to the public.

Monetary Restraint

Open market operations have long been the major central banking instrument in Canada, and the changes in the Bank of Canada Act in 1954 removed the last formal impediments to the central bank's operating over the whole range of the government securities market. Discount rate policy has come to actively supplement open market operations only since early 1955. While the Bank of Canada discount rate had been changed but twice from 1935 (when the bank had begun operations) to the beginning of 1955, it has since been altered five times. Informal agreements between the central bank and the commercial banks have also been relied upon; these have been made possible by the compact nature of the country's commercial banking system, which comprises only nine banks, with nation-wide branch systems. However, the power to vary the minimum cash reserve requirements of the chartered banks that was given to the Bank of Canada in 1954 has so far not been used, as it is intended, according to the Governor of the Bank of Canada, only for exceptional circumstances.

Throughout the mild economic downturn of 1953-54 the Bank of Canada pursued a policy of active ease. Treasury bill rates as well as the yields of short and medium-term government bonds reached three-year lows in February 1955 (see chart), leaving the Bank of Canada discount rate far out of touch with the market. By early 1955 the day-to-day loan arrangements had become well-established, and the authorities therefore thought it desirable, by instituting a more flexible discount rate policy, to



prepare for possible borrowing from the central bank in the event of a tightening of monetary conditions: the discount rate was accordingly reduced to 1½ from 2 per cent on February 14, 1955 in order to bring it into closer alignment with short-term market rates.

During the following months, monetary policy can be said to have been directed at moderate ease, and the banks were able to add to their reserves. However, as deposits increased, the banks' average cash ratio fell to a new low of 8.3 per cent by June, compared with 8.7 in the first quarter, and short-term interest rates rose noticeably. In the third quarter of 1955, monetary policy became, according to the Bank of Canada's annual report, "one of offering increasing resistance to further [credit] expansion". Reflecting the rise in market interest rates, the discount rate was increased to 2 per cent on August 5. Credit policy apparently became somewhat more restrictive in the fourth quarter, interest rates continued to rise, and the discount rate was raised in two steps to 2¾ per cent. The chartered banks and the jobbers had some recourse to Bank of Canada credit during most of this time, a practice hitherto rare in Canadian banking history.

Meanwhile, the Bank of Canada reviewed general credit developments with the chartered banks, and in November made three requests of the banks pertaining to their operations. First, the Bank of Canada suggested that applications "for new and increased credits should be examined very carefully, and existing credit limits surveyed with a view to maintaining control over future growth". Secondly, the Bank of Canada obtained, as already noted, the agreement of the banks to stop making new commitments for term lending. Finally, agreement was reached on the adoption of a minimum daily average ratio of 15 per cent of liquid assets—cash, day-to-day loans, and Treasury bills—to deposits, to be maintained during each month from June 1956 on. Such a ratio, it was said, would in the future make monetary restraint measures more quickly effective, since the banks would no longer be as free to liquidate their Treasury bill holdings in order to satisfy a growing demand for loans and would have to start selling longer-term government securities sooner.

After the turn of the year a slight easing, partly seasonal, occurred in monetary conditions, but the upward movement in interest rates was quickly resumed, and on April 4, 1956 the discount rate was raised to 3 per cent. By the beginning of May the Treasury bill rate reached an all-time peak of 2.91 per cent and other market rates approached the highs of late 1953. Meanwhile, the pattern of Canadian yields changed markedly, with the three to five-year yields standing above the long-term yields, while the spread of Canadian interest rates above United States rates again widened significantly. Subsequently, interest rates eased somewhat, but the banks resumed their borrowings from the Bank of Canada and their average cash ratio remained close to the minimum. Not only are market interest rates now well above the 1955 lows, but the chartered banks' loan rates and their rates on savings accounts have also been adjusted upward, marking a departure from the tradition of rate stability.

The Present Situation

In its present form the Canadian money market has been operating for only two years, but during this relatively short period it has functioned fairly smoothly and, more particularly, it has come through its first period of tight money reasonably well. Appropriate instruments are available for the successful operation and development of the market, and the banks, the nonbank investors and borrowers, and the jobbing intermediaries have all shown marked interest and ability as participants. Some technical problems still remain, but with the passage of time the market continues to acquire more experience and greater adaptability to changing economic conditions.

While the broadening of the market has undoubtedly increased the effectiveness of credit policy, monetary restraint has faced various problems. In particular, the chartered banks follow the general practice of making rather large advance loan commitments to their customers, with the result that monetary restraint is reflected in bank loans only after some delay. Moreover, while the floating exchange rate has given the Canadian authorities a certain degree of freedom in their conduct of credit policy, the interaction of the Canadian with the United States securities market tends to impose a limit on the tightness that the Bank of Canada can enforce on the market in Canada. Whenever the spread between Canadian and United States interest rates widens, there are always some Canadian borrowers who turn to the United States market, and at the same time United States funds flow to Canada. On the other hand, this close link with the United States tends to provide a cushion for the Canadian balance of payments, and is a considerable advantage in the continued expansion of the Canadian economy.

Although the policy of credit restraint has not led to a decline in bank loans—and was not intended to do so—it has significantly slowed down the expansion of the money supply. Moreover, it has led to a reduction in banking liquidity, so that a further slowing-down in loan expansion seems in prospect, particularly since loan commitments are being worked off. The reduced general availability of funds has been felt throughout the economy, and seems to have led to a postponement of some capital expenditures. So far the pressures of excess demand have not been extreme, and the moderate monetary restraint exercised till now has succeeded in keeping the financial expansion reasonably well within the limits of physical growth.

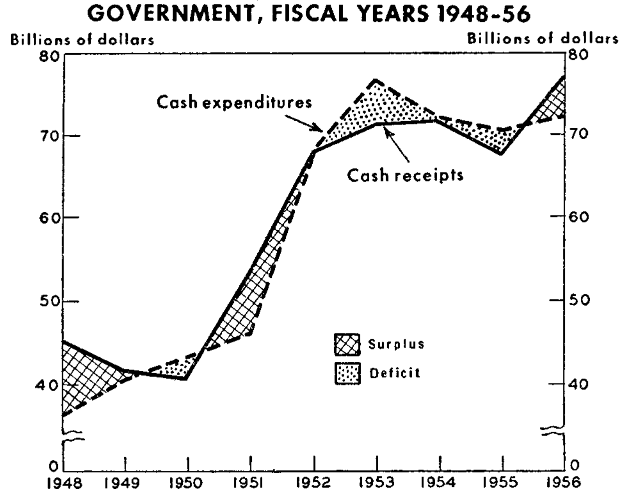
FEDERAL FINANCES IN THE FISCAL YEAR 1956

A sharp increase in Federal tax receipts enabled the Government to close the fiscal year 1956 with surpluses of 1.8 billion dollars in the conventional administrative budget and 5.1 billion dollars in the consolidated cash budget. Save for a cash surplus of less than 50 million dollars in the fiscal year 1952, the Federal Government has not had either a budget or cash surplus since the fiscal year 1951, when the post-Korea rise in tax receipts exceeded the increase in Federal defense spending (see Chart I).

Last year's surplus coincided with an advance in the gross national product to the highest level in the nation's history. In retrospect, it appears that the surplus—and the modest amount of debt retirement which it permitted—had a stabilizing influence on the economy. Together with the Federal Reserve policy of credit restraint, the excess of receipts over expenditures in the Government's accounts helped to control inflationary forces. While the expectation of a surplus stimulated discussion in some quarters of possible tax reduction, the continued operation of the economy at close to capacity reinforced the arguments for postponing a tax cut until the surplus becomes more ample, or until there is no longer any risk that a tax cut would have undesirable inflationary effects.

Chart I

CASH RECEIPTS AND EXPENDITURES OF THE FEDERAL GOVERNMENT, FISCAL YEARS 1948-56



Sources: Daily Statement of the United States Treasury and Treasury Bulletin.

The following review of the fiscal-year results, as well as the accompanying charts and statistical tables, is based upon the Federal Government's cash rather than its budget accounts. The cash accounts are generally believed to be more satisfactory than the budget accounts for purposes of economic analysis, because they exclude intragovernmental transfers and present the consolidated results of budget, trust fund, and Government agency transactions; thus, the cash accounts provide an all-inclusive measure of the flow of cash payments and receipts between the public and the Federal Government. The surplus or deficit in the cash accounts (as reported in the *Daily Statement of the United States Treasury*), when adjusted for changes in the Treasurer's balance, indicates the amount of net Federal cash borrowing or debt redemption.[1]

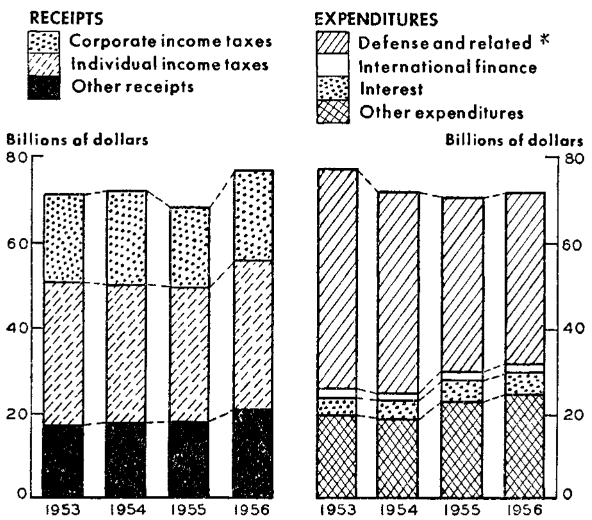
Cash Income

In the fiscal year which ended June 30, Federal cash income was by far the highest on record. Even though important tax reductions were made two years ago, the growth of the tax base since then has more than offset the effects of the lower rates. From a level of about 71.5 billion dollars in the fiscal years 1953 and 1954, cash receipts declined to about 68 billion dollars in the following year and then rose to 77 billion dollars in fiscal 1956.

As shown in Table I, every category of Federal income increased in fiscal 1956. Of the total increase of 9.3 billion dollars, 3.7 billion was in individual income taxes (withheld and nonwithheld), 3.1 billion was in corporate income taxes, and most of the remainder was divided between excise taxes and old-age and railroad retirement taxes. For the most part, these increases in receipts were a response to the substantial expansion of the tax base with the improvement in business conditions during the year.

[1] The *Daily Statement* excludes certain net expenditures and borrowing operations of Government-sponsored enterprises.

Chart II
FEDERAL CASH RECEIPTS AND EXPENDITURES BY TYPES, FISCAL YEARS 1953-56



* For items included, see Table I.
Sources: Daily Statement of the United States Treasury and Treasury Bulletin.

Despite the reductions in individual income tax rates which were made on January 1, 1954, receipts from this tax were higher in the fiscal year 1956 than in 1953, which was the previous best fiscal year (see Chart II). For corporate income taxes, however, the rise in fiscal 1956 was not quite enough to compensate for the loss of revenue attributable to the repeal of the excess profits taxes as of December 31, 1953.

The fiscal year 1956 was the first full year in which the broadened earnings base and coverage under the Social Security Amendments of 1954 were effective. As a reflection of these legislative changes, the increase in receipts was proportionally larger for old-age taxes than for any other tax category.

Cash Expenditures

Cash expenditures increased by about 2 billion dollars in the fiscal year 1956, but at 72 billion dollars they were still well under the post-Korea peak of nearly 77 billion dollars in the fiscal year 1953.

As illustrated in Chart II, since 1953 there has been a sizable cutback in defense and related expenditures, which has been partly offset by increases in other expenditure categories. From 1955 to 1956, however, the reduction in defense and related expenditures was very small, and the rate of these expenditures in the most recent months showed little change from a year ago.

According to the tabulation in Table I, the largest increases in expenditures in the fiscal year 1956 were for old-age and railroad retirement benefits and for "all other" expenditures (which include the regular operating costs of the Government). The latter increase partly reflects the upward adjustment of Government salaries in the summer of 1955, while the rise in benefit payments can be attributed to the liberalization of benefit rates and the continued growth in the number of retired persons eligible for social security payments. Veterans benefits also increased in fiscal 1956. On the other hand, unemployment payments declined, owing to the shrinkage in covered unemployment as the economy advanced to near-capacity operations.

Expenditures by the Commodity Credit Corporation (CCC) amounted to 3.8 billion dollars in fiscal 1956, which is higher than in the year before. Near-record agricultural output in the calendar year 1955 was accompanied by only modest increases in domestic and foreign demand. Federal price-support activities through CCC operations helped to stem the price decline for basic crops.

The cost of servicing the public debt in the fiscal year 1956 increased by about 400 million dollars, to 5.1 billion dollars, partly because of a somewhat larger average debt during the year and partly because of higher interest rates. The computed average annual interest rate on the public debt advanced from about 2.3 per cent in the fiscal year 1955 to 2.5 per cent last year.

Public Debt Transactions

The amount of publicly held Federal debt (including agency obligations) was reduced by 4.8 billion dollars in

Table I
Cash Income and Expenditures of the Federal Government, Fiscal Years 1955 and 1956
(In billions of dollars)

Item	1955	1956	Change 1955-56
Cash income—total	**67.8**	**77.1**	**+9.3**
Withheld income taxes	21.2	24.0	+2.8
Nonwithheld income taxes	10.4	11.3	+0.9
Corporate income taxes	18.2	21.3	+3.1
Excise taxes	9.1	10.0	+0.9
Old-age and railroad retirement trust funds	5.9	7.0	+1.1
Unemployment trust fund	1.2	1.4	+0.2
All other receipts	5.2	5.8	+0.6
Less: tax refunds	− 3.4	− 3.7	−0.3
Cash expenditures—total	**69.9**	**72.0**	**+2.1**
Defense and related*	40.9	40.1	−0.8
International finance and aid†	1.7	1.5	−0.2
Interest on debt	4.7	5.1	+0.4
Veterans Administration	4.1	4.6	+0.5
Commodity Credit Corporation	3.4	3.8	+0.4
Old-age and railroad retirement trust funds	5.0	6.1	+1.1
Unemployment trust fund	2.0	1.4	−0.6
All other expenditures	7.9	9.1	+1.2
Clearing account	0.2	0.3	+0.1
Net cash income (+) or deficit (−)‡	**− 2.1**	**+ 5.1**	**+7.2**

Note: Because of rounding, figures do not always add to totals.

* Military outlays by Defense Department and expenditures for strategic and critical materials, military assistance under Mutual Security Act, Atomic Energy Commission, maritime activities, the Coast Guard, defense production activities, and redemption of Armed Forces Leave bonds.

† Economic and technical assistance and "direct forces support" under Mutual Security Act and net redemption of notes issued to International Monetary Fund.

‡ On the basis of the series entitled "Receipts from and Payments to the Public", the fiscal 1955 cash deficit was 2.7 billion dollars; data on this basis for fiscal 1956 are not as yet available. The difference between that series and the data given in the table is accounted for chiefly by net payments by Government-sponsored corporations from cash balances held outside the Treasury. The latter payments are not reported in the *Daily Statement.*

Sources: Based on *Daily Statement of the United States Treasury* and *Monthly Statement of Receipts and Expenditures of the United States Government.*

the fiscal year 1956. This amount is somewhat less than the cash surplus because 300 million dollars of the surplus was added to the Treasurer's balance (see Table II). Exclusive of agency borrowing, net cash debt redemption was 5.5 billion dollars.

Only part of the cash debt redemption, however, represented a reduction in the gross public debt. At the same time that the Treasury was retiring publicly held debt, it was also borrowing 3.8 billion on a noncash basis, mainly in the form of increased liabilities to the trust funds (see Table II). Thus, the reduction in the gross public debt during the fiscal year was limited to 1.6 billion dollars, from 274.4 billion dollars to 272.8 billion. This decline marked a reversal of the generally rising trend of the public debt since the fiscal year 1951.

The cash debt redemption in fiscal 1956 included 1.9 billion dollars of Savings notes, 1.2 billion (net) of Savings bonds (at issue price), and almost 1.7 billion of marketable and other miscellaneous issues. The retirement of matured Treasury Savings notes just about closes the Treasury's books on borrowing through such securities. None has been sold since October 1953, and at the end of fiscal 1956 less than 20 million remained to be redeemed.

Flotations of new marketable issues (excluding the roll-over of regular Treasury bills) totaled 38.3 billion dollars in fiscal 1956,[2] or about one-third below the volume in the prior fiscal year. Of the 1956 total, 8.8 billion represented new money borrowing. More than three fourths of the new money issues consisted of tax anticipation securities, and the remainder was obtained through an increase of 1.3 billion dollars in the weekly bill issue and an 820 million additional issue of the forty-year bonds originally floated in February 1955.

About 29 billion of maturing issues during the fiscal year were refunded into new issues of short or intermediate maturity; the longest original maturity among the new securities offered in exchange was two and one-half years. Due to the preponderance of short-term securities in the exchange offerings, the average maturity of the marketable debt was reduced by six months during fiscal 1956 to five years and five months. During fiscal 1955, the average maturity had been increased by three months.

[2] The flotations included about 500 million dollars of 1½ per cent notes (Series EA and EO) issued by the Treasury in exchange for Investment Series B bonds.

Table II
Federal Cash Operations and Changes in Debt, Fiscal Years 1955 and 1956
(In billions of dollars)

	Item	1955	1956
	Cash surplus (−) or deficit (+)	**+ 2.1**	**− 5.1**
Add:	Change in Treasurer's balance	− 0.5	+ 0.3
Equals:	Net cash debt redemption (−) or borrowing (+) from the public	+ 1.6	− 4.8
Less:	Net sales of securities of Government corporations	0.7	0.7
Equals:	Net change in gross public debt held by the public	0.9	− 5.5
Add:	Net investment by Government agencies and trust funds	1.6	3.2
	Net accruals of interest on Savings bonds	0.5	0.4
	Other noncash borrowing	0.1	0.2
Equals:	**Net reduction (−) or increase (+) in gross public debt**	**+ 3.1**	**− 1.6**
	Memorandum (end of year):		
	Gross public debt	274.4	272.8
	Debt subject to ceiling	273.9	272.4
	Treasurer's balance	6.2	6.5

Note: Because of rounding, figures do not always add to totals.
Source: *Daily Statement of the United States Treasury.*

Seasonal Factors in Treasury Financing

In fiscal 1956, as in other recent fiscal years, the Treasury's cash requirements underwent marked seasonal swings. In the first half of the fiscal year (July-December 1955) the Government incurred a cash deficit of 6.9 billion dollars, while in the second half (January-June 1956) there was a cash surplus of 12.0 billion. The first half's deficit, along with the Treasury's cash requirements to cover the attrition in refundings and net redemptions in miscellaneous debt operations, was met partly through drawing down the cash balance accumulated in the preceding six months and partly through new money offerings aggregating 8.8 billion dollars. The second half's cash surplus, on the other hand, went to retire debt (mostly tax anticipation series) held by the public and to restore the Treasury's balance.

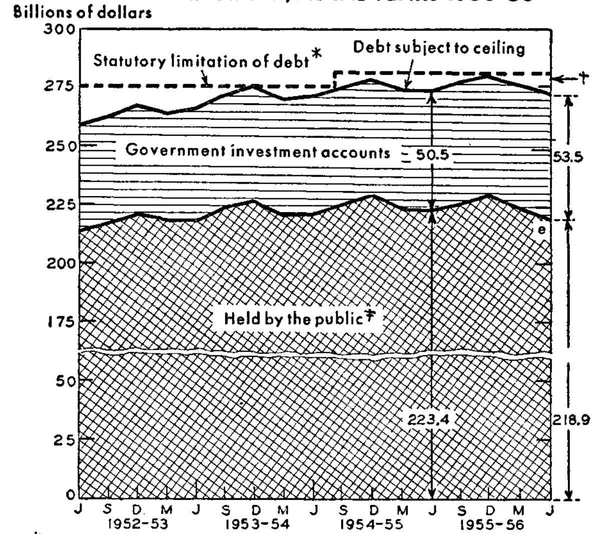
The largest seasonal swing in Federal tax receipts during fiscal 1956 occurred in corporate income taxes. Out of total corporate tax receipts of 21.3 billion dollars, the Treasury collected more than three quarters in the January-June period, with as much as 70 per cent being received in two months alone—March and June. This seasonal concentration of corporate tax payments is the result of the Mills plan, which starting in 1951 gradually compressed corporate tax payments into the six months immediately following the close of each corporation's taxable year. The "current payment" provision of the Internal Revenue Code of 1954, however, will effect a progressive adjustment in this payment schedule. Under this provision, calendar-year corporations were required to remit 10 per cent of their estimated 1955 tax liability in excess of $100,000 in two equal instalments in September and December of 1955, and to pay the remainder of their 1955 taxes in the following March and June. Increasingly larger current-year payments will be required during the next four years, until finally the larger corporations will be paying almost half of their taxes in the second half of their taxable year and the balance in the six months after the close of the year. This change will bring about a more even distribution of tax receipts during the fiscal year and thus reduce the Treasury's need for seasonal borrowing.

Individual income tax receipts are characterized by a milder seasonal pattern. While the major share of these taxes is subject to current withholding arrangements, or is collected through quarterly payments of estimated non-withheld taxes, receipts continue to be somewhat clustered in the January-June period because final returns for the preceding year, as well as three of the four quarterly payments of estimated taxes, are received then.

The influence of these intra-fiscal-year fluctuations in receipts on the public debt is illustrated in Chart III for the period 1953-56. On a quarterly basis the public debt reached a high at the middle of each fiscal year. During fiscal 1956 Treasury borrowing to cover the first half's deficit raised the debt subject to statutory limitation to 280.3 billion dollars on December 31, or slightly under the temporary ceiling of 281 billion dollars then in effect.

The debt subject to ceiling was reduced by about 8 billion dollars during the January-June period of surplus financing. At 272.4 billion dollars on June 30, such debt was well under the permanent ceiling of 275 billion which then became effective. Because the debt subject to ceiling was 1.5 billion dollars less than a year earlier, and because a budget surplus is expected for the fiscal year 1957, the Administration requested a lowering of the temporary ceiling to 278 billion dollars. This request was enacted into law on July 9, to remain in effect through June 30, 1957.

Chart III
FEDERAL DEBT SUBJECT TO STATUTORY LIMITATION END OF QUARTER, FISCAL YEARS 1953-56



* The statutory limitation of 275 billion dollars has been in force since June 26, 1946. It was temporarily increased, by an act approved August 28, 1954, to 281 billion until June 30, 1955. An act approved June 30, 1955 continued that temporary increase to June 30, 1956. An act approved July 9, 1956 has set the new temporary ceiling at 278 billion until June 30, 1957.
† New temporary ceiling.
‡ Includes debt held by the Federal Reserve System.
e Partly estimated by the Federal Reserve Bank of New York.
Source: Treasury Bulletin.

SELECTED ECONOMIC INDICATORS
United States and Second Federal Reserve District

Item	Unit	1956			1955	Percentage change	
		June	May	April	June	Latest month from previous month	Latest month from year earlier
UNITED STATES							
Production and trade							
Industrial production*	1947-49 = 100	141*p*	142	143	139	− 1	+ 1
Electric power output*	1947-49 = 100	221	217	215	197	+ 2	+12
Ton-miles of railway freight*	1947-49 = 100	—	108*p*	113	103	− 4	+ 2
Manufacturers' sales*	billions of $	27.7*p*	27.8	27.2	27.1	#	+ 2
Manufacturers' inventories*	billions of $	49.1*p*	48.6	48.0	43.8	+ 1	+12
Manufacturers' new orders, total*	billions of $	28.1*p*	28.9	27.8	27.8	− 3	+ 1
Manufacturers' new orders, durable goods*	billions of $	14.4*p*	14.9	14.1	14.0	− 3	+ 3
Retail sales*	billions of $	—	15.9*p*	15.5	15.3	+ 3	+ 3
Residential construction contracts*	1947-49 = 100	280*p*	286	315	290	− 2	− 3
Nonresidential construction contracts*	1947-49 = 100	253*p*	237	252	228	+ 7	+11
Prices, wages, and employment							
Basic commodity prices†	1947-49 = 100	88.3	90.4	91.8	90.2	− 2	− 2
Wholesale prices†	1947-49 = 100	114.2*p*	114.4	113.6	110.3	#	+ 4
Consumer prices†	1947-49 = 100	116.2	115.4	114.9	114.4	+ 1	+ 2
Personal income (annual rate)*¶	billions of $	324.2*p*	322.8	321.7	306.0	#	+ 6
Composite index of wages and salaries*	1947-49 = 100	—	147*p*	147	141	#	+ 4
Nonagricultural employment*‡	thousands	51,437*p*	51,389*p*	51,327	50,073	#	+ 3
Manufacturing employment*‡	thousands	16,828*p*	16,892*p*	16,918	16,649	#	+ 1
Average hours worked per week, manufacturing†	hours	40.1*p*	40.0	40.3	40.7	#	− 1
Unemployment	thousands	2,927	2,608	2,564	2,679	+12	+ 9
Banking and finance							
Total investments of all commercial banks	millions of $	72,750*p*	73,570*p*	74,700*p*	80,080	− 1	− 9
Total loans of all commercial banks	millions of $	87,720*p*	86,030*p*	85,340*p*	75,183	+ 2	+17
Total demand deposits adjusted	millions of $	105,080*p*	104,190*p*	106,110*p*	103,234	+ 1	+ 2
Currency outside the Treasury and Federal Reserve Banks*§	millions of $	30,720*p*	30,629	30,551	30,231	#	+ 2
Bank debits (337 centers)*	millions of $	76,488	79,760	75,548	72,352*r*	− 4	+ 6
Velocity of demand deposits (337 centers)*	1947-49 = 100	135.6*p*	138.1	138.8	130.0	− 2	+ 4
Consumer instalment credit outstanding†	millions of $	28,890	28,591	28,260	24,914	+ 1	+16
United States Government finance (other than borrowing)							
Cash income	millions of $	12,192	6,879	4,368	11,045	+77	+10
Cash outgo	millions of $	6,898	6,200	5,428	6,677	+11	+ 3
National defense expenditures	millions of $	3,505	3,444	3,009	3,694	+ 2	− 5
SECOND FEDERAL RESERVE DISTRICT							
Electric power output (New York and New Jersey)*	1947-49 = 100	158	153	157	149	+ 3	+ 6
Residential construction contracts*	1947-49 = 100	—	258	285	215	− 9	+22
Nonresidential construction contracts*	1947-49 = 100	—	315	268	277	+17	+26
Consumer prices (New York City)†	1947-49 = 100	113.8	113.0	112.3	111.8	+ 1	+ 2
Nonagricultural employment*	thousands	—	7,706.4*p*	7,678.2	7,638.7*r*	#	+ 2
Manufacturing employment*	thousands	2,705.7*p*	2,680.8	2,670.0	2,699.3*r*	+ 1	#
Bank debits (New York City)*	millions of $	65,494	70,869	65,715	62,624	− 8	+ 5
Bank debits (Second District excluding New York City)*	millions of $	4,901	5,170	5,072	4,800	− 5	+ 2
Velocity of demand deposits (New York City)*	1947-49 = 100	166.0	180.2	176.0	158.0	− 8	+ 5
Department store sales*	1947-49 = 100	115	110	104	104	+ 5	+11
Department store stocks*	1947-49 = 100	126	123	124	115*r*	+ 2	+10

Note: Latest data available as of noon, August 1, 1956.
p Preliminary.
r Revised.
* Adjusted for seasonal variation.
† Seasonal variations believed to be minor; no adjustment made.
‡ Revised series. Back data available from U. S. Bureau of Labor Statistics.
# Change of less than 0.5 per cent.
§ Seasonal factors revised back through 1938.
¶ Revised series. Back data available from U. S. Department of Commerce.
Source: A description of these series and their sources is available from the Domestic Research Division, Federal Reserve Bank of New York, on request.