# FEDERAL RESERVE BANK OF NEW YORK

# MONTHLY REVIEW

## JANUARY 1961

**Contents**



**Volume 43** **No. 1**

# The Business Situation

The sluggish pace of economic activity in recent months has continued to be evident in most of the current indicators reported during December. It has also had its effect on spending plans indicated in the recently published results of two surveys taken early in the fourth quarter. These point to mild reductions in businessmen's plans for fixed investment during the second half of 1960 and the first quarter of 1961 as well as to reductions in consumers' near-term intentions to purchase durable goods. This hesitant attitude on the part of two important groups of spenders is one of the factors causing the current weakness in durable goods sales at both the manufacturing and the retail levels. It is echoed in the prevalent cautious views of many business analysts who foresee only small gains in sales and a continued squeeze on profits in 1961. In combination, these factors seem to have caused a further scaling-down of desired inventory levels, leading to some additional declines in industrial production and nonagricultural employment.

### SPENDING PLANS AND SALES

The latest quarterly survey of businessmen's capital spending plans and actual outlays, taken by the Commerce Department and the Securities and Exchange Commission in October and early November, shows that plant and equipment spending in the third quarter declined to a seasonally adjusted annual rate of $35.9 billion. This was $0.4 billion below the peak rate reached in the second quarter of 1960 and $1.6 billion less than planned outlays indicated in a similar survey made in the second quarter (see Chart I). Fourth-quarter outlays were estimated to have been trimmed by another $0.3 billion. If actual outlays match these estimates, the decline in capital spending during the second half of the year will have been relatively moderate—somewhat less than a third of the drop occurring in the two quarters following the 1957 peak. Total 1960 outlays of $35.7 billion would be almost 10 per cent above the 1959 level but would fall short of the 13 per cent gain anticipated at the beginning of the year.

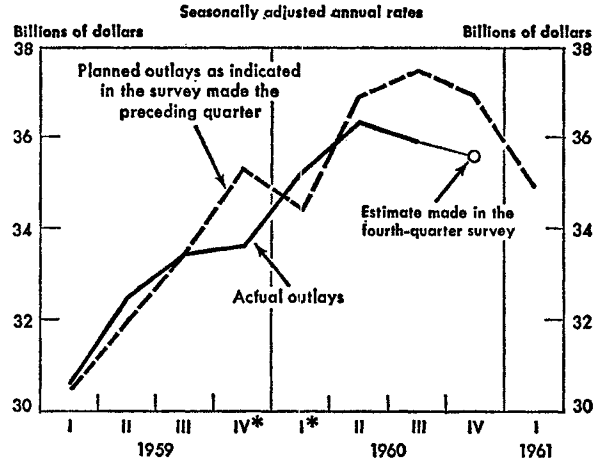
The dip in capital spending is expected to continue, at a somewhat accelerated rate, in the first quarter of 1961, when outlays are scheduled to decline to a $34.9 billion rate. This expectation is generally consistent with the results of a survey of capital appropriations by large manufacturing firms, taken in the third quarter by the National Industrial Conference Board. The declines shown by this survey, both in new appropriations (spending plans approved by top-level management) and in backlogs of appropriations, were interpreted as implying a 5 to 10 per cent reduction in outlays in subsequent months.

The sag in capital spending plans appears to be paralleled by some curtailment in consumer intentions to purchase certain durable goods. In the October survey made by the Census Bureau for the Federal Reserve System, the proportion of consumers planning to buy automobiles (new or used) and various appliances within the next six months was substantially (10-20 per cent) below October 1959. While plans to buy cars and television sets rose from July to October, the rise may well have been less than seasonal. These results must be interpreted with some caution, since quarter-to-quarter fluctuations are not always closely associated with current movements in retail sales and the year-to-year decline may be exaggerated by the sharp peak in plans in October 1959. It may be significant, however, that the percentage of consumers planning durable goods purchases stood above the year-ago level in January and April of 1960, was about equal in July, and fell below in October.

Chart I

PLANT AND EQUIPMENT OUTLAYS

Seasonally adjusted annual rates




*Periods particularly affected by the steel strike.

Sources: United States Department of Commerce and Securities and Exchange Commission.

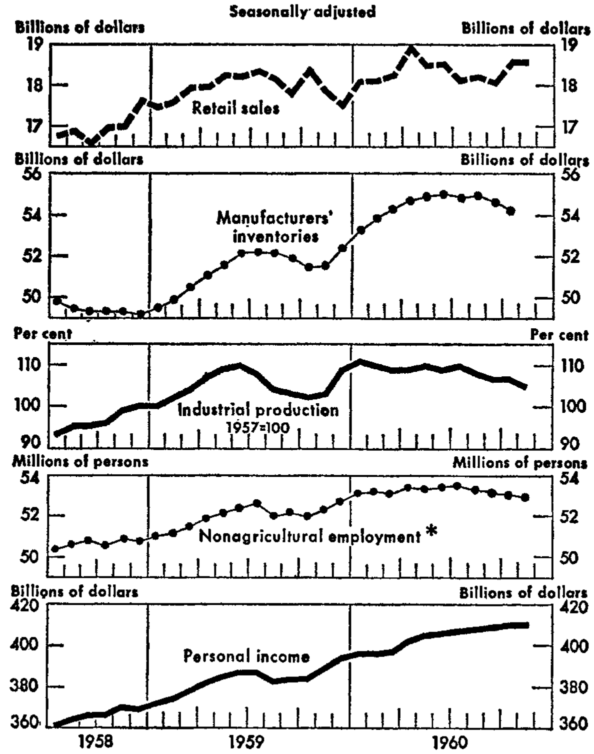
This scaling-down of businesses' and consumers' planned purchases for final use may already have been a factor in sales reductions in some sectors, but has not resulted in any sharp declines. At the retail level, sales in November (seasonally adjusted) remained virtually unchanged at the improved October rate (see Chart II). A small decline in sales at durable goods outlets was offset by a similar rise at nondurable goods stores, according to the advance report. The pace of new car sales improved slightly (after adjustment for the number of trading days) on the good October performance and set a new record for November. Although the proportion of sales attributable to 1960 models—at bargain prices—was reduced from the preceding month, an increase in the proportion of sales of compact cars and continued price reductions for used cars may have held down the dollar volume of total car sales. Incomplete data available for December suggest that auto sales were dropping somewhat; department store sales, however, were apparently registering approximately their customary seasonal upsurge.

Manufacturers' sales, on the other hand, have declined gradually but steadily to a November level almost 6 per cent below their April peak, with 70 per cent of this decline recorded in the durable goods sector. New orders have also moved down somewhat for the second consecutive month, reaching a new low for the year. These declines presumably reflect, however, the continued downward movement in business purchasing for inventories as well as declines in final demand. Total business inventories were liquidated at an increased pace in October, with the major reductions occurring in durable goods manufacturers' stocks of purchased materials and goods in process. Declines continued at the manufacturing level in November.

Chart II

CURRENT ECONOMIC MEASURES

Seasonally adjusted




*Payroll survey.

Note: Alaska and Hawaii included in employment and in retail sales since January 1960.

Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

#### EFFECTS ON PRODUCTION AND EMPLOYMENT

Reflecting the pressures associated with some weakness in final sales and with inventory liquidation, industrial production slackened once again in November after remaining about unchanged between September and October (see Chart II). The seasonally adjusted total index slipped from 107 to 105 per cent of the 1957 base, as output of metals, textiles, and construction materials continued to decline, automobile assemblies were cut back sharply after a rise in October, and production of some other consumer goods—including apparel, appliances, and television sets—was reduced. Output of business equipment rose slightly from the strike-curtailed October level. More recent indicators show the rate of steel production remaining about level from mid-November to mid-December at slightly below 50 per cent of capacity but subsequently dipping, in part because of the holidays. Automobile production schedules appeared to be down somewhat more than seasonally in December.

Paralleling the movement in production was a further curtailment in nonagricultural employment which declined in November by about 100,000 persons (seasonally adjusted) to 52.9 million (see Chart II), according to the payroll survey taken in the middle of the month by the Bureau of Labor Statistics. About 60 per cent of this reduction was in manufacturing, where cutbacks were widespread, but employment in all other major sectors except services and government also declined. Between July and November of 1960 nonfarm employment fell by about 450,000, or 60 per cent of the drop during the same months of 1957 which marked the early part of the 1957-58 recession (peaks in employment occurred in July of both 1957 and 1960). The major difference lay in the greater expansion of hiring by State and local governments during the recent period. On the other hand, the Census household survey taken in early November showed a rise in both farm and nonfarm employment, the latter primarily because of the temporary hiring of election workers. Total employment rose almost 1 per cent, and unemployment was reduced slightly on a seasonally adjusted basis. The minor decline in the seasonally adjusted unemployment rate to 6.3 per cent from 6.4 per cent in October does not appear to constitute a significant turning point in employment developments, particularly in view of the further rise in unemployment insurance claims in early December.

Although manufacturing employment and the average number of hours worked declined, personal income in November maintained the October level of $409.5 billion (seasonally adjusted annual rate). Reductions of $0.4 billion in wages and salaries and $0.1 billion in business and professional income were offset by a further increase in transfer payments. While November was the first month since February 1960 in which personal income failed to rise, corporate profits began to fall in the second quarter, and in the third declined further to a seasonally adjusted annual rate of $41.5 billion, $7.3 billion below the first-quarter peak. This decline resulted in part from reduced profit margins, as sharpened competition led to scattered price declines and some costs continued to creep up. It also reflected a smaller volume of sales in some industries.

In contrast to the slackness of domestic demand in the industrial sector, the number of private housing starts in November maintained the improved October rate. United States exports, after rising about 6 per cent in October and carrying the trade surplus to the highest level in over three years, remained approximately steady in November at a seasonally adjusted annual rate of $20.4 billion.

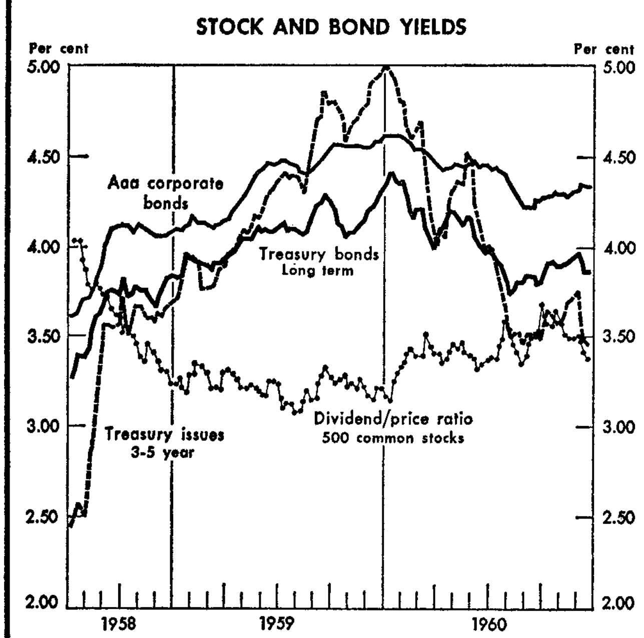
## The Money Market in the Fourth Quarter

Bank reserve positions eased further during the fourth quarter, as the Federal Reserve System more than met seasonal and other reserve needs through sizable purchases of Government securities and the liberalization of reserve requirements. Bank credit expanded substantially over the quarter and, with this expansion concentrated until late in the quarter in the acquisition of Government securities, bank liquidity positions were improved. Some reserve pressures were in evidence at times in the central money market, particularly during October and early November, but over the balance of the period Federal funds were generally in comfortable supply, trading at rates well below the 3 per cent discount rate through the end of December.

By December, too, a much more confident mood had emerged in the securities markets, following a period of cautious hesitation in October and November, when investors failed to find in the welter of economic data and comment a single clear configuration upon which action could be based. While business news continued to show some slack in the economy, there was press speculation that the cyclical low in interest rates, and perhaps even in the economy as a whole, had been passed. Meanwhile, the stock market seesawed to reach a two-year low and then a four-month peak. In the background throughout the October-November period was the concern over the balance-of-payments situation — heightened by the flurry of gold prices in the London market—which brought new doubts to the market over the lengths to which monetary ease might proceed. Very much in the forefront was the Presidential election, bringing political uncertainties to a peak in early November.

In this setting, prices of fixed-income securities moved inconclusively within narrow bounds. Institutional investors generally held to the sidelines in the corporate market, where a heavy volume of new offerings was floated. Market congestion frequently developed, leading to higher yield levels on new issues and to syndicate terminations and higher yields on slow-moving recent issues. This congestion also weakened the market for Treasury bonds, where rates had fallen further from earlier peaks, as the resulting yield advantage prompted some switching into corporates. In the market for Treasury bills, rates fluctuated within a relatively narrow range, with the rate on three-month bills descending briefly to 2.07 per cent in late October but rebounding sharply before declining again to close the year at 2.20 per cent.

The strengthening of confidence in December extended to the markets for both long- and short-term fixed-income securities. Business indicators reinforced a growing consensus that a business upturn was at least some months away, while the reduced gold outflow and declining interest rates in Europe led some market participants to take a more confident view of the balance-of-payments situation. A 5 per cent rate on a utility issue finally broke the ice of investor resistance in the corporate bond market, and de-




Note: Latest data plotted: week ended December 23, 1960.

Sources: Aaa corporate bonds: Moody's Investors Service; Treasury issues: Board of Governors of the Federal Reserve System; dividend/price ratio: Standard & Poor's Corporation.

mand soon spread to other corporate and Treasury issues. At the same time, reserves released through changes in Regulation D brought good bank demand, absorbing the corporate bill sales in preparation for the December tax and dividend date so that the usual year-end rise in rates did not occur. With bank loans over the quarter rising less than seasonally and bank liquidity positions considerably improved, some bank demand reached also into the market for intermediate-term Treasury issues to raise prices there as well. By the end of the year, firm confidence ruled most markets, bolstered by the smooth passage through the December period of heavy liquidity needs and by the breather in new corporate offerings. (See chart.)

## MEMBER BANK RESERVES

With the Federal Reserve System providing ample reserves for seasonal and other needs, bank reserve positions reflected increased ease during the fourth quarter. Total reserves rose more than seasonally over the three months, increasing by $550 million from September to December. Borrowings at the "discount window" continued to decline, and free reserves averaged $578 million compared with $252 million during the previous quarter.

Over the quarter, System open market purchases and changes in reserve requirements and vault cash eligibility provided member banks with sufficient reserves to offset substantial drains from operating factors and to meet the additional reserve needs associated with expanded bank credit and deposits. The principal drain on reserves was the seasonal expansion in currency in circulation, which aggregated $1.2 billion over the thirteen-week period ended December 28. Another $850 million reserve drain stemmed from further gold losses, which were heaviest in early November and lessened in December. Reserves were also absorbed by a rise of some $650 million in required reserves, most of it coming at the time of increased bank lending around the December tax date. System purchases of securities were concentrated in October and November, while most of the December reserve need was met through the vault cash and reserve requirement changes. Over the thirteen-week period as a whole, System outright holdings of Government securities rose by about $275 million.

In addition, reserves totaling about $1.5 billion were supplied to member banks through the changes in Regulation D. Effective November 24, member banks were permitted to count all vault cash, rather than previously prescribed percentages, toward satisfying reserve requirements. At the same time, reserve requirements for country banks, which held vault cash equivalent to about 4½ per cent of their net demand deposits (compared with a 1½ per cent ratio held by all other banks) and thus benefited most from the vault-cash liberalization, were increased from 11 per cent to 12 per cent, making their net gain from the Regulation D changes about $500 million. Effective December 1, reserve requirements for central reserve city banks were reduced from 17½ per cent to 16½ per cent, the level in effect for reserve city banks.

Over the first half of the quarter, with much of the increased reserve availability still reflecting the vault-cash liberalization of early September, excess reserves remained concentrated at the country banks and the money market banks came under occasional pressures, particularly in the early weeks of October and of November. The money market was generally easier over the rest of the quarter, however, as the further addition to reserves through changes in Regulation D evidently reached the money market centers more readily than in September. The effective rate on Federal funds was generally between 2½ and 3 per cent during the first half of the quarter, except for a brief period after mid-October when it went to as low as ¼ per cent, and remained at 2 per cent or lower on most days after the middle of November. Correspondingly, rates on new and renewal loans to Government securities dealers by major New York City banks rose through mid-November to a range of 3¾-4¼ per cent and moved

**Table I**
**Changes in Factors Tending to Increase or Decrease Member Bank Reserves, December 1960**
In millions of dollars; (+) denotes increase, (−) decrease in excess reserves

| Factor | Daily averages—week ended | | | | Net changes |
|---|---|---|---|---|---|
| | Dec. 7 | Dec. 14 | Dec. 21 | Dec. 28 | |
| **Operating transactions** | | | | | |
| Treasury operations* | − 11 | − 41 | − 74 | + 85 | − 41 |
| Federal Reserve float | − 175 | + 215 | + 879 | + 21 | + 940 |
| Currency in circulation | − 84 | − 316 | − 136 | − 21 | − 557 |
| Gold and foreign account | + 22 | + 125 | − 135 | − 89 | − 77 |
| Other deposits, etc. | − 78 | − 177 | + 256 | + 30 | + 31 |
| Total | − 326 | − 193 | + 789 | + 25 | + 295 |
| **Direct Federal Reserve credit transactions** | | | | | |
| Government securities: | | | | | |
| Direct market purchases or sales | − 186 | − 40 | − 371 | − 64 | − 661 |
| Held under repurchase agreements | − 16 | — | + 24 | + 104 | + 112 |
| Loans, discounts, and advances: | | | | | |
| Member bank borrowings | − 53 | + 10 | + 4 | − 25 | − 64 |
| Other | − 1 | − 1 | — | + 1 | − 1 |
| Bankers' acceptances: | | | | | |
| Bought outright | + 1 | − 1 | + 1 | — | + 1 |
| Under repurchase agreements | — | — | + 1 | + 4 | + 5 |
| Total | − 257 | − 31 | − 341 | + 21 | − 608 |
| **Member bank reserves** | | | | | |
| With Federal Reserve Banks | − 583 | − 224 | + 448 | + 46 | − 313 |
| Cash allowed as reserves† | − 177 | + 236 | + 72 | − 59 | + 72 |
| **Total reserves†** | − 760 | + 12 | + 520 | − 13 | − 241 |
| **Effect of change in required reserves†** | + 266 | − 8 | − 478 | − 26 | − 246 |
| **Excess reserves†** | − 494 | + 4 | + 42 | − 39 | − 487 |
| Daily average level of member bank: | | | | | |
| Borrowings from Reserve Banks | 60 | 70 | 74 | 49 | 63‡ |
| Excess reserves† | 701 | 705 | 747 | 708 | 715‡ |
| Free reserves† | 641 | 635 | 673 | 659 | 652‡ |

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 December 28, 1960.

irregularly lower during the remainder of the quarter to a range of 3-3¼ per cent.

## BANK CREDIT AND RELATED DEVELOPMENTS

With reserve availability rising and total bank loans about unchanged for the first two months of the quarter—compared with increases in most other recent years and a net decline in the downturn period of 1957—the banks put a large portion of their surplus funds into investments, particularly Treasury issues. Total bank credit, in consequence, rose by $2.7 billion for the two months, compared with an average increase of $1.8 billion in like periods of recent years. Data for weekly reporting banks through December 21 suggest that bank credit also rose more than seasonally in the final month of the year, sparked by a sizable increase in business and securities loans around the December tax date. For the quarter as a whole, bank loans to business were not so strong as usual, reflecting especially the weak October performance.

Business borrowing from banks, however, was an inadequate measure of total business demand for short-term credit, as the widening spread between bank lending rates and other short-term money rates diverted business borrowing into other channels. The outstanding volume of commercial paper continued its sustained rise, expanding by some $540 million in October and November to reach new record levels, while bankers' acceptances outstanding rose by about $200 million over the two months to reach and then surpass the previous record set in 1929. Finance companies in particular stepped up their borrowing through bond issues and directly placed paper, reducing their indebtedness to the banks through the quarter until the December tax and dividend period, when the maturity of a large volume of their paper placed with corporations brought a sharp though temporary rise in their borrowing from the banks.

The banks' real estate loans, however, continued to reflect weakness in that sector, the $0.1 billion rise during October-November being smaller than in any recent year but 1957. The behavior of consumer loans, meanwhile, was maintained at roughly the pace of recent years.

Expansion of the banks' securities holdings, which began during the summer after a steady runoff since early 1959, continued during the fourth quarter. The rise was concentrated in October, when banks subscribed heavily to the newly offered June 1961 tax anticipation bills. Holdings of Governments declined slightly in November but appear to have risen substantially in December, on the basis of weekly reporting bank data through December 21.

The continuing absorption of securities and particularly of short-term Treasury issues brought some further improvement in commercial bank liquidity positions during the fourth quarter. By mid-December, loan-deposit ratios at New York City weekly reporting banks stood at 65.9 per cent, compared with 66.1 per cent at the end of September, and were 59.2 per cent at banks outside New York, compared with 60.3 per cent at the end of September. Over the same period, the ratio of selected short-term liquid assets (including Treasury notes and bonds maturing within one year) to deposits had risen from 14.9 to 18.8 per cent at the New York City banks and from 10.8 per cent to 14.0 per cent at banks outside New York City. By December, with their liquidity positions thus enhanced, banks were extending their purchases of Government securities into the medium-term range, thus contributing one more element to the strength developing in that segment of the market.

The uneven increase in total bank credit over the first two months of the quarter was only partially reflected in the daily average money supply, which rose more than seasonally in October but declined slightly in November, so that for the two months as a whole the rise in the money supply fell $0.6 billion short of the normal seasonal expansion. This was due in part to the unseasonally high level of Treasury deposits and to the rise in time and savings deposits, which have become increasingly attractive against the background of declines in most other short-term rates. Indeed, the $5.0 billion rise in time deposits (seasonally adjusted) at commercial banks during the six-month period ended November 30—representing an annual rate of growth of about 14 per cent—was the greatest in the postwar period. For similar reasons, in the Treasury's Savings bond program sales surpassed redemptions (at issue price) in November for the first time since August 1955.

### GOVERNMENT SECURITIES MARKET

In the Treasury bill market during the quarter, a succession of temporary influences set off brief rate movements within rather narrow bounds. Early in the period the Treasury's financing operation—in which $3 billion, net, of new money was raised through sales of June 1961 tax anticipation bills and the partial roll-over of maturing one-year bills—provided the center of attention. Dealer inventory liquidation preparatory to the offering, and some apprehension over the amount of new money to be raised, carried rates upward until October 11, when a strong showing in the roll-over auction and the lightened dealer inventories brought a reversal in market sentiment which carried rates back down. Later, the amendment of Regulation D and the Treasury's November refunding (in which maturing issues were exchanged for $9.1 billion of 15-month 3¼ per cent notes and $1.2 billion of 5½-year 3¾ per cent bonds) influenced the market. Both the initial psychological impact of the October 26 Regulation D announcement and the build-up in dealer inventories in anticipation of a strong demand arising on swaps out of rights to the refunding strengthened the market, and the three-month bill rate declined on October 28 to 2.07 per cent, the lowest level in two years. The market then weakened once more, however, as the 3¼ per cent rate on the 15-month Treasury note offered in the refunding apparently proved attractive to many investors who might otherwise have swapped into bills, and as reassessment of the Regulation D changes convinced some observers that seasonal System demand for bills might be reduced.

As it developed, the changes in Regulation D were a strengthening influence, helping to halt the seasonal rate rise in mid-November and contributing to a downward movement thereafter. The released reserves reached the money and Treasury bill markets with far greater dispatch than had those released by the September vault-cash liberalization and contributed to the good bank demand which, along with relatively comfortable corporate liquidity positions, helped the market's smooth passage through the period of corporate bill sales before the December tax and dividend dates. The released reserves also facilitated the banks' provision of a large volume of loans to Government securities dealers around the tax date, when a sizable volume of the dealers' repurchase-agreement borrowing from corporations matured. The market's performance reinforced the shift from caution toward confidence, and was reflected in an average issuing rate on the six-month bill of 2.333 per cent, a new low, on December 23 and in the maintenance of the three-month bill rate at around the 2⅛-2¼ per cent level, in contrast to the usual year-end rise. Over the quarter as a whole, the three-month bill rate was down 10 basis points to close at 2.20 per cent.

In the Government bond market, as noted earlier, a hesitant atmosphere persisted through virtually all of October and November. A flurry of price rises did occur in late October—reflecting news of low housing starts in September, the stock market's decline to a two-year low, and the initial interpretation of greater ease given changes in Regulation D—and several very brief rallies developed in November. But for most of these two months, prices drifted downward. The underlying uncertainties were compounded at the beginning of the quarter by the recent addition to the supply of longer maturities resulting from September's advance refunding, by congestion in the corporate bond market, and by investor disposition to await a large $250 million utility issue offered October 25.

The economic outlook continued clouded during November, with news of still-sluggish business performance offset first by a sustained rally in stock prices and then by a wave of press speculation that the business and interest rate cycles might have already passed their lows. While this uncertainty contributed to investor reluctance in both corporate and Treasury bond markets, the corporate market was also the scene of heavy new offerings, and the consequent congestion and rise in yields in that market prompted some switching out of Governments into the higher yielding corporates. By the end of November, yields on most long-term Treasuries were back up to a 3.95-4.10 per cent range from the 3.70-3.95 per cent levels prevailing at the end of September.

The Treasury's November offering of 4 per cent bonds of 1969 at a price of 100½, to holders of about $750 million of Series F and G Savings bonds maturing in 1961, drew exchange subscriptions for $147 million and had little effect on the market.

Toward the end of November a combination of bearish business news, more favorable market appraisals of balance-of-payments prospects, and expectations of continuing ease ahead began to bring the market outlook into clearer focus. By early December these accumulating signs finally brought institutional investors off the sidelines in the corporate bond market at the higher—near 5 per cent—yields that were reached. Caution gave way to confidence, and strength in Treasury bills and in corporate bonds was communicated to all sectors of the Treasury bond market. With the increasing volume of surplus bank funds and the scarcity of some short issues, bank demand spilled into the intermediate area and prices moved upward. At the year's end, the sharp December increases had carried prices of intermediate-term issues to about ⅜ to ¾ point higher than their end-of-September levels and prices of longer maturities some ⅛ to 1 point higher.

### OTHER SECURITIES MARKETS

In the corporate bond market, the volume of new issues was quite heavy and corporate bond yields rose over the first two months of the quarter before leveling-off in December. New tax-exempt offerings, on the other hand, were moderate and yields were relatively steady.

In the corporate market, about $1,500 million in new bonds was offered during the quarter, slightly above the level of the previous quarter and appreciably more than the $950 million offered during the fourth quarter of 1959. This brought total new offerings to $4.7 billion for 1960, compared with $3.4 billion in 1959. Over the first two months of the quarter, the large supply of unsold recent offerings and the heavy schedule of new offerings had a restraining influence on buying interest, forcing yields up on succeeding new issues and bringing substantial price concessions upon the termination of offering syndicates. Investor resistance finally thawed in early December, when a 5 per cent yield on a utility bond brought a quick sellout; in the climate of increasing confidence and with fewer new offerings ahead, demand quickly spread to other issues. Average yields on seasoned Aaa-rated bonds, which had risen from 4.27 to 4.33 per cent over the first two months of the quarter in Moody's index, moved to 4.35 per cent at the year's close.

In the market for tax-exempt issues, the pressure of heavy new offerings built up during the third quarter was relieved considerably, as only $1,200 million in new bonds was offered during the fourth quarter compared with some $1,650 million during the third quarter and $1,300 million in the last quarter of 1959. For the year, tax-exempt issues totaled $6.4 billion, down somewhat from the $6.6 billion 1959 total. Despite this relatively light volume, new offerings—a number of them quite closely priced—met mixed receptions and the advertised inventory of dealers' tax-exempt offerings remained at relatively high levels through December. Average yields on seasoned Aaa-rated bonds went from 3.18 per cent at the beginning of the quarter to 3.14 per cent at the end of November and 3.11 per cent at the year's close.

In the market for short-term paper, activity continued at record high levels, with rates fluctuating quite narrowly in line with Treasury bill rates. A decline in commercial paper rates over the quarter, interrupted by a brief upward movement in November, left the offered rate on prime 4- to 6-month paper at 3⅛ per cent, down ¼ of a percentage point from the end-of-September level. Rates on finance company paper were adjusted upward in mid-November and downward in December, bringing the offered rate on 60- to 89-day paper to 2⅝ per cent, down ⅜ per cent in the quarter. Rates on bankers' acceptances, buoyed by record demand from foreign central banks, remained unchanged until mid-December, when a ⅛ per cent reduction occurred, making the bid rate on prime 90-day paper 3 per cent.

**Table II**
**Short-Term Interest Rates**

| Date | Average issuing rate on new Treasury bills | | Bankers' acceptances 90-day unendorsed bid rate | Commercial paper 4- to 6-month offered rate | Sales finance company paper 60- to 89-day offered rate |
|---|---|---|---|---|---|
| | 3-month | 6-month | | | |
| **1960** | | | | | |
| Sept. 26 | 2.286 | 2.729 | 3⅛ | 3⅜ | 3 |
| Oct. 3 | 2.473 | 2.925 | 3⅛ | 3⅜ | 3 |
| Oct. 10 | 2.698 | 3.079 | 3⅛ | 3⅜ | 2¾ |
| Oct. 17 | 2.406 | 2.806 | 3⅛ | 3⅜ | 3 |
| Oct. 24 | 2.129 | 2.569 | 3⅛ | 3¼ | 2⅛-3* |
| Oct. 31 | 2.127 | 2.453 | 3⅛ | 3⅛ | 2-2¾* |
| Nov. 7 | 2.390 | 2.572 | 3⅛ | 3⅛ | 2¾ |
| Nov. 14 | 2.624 | 2.825 | 3⅛ | 3¼ | 2¾ |
| Nov. 21 | 2.396 | 2.749 | 3⅛ | 3⅜ | 2⅞ |
| Nov. 28 | 2.326 | 2.640 | 3⅛ | 3⅜ | 2⅞ |
| Dec. 5 | 2.328 | 2.663 | 3⅛ | 3⅜ | 2⅞ |
| Dec. 12 | 2.334 | 2.621 | 3 | 3¼ | 2¾ |
| Dec. 19 | 2.222 | 2.392 | 3 | 3¼ | 2¾ |
| Dec. 23† | 2.148 | 2.333 | 3 | 3⅛ | 2⅝ |
| Dec. 30† | 2.234 | 2.429 | 3 | 3⅛ | 2⅝ |

* Upper rate applies to maturities in 1961.
† Because of the holidays on December 26 and January 2, the Treasury bill auctions were held on December 23 and 30.

# Foreign Exchange Markets During 1960

The year 1960 was one of rapid evolution in the foreign exchange markets. As the world adjusted more fully to the decisive steps toward freedom of exchange transactions taken in Western Europe at the end of 1958, new influences affecting exchange rate movements of the principal currencies emerged. While major shifts in balance-of-payments positions on trade and service accounts continued to play a basic role in determining the strength and weakness of various currencies, such shifts were frequently overshadowed by the emergence of capital movements as a decisive factor affecting exchange markets. The increased size and volatility of short-term capital movements, in particular, posed major problems for the monetary authorities of the countries most directly concerned. Such difficulties, however, were almost universally recognized as the logical consequence of the freedom of exchange transactions the world had so long been striving to achieve, and methods to cope with these difficulties began to evolve. Partly because of these efforts, the basic stability of the world exchange rate structure was preserved in 1960 without major setbacks in the field of exchange liberalization.

The increased influence of capital transfers on exchange markets makes the task of interpreting exchange rate movements more difficult. The variety and relative strength of the forces underlying capital movements are often harder to identify than the factors accounting for shifting trade patterns. Moreover, statistical reporting on international capital movements has not kept pace with their growing role in the exchange markets.

Conceptually, one can distinguish at least four types of private capital movements, each differently motivated. Direct investment in plant and equipment and the purchase of foreign bonds and stocks, for example, respond for the most part to gradual changes in the investment climate and economic prospects of specific countries and, therefore, generally affect longer run trends rather than short-run variations in exchange rates. Nevertheless, they may play a dominant role at any given time. Short-run speculative capital transfers, on the other hand, are induced by anticipated changes in the quotations of particular currencies and, therefore, can exert intense short-run pressures on exchange markets, even in the face of comprehensive official controls on exchange transactions. Still another type of capital movement is that associated with trade financing. Such flows vary with the volume of world trade as well as with payment terms. During periods of strains on particular currencies, however, the speeding or slowing-up of commercial payments may intensify and become part of the above-mentioned speculative capital movements—the so-called "leads and lags". Some short-term capital movements, finally, arise from interest rate differentials between international financial centers and are not necessarily speculative in character. It is this last type of transfer which seems to have increased considerably in volume and in importance as an exchange market factor since the widespread restoration of external convertibility two years ago. Convertibility has indeed opened the door for the re-emergence of an "international money market".

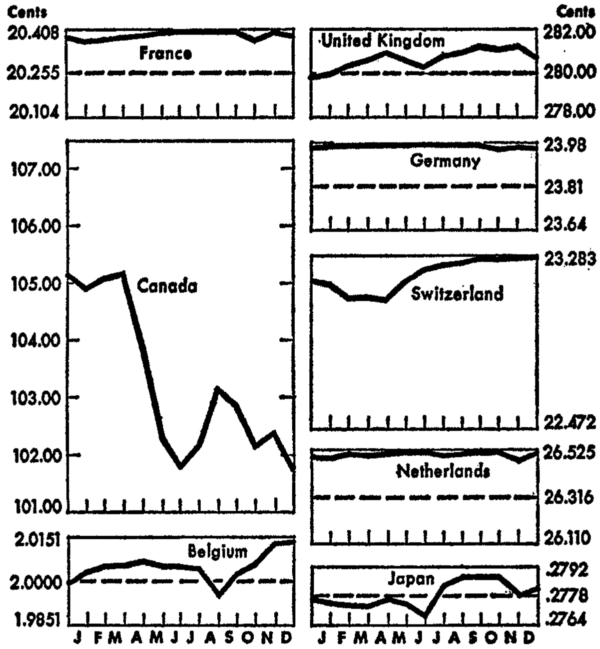
The United States dollar was one of the currencies most directly affected by short-term capital movements during 1960. Despite a striking improvement in the country's trade surplus from about $1 billion in 1959 to an estimated $4 billion or more in 1960, the United States balance-of-payments deficit declined only moderately from the 1959 deficit of $3.8 billion, according to present estimates. A substantial offset to the improvement in the trade balance was provided by an increased outflow of short-term capital, a good part of which cannot be traced readily as to its composition and destination but is reflected in a negative figure for the "errors and omissions" item in United States balance-of-payments statistics. Nevertheless, the available evidence suggests a fairly close relationship between the size and timing of the outflow of funds from the United States and the differentials between short-term interest rates here and abroad. Movements in relative interest rates reflected, of course, divergent cyclical developments in the economies of the United States and other major industrial countries.[1] The slackening of domestic business activity and the concurrent relaxation of credit restraint have tended to reduce interest rates here. In contrast, the boom in most Western European countries and Japan continued, albeit at an apparently abated pace, and credit policies remained relatively restrictive until late in the year. As a result, an interest incentive to move funds abroad existed during much of 1960.

The "excess supply" of dollars in the world's exchange markets, corresponding to the United States balance-of-payments deficit, pressed the dollar toward the official

[1] Recent economic and financial developments abroad were surveyed in the *Monthly Review* for December 1960, p. 216.

**EXCHANGE RATES IN 1960**

*Monthly averages of noon buying rates; cents per unit of foreign currency*




——— = par value of currency.

Note: Except for Canada, outside boundaries represent official support levels.

Source: Board of Governors of the Federal Reserve System.

support limits of foreign central banks for much of the year. This fact is reflected in the accompanying chart in the quotations of the major foreign currencies above par and the frequency with which the quotations were at the point where foreign central banks were required (under International Monetary Fund rules) to act as residual buyers of surplus dollars being offered in the market. The chart also shows, however, some improvement in dollar quotations toward the year end.

Developments during 1960 affecting the pound sterling were in certain important respects the obverse of the position of the United States dollar. Despite a substantial weakening in the trade balance of Great Britain and the overseas sterling area, the sterling quotation in the exchange markets tended upward during most of the year. This trend became particularly pronounced after midyear, following an increase in the British bank rate from 5 to 6 per cent in June and a reduction in the discount rates of the Federal Reserve Banks from 4 to 3 per cent in two steps in June and August. (Earlier, the pound had shown occasional weakness—declining to the year's low of $2.7982 in mid-January and falling again after the collapse of the summit meeting in mid-May.) Following the increase in the incentive to move funds to London—this incentive vis-à-vis New York reached nearly 3.5 per cent on an uncovered and almost 1.7 per cent on a covered basis at midyear—there was clear evidence of sizable movements into sterling securities from both the United States and the European Continent. Funds also moved to London in October and November for the purchase of gold. Sterling then strengthened, reaching a high for the year (and a high since April 1959) of $2.8177 in early November. Meanwhile, however, the British authorities had become concerned over the possible adverse consequences to the sterling area and the international financial mechanism of an excessive inflow of short-term funds. "External considerations" were therefore the predominant factor in the two bank rate reductions in October and December which brought the rate back to 5 per cent. Sterling dropped substantially toward the year end, closing at $2.8034.

The forward quotations for sterling adjusted considerably but not completely to the changing relationship between spot exchange rates and relative interest rates during the year. Thus, the forward discounts on three- and six-month sterling widened to 170 and 240 points by mid-July (the largest spreads from the spot quotation since August 1958), following the pronounced increase in the New York-London interest differential. A covered arbitrage interest differential in favor of London, however, remained throughout the latter part of the year, and the forward discounts on sterling fluctuated somewhat erratically.

Among Continental currencies the German mark was especially strong, reflecting a balance-of-payments surplus based in part on a merchandise surplus and NATO troop receipts but also on sizable short-term capital inflows.[2] Capital inflows also pushed up the Swiss franc rate after the first quarter of the year, reflecting in part the repatriation of Swiss funds previously invested abroad and in part the familiar phenomenon of foreign funds transferred to Switzerland during periods of increased international tensions such as developed following the collapse of the summit meeting in May. Political factors also showed up quite clearly in the temporary weakness of the Belgian franc during July and August following the Congo crisis and, to a lesser extent, in the reaction of the French franc to domestic political uncertainties and difficulties in Algeria at the beginning and close of the year. Generally, however, these currencies remained strong.

The Canadian dollar, after advancing to a high of $1.05⅜ in early March primarily on the strength of

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[2] See *Monthly Review*, December 1960, p. 206.

Canadian bond flotations in New York, dropped sharply to just over $1.01 in late May as commercial interests on both sides of the border appeared to feel that the Canadian currency was overpriced.[3] This downward trend was reversed temporarily by a return flow of capital funds and several new bond flotations, only to give way once again to erratically lower quotations as the market reacted to officially expressed concern over the prospects for the Canadian economy. Late in December, along with tax concessions to domestic enterprises designed to stimulate the economy, the Government announced increased taxes on foreign investments with a view to curbing excessive inflows of capital; as a consequence, the Canadian dollar quotation fell sharply, reaching a low for the year of just under $1.00¼ on December 28—the lowest since early 1956. At the year end, the quotation was $1.00⅜.

In Latin America, stabilization policies in Argentina, Chile, and Peru resulted in steady quotations for the currencies of these countries in 1960, following long periods of rapid depreciation. The Brazilian cruzeiro, heavily supported by the authorities, also maintained its value despite fluctuations during the year. The Venezuelan authorities imposed exchange controls in November in order to protect the official bolivar quotation from strong adverse pressures and also instituted a second (free) exchange market, in which the bolivar depreciated.

Other developments during the year included the establishment in August of a new parity of 9 Turkish lire to the dollar, compared with a previous par value of 2.80; a depreciation of the Philippine peso combined with a liberalization of exchange controls; and the announcement of a revaluation of the Russian ruble, effective at the beginning of 1961. In terms of its theoretical gold content, the new ruble is worth $1.11 in contrast to $0.25 under the previous official rate. However, the change was accompanied by a simultaneous internal exchange of ten old rubles for one new, with corresponding alterations in all domestic prices, wages, and debts. Thus, the move actually represented a devaluation of the former official rate (4 rubles=$1) to nearly the previous tourist rate (10 rubles=$1), which was merged with the new general rate. In any case, so long as the ruble remains primarily an internal accounting unit rather than an internationally traded currency, the change will have no practical significance for the exchange markets.

[3] Since the Canadian authorities do not undertake to keep the value of the Canadian dollar within any specified limits, its range of variations is theoretically unlimited. In practice, however, it has fluctuated from a low of $0.9319 (June 1951) to a high of $1.0617 (August 1957) in relation to the United States dollar over the past decade.

## Postwar Employment Fluctuations in the Second District

Fluctuations in economic activity in the Second Federal Reserve District during the postwar period have broadly paralleled those in the nation, but there have been some significant differences between the national and the District patterns.[1] In general, the contractions in the District have been slightly less severe than those in the nation while recoveries and expansions have been considerably less vigorous than those for the country as a whole. The broad economic pattern that the District has followed in the postwar period can be characterized as one of a milder cycle superimposed on a somewhat slower growth trend than that experienced by the nation.

### DISTRICT EMPLOYMENT PATTERNS

While a wide range of comprehensive indicators of economic activity is available at the national level, the data which can be used for measuring the volume of activity in the District are quite limited. For this reason, the present analysis of economic fluctuations in the Second Federal Reserve District is largely based on employment statistics. These tend to move in the same direction as a region's over-all activity, even though the amplitude of their swings is normally less than are the variations in output.

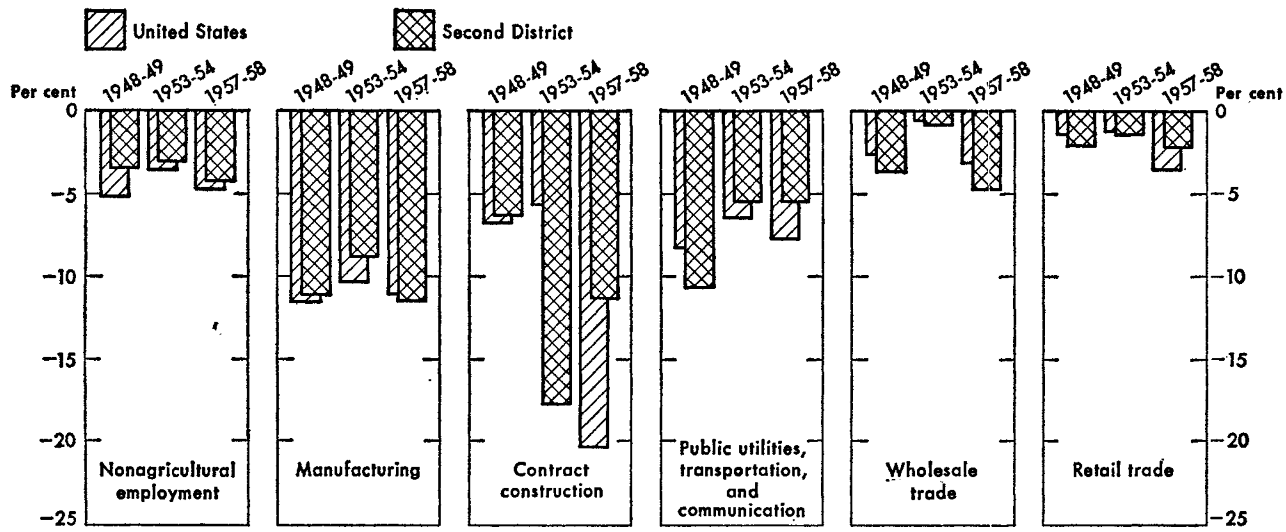
Chart I indicates the lesser magnitude of cyclical downturns in employment in the District as compared with the nation as a whole. The differential shows up not only with respect to total nonagricultural employment, but usually also for each of the main component sectors of employment except for wholesale and retail trade. The difference was most marked in the recession of 1948-49, but District declines in employment were also milder in the downturns of 1953-54 and 1957-58.

Three sectors of nonfarm employment—finance, insurance, and real estate; services and miscellaneous industries; and government—are not shown in Chart I because, in

[1] The Second District includes all of New York State, twelve primarily industrial counties of northern New Jersey (Sussex, Passaic, Bergen, Hudson, Essex, Warren, Morris, Union, Hunterdon, Somerset, Middlesex, and Monmouth), and Fairfield County, Connecticut.

Chart I

POSTWAR RECESSIONS IN THE UNITED STATES AND IN THE SECOND DISTRICT
PERCENTAGE CHANGE IN EMPLOYMENT, PEAK TO TROUGH




Note: Data refer to the percentage drop from the peak date to the trough date of each specific series.

Sources: United States, New York, New Jersey, and Connecticut Departments of Labor.

both the District and the nation, they have been largely free from cyclical swings in the whole of the postwar period. The steady growth of these sectors even during periods of general recessions has in fact been one of the reasons why the amplitude of postwar cycles in both District and national employment has been held to comparatively modest proportions. Currently about one third of both national and District employment is in these three sectors.

Looking at the opposite side of the coin, Chart II indicates that the postwar expansions have been considerably less vigorous in the District than the nation. Between the cyclical trough of 1949 and the peak of 1953, nonfarm employment grew by nearly 18 per cent in the nation in comparison with only around 12 per cent in the District. In the recovery of 1954-57, the District's rate of addition to nonfarm payrolls was only about half that of the nation. In the upswing from the spring of 1958 to mid-1960,[2] the District performed somewhat more vigorously, relative to the nation, but still lagged behind the nation's performance. Over this two-year expansion period, District nonfarm employment grew by about 5 per cent in comparison with the nation's addition of 7 per cent.

[2] Although total nonfarm employment has edged down slightly since May 1960 in the District and July in the nation, it is not yet clear that these months will be established as "cyclical highs".

While the amplitude of cyclical fluctuations in the District has been less pronounced than in the country as a whole, the duration of recession periods has been somewhat longer than for the nation. Again measuring by the behavior of nonagricultural employment, the 1948-49 decline lasted twelve months in the District as compared with eleven months in the nation; the recession of 1953-54 persisted for sixteen months in the District, compared with thirteen months in the nation; and the 1957-58 downturn continued for twelve months in the District, compared with nine months nationally. The typical pattern for most component sectors of employment, as well as for nonfarm employment as a whole, has been to turn down in the District from one to several months before their national counterparts and to lag behind them by similarly varying periods on the upturn. As a result, most of the declines in particular sectors of employment in the District have also been longer than those of the nation. This tendency of the District to lag behind the nation on the upturns and lead it into the downturns has meant not only longer recessions for the District, but also shorter periods of revival and prosperity. Thus, the upswing of 1949-53 lasted forty-three months in the District as compared with forty-five months in the nation; the expansion of 1954-57 persisted for only thirty-two months in the District, compared with thirty-seven months in the nation; and the upswing beginning in 1958 continued for twenty-six months in the District, compared with twenty-eight months nationally. Employment totals in both the District and the nation, as noted earlier, reached peaks around the middle of 1960 and have edged downward slightly since then.

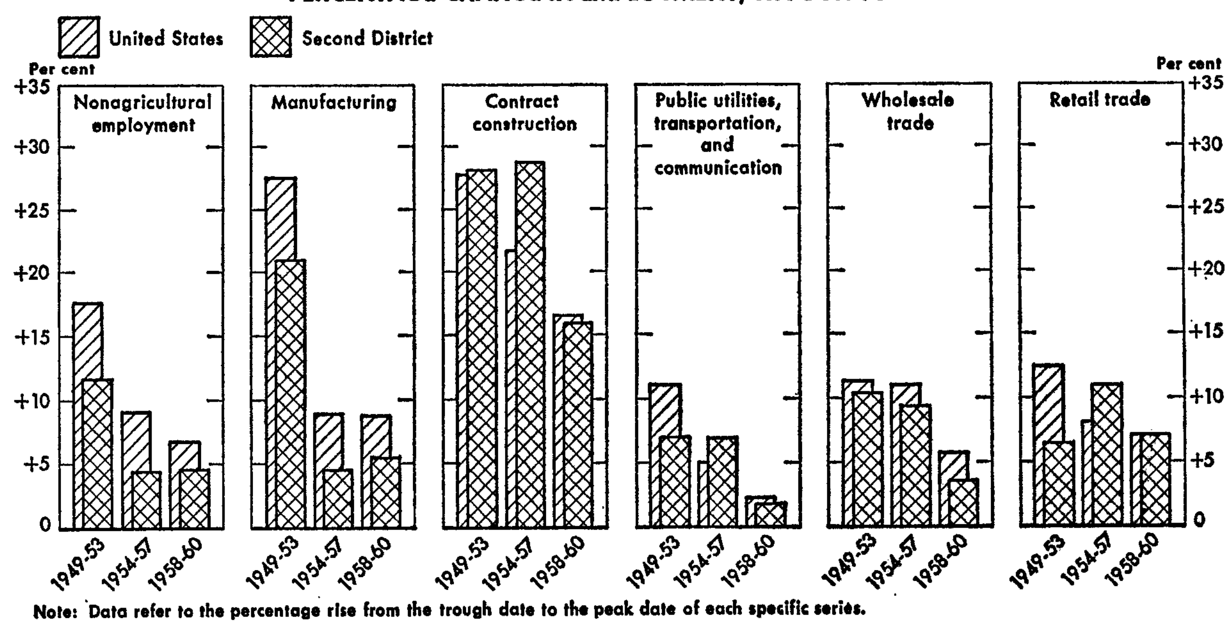
### UNDERLYING FACTORS

A number of factors appear to have contributed to the relative mildness of the District's cyclical swings, some of them growing out of the area's basic economic structure—or "industry mix"—and others associated with specific developments that tended to affect the District's economy in a countercyclical fashion. First, while about as large a portion of the District's nonfarm work force is engaged in manufacturing as in the nation as a whole (see Chart III), the District's manufacturing industries are relatively more heavily oriented toward the production of consumer goods. Although present methods of classification rule out precise estimates, it is probable that roughly 60 per cent of the manufacturing employees in the District are now employed in consumer goods industries as compared with around 50 per cent in the nation as a whole. From a cyclical point of view, this higher ratio is, of course, favorable since, in any recession, producer goods are typically much more severely hit than consumer goods. Further, the District holds a cyclical advantage in terms of the particular kinds of consumer and producer goods which it manufactures. It is comparatively strong in the production of consumer nondurable goods, such as apparel and printed matter, and relatively weaker in the production of consumer durables, such as automobiles. Demand for nondurables, being less readily postponable, generally fluctuates less than for durables. Moreover, the District's producer-goods mix is such that it leans less heavily on the production of the most cyclically sensitive of these goods, such as iron and steel and heavy industrial machinery.

In addition, a much larger proportion of the Second District's employment is in "white collar" jobs than in the nation as a whole. According to Census Bureau estimates, about 44 per cent of the nation's workers hold "white collar" jobs at present. In the District, it is estimated from State-wide Census data, the "white collar" proportion is more than 50 per cent. It is not obvious from the broad classifications shown in Chart III that this should be so, but within manufacturing and some of the other groupings in the chart the proportion of clerical, managerial, and other "nonproduction" workers tends to run relatively high in this District—at least partly reflecting the concen-

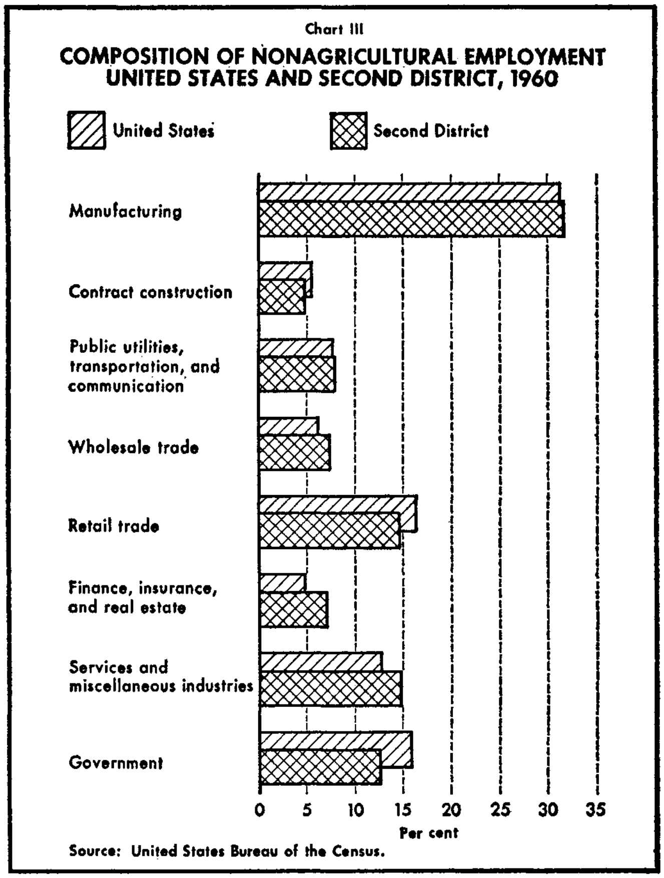
Chart II

POSTWAR RECOVERIES IN THE UNITED STATES AND IN THE SECOND DISTRICT
PERCENTAGE CHANGE IN EMPLOYMENT, TROUGH TO PEAK




Note: Data refer to the percentage rise from the trough date to the peak date of each specific series.

Sources: United States, New York, New Jersey, and Connecticut Departments of Labor.




tration of national headquarters of major business concerns and trade associations in the New York City area. It is noteworthy in this connection that, according to a recent study, some 25 per cent of the nation's corporation directors live in the New York City area.

The marked diversification of the District's economy has also been a factor cushioning its susceptibility to cyclical influences. In New York State alone, nearly all of the more than 400 different types of manufacturing classifications recognized by the United States Bureau of the Census are represented. More significantly, manufacturing and other activity tends to be distributed over the District in such a way that workers laid off in one industry are often able to find employment in other lines without major changes in location. No single industry, or small group of industries, dominates the scene—either over the whole District or over the various subregions within the District. Thus, while some industries, of course, play relatively important roles in certain areas—such as apparel production and publishing in New York City, petrochemicals in northern New Jersey, steel in the Buffalo area, and electrical equipment in and around Schenectady—there are few large one-industry towns and areas, and this has undoubtedly assisted the adjustment process when particular industries are affected by secular or cyclical adversity.

Apart from these general factors, the timing of certain specific developments appears to have made some contribution to the mildness of the District's cyclical swings. Thus, in 1948, just prior to the onset of recession, the Port of New York Authority took over Idlewild Airport from New York City and began a $55 million development program. In the same year the United States Supreme Court handed down a decision which forced the nation's steel producers to abandon the basing point pricing system. This action caused many steel firms to open, or reopen, facilities in the Northeast so as to be nearer to their markets and thus to save on the transportation charges that were now figured from the mill instead of Pittsburgh. Buffalo, Syracuse, Watervliet, and Lackawanna in particular received a stimulus directly from this source.

The recession of 1954 was blunted in some areas of the District by large public expenditures for construction, although total construction employment dropped sharply in the District. Construction on the St. Lawrence Power Project began in August 1954, the month the economy reached its trough, while work on the St. Lawrence Seaway began shortly thereafter. Eventually, more than $1 billion was spent directly on these twin projects, and additional millions were spent for harbor and dock facilities, housing, public utilities, and industrial expansion—much of it in New York State.

Finally, the District's slower long-term growth rate and comparative economic maturity also may have helped to moderate its cyclical swings, while tending at the same time to lengthen its recessions somewhat and shorten its recovery periods. One factor that may tend to dampen fluctuations in such "older" areas—which are often characterized by relatively high levels of personal income, substantial backlogs of savings, and readier access to credit—is the greater stability of consumer spending. At the same time, the factors that produce slower long-run growth may, as expansions mature, permit contractionary forces to gain the upper hand more quickly while correspondingly retarding the date when recovery sets in. As far as the Second Federal Reserve District is concerned, however, it remains a matter of conjecture to what extent such influences have, in fact, affected the region's cyclical pattern.

## CONCLUSION

Both favorable and unfavorable conclusions emerge from the foregoing analysis. On the plus side, the relative mildness of recent fluctuations in employment in this area is heartening. Moreover, the forces apparently underlying this pattern suggest that it has been no mere chance occurrence but is rooted in the basic make-up of the District's economy. On the less favorable side are the inescapable facts that the District's growth has not kept pace with the national average and that its recessions have tended to be longer. The available evidence, to be sure, suggests no signs of serious or general stagnation in the Second District economy. Indeed, the District has in many respects shown an impressive capacity for adaptation to changing conditions of technology and demand. Nevertheless, the record reviewed here suggests the need for more vigorous public and private action that will help to speed up this adaptive process and lead to a fuller realization of the District's growth potential.