

# FEDERAL RESERVE BANK OF NEW YORK



## MONTHLY REVIEW

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### Contents

The Business Situation .....	182
Recent Developments in Bank Liquidity ..	185
The Money Market in October .....	189

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## The Business Situation

Assessment of the strength of the current economic expansion continues to be complicated by the fact that many of the more important recent statistics bear the imprint of various special influences. Strikes, abnormal weather conditions, and irregular fluctuations in defense outlays played a large role in the slowing of gross national product expansion during the third quarter and the slight decline in industrial production during September, although the precise importance of these factors remains difficult to evaluate. Information that has become available in the past few weeks suggests that a somewhat more pronounced improvement in over-all activity may now be getting under way. Since mid-September, in particular, consumer spending at department stores has risen noticeably and purchases of automobiles have been stepped up. There are also indications that the rate of defense orders has increased substantially. These are fragmentary data, however, and no clear evidence is as yet at hand to indicate how much momentum the economy will gain during the fall seasonal upturn.

A noteworthy feature of the current business expansion has been the relative stability of prices, especially at the wholesale level. While the consumer price index rose by 0.2 per cent in September, the entire advance since the February trough in business has been only about 0.5 per cent, and wholesale prices have moved down on balance. Over the sixteen-month period since the beginning of the recent recession, prices at both the wholesale and retail levels have risen less than over the comparable months in 1957-58. Yet it is clear that the real testing period for prices still lies ahead.

### THE FIRST HALF YEAR OF BUSINESS EXPANSION

In contrast to the near-record \$15 billion rise in GNP during the second quarter of 1961—the initial full quarter of upswing in general business activity—the third-quarter advance amounted to a more modest \$10 billion, according to estimates by the President's Council of Economic Advisers.

Just as there was a danger of overestimating the momentum of the business upswing on the basis of the GNP data for the second quarter of 1961,<sup>1</sup> it must be recognized

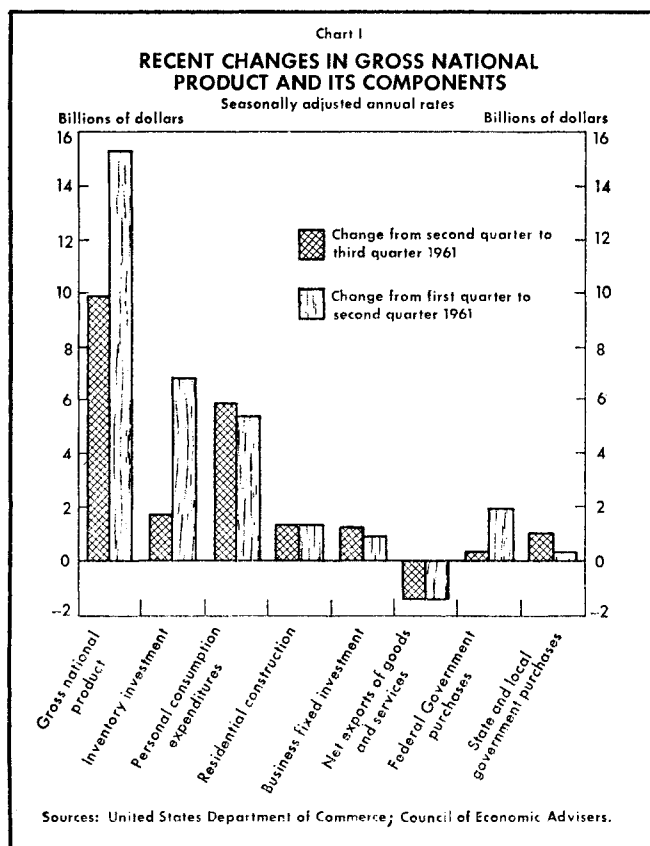
that the smaller GNP advance during the summer months may have failed to reflect the full underlying strength of the expansion. Much of the GNP gain during the April-June quarter was attributable to the unusually prompt and sharp shift in inventory investment (see Chart I), resulting from a swing from rapid inventory liquidation to moderate inventory accumulation (a swing which in large part reflected restocking by automobile dealers). While inventory investment made a substantially smaller contribution to the GNP advance in the third quarter of 1961, the rise in final demand during that period was only slightly less than the second-quarter increase. Allowance must be made, moreover, for several unusual and temporary factors, already noted, that tended to dampen the growth of final demand during recent months.

The continuing rise during the July-September quarter in all of the broad sectors of final demand except one could in itself be regarded as evidence of strength in the underlying economic situation. The only decline was in the foreign trade sector, where a small gain in exports was more than offset by a large increase in imports. Yet some of the July-September increases in domestic final demand were considerably smaller than the second-quarter gains. This was notably true of consumer outlays on durable goods and Federal Government expenditures on defense. (The lag in defense expenditures was, however, almost certainly a temporary development, induced by the irregular timing of defense contracts and disbursements. The 1962 Budget Review, released at the end of October, clearly implies a substantial step-up in defense spending during the fiscal year ending next June.) While private fixed business investment rose between the second and third quarters, the nonresidential construction component actually declined slightly.

It is also instructive to compare the over-all expansion in GNP during the second and third quarters of 1961 with the gains in GNP during the initial half years of the two previous cyclical upswings. The 5 per cent rise in GNP during the first half year of the current expansion<sup>2</sup> was appreciably below the rise during the first full half year of business upswing in 1954-55 (6.2 per cent), but only

<sup>1</sup> See *Monthly Review*, August 1961, p. 134.

<sup>2</sup> I.e., the first half year of expansion in the broadest sense, as manifested by trends in production, employment, and a wide range of other indicators.



either of the two preceding expansions. Undoubtedly, special factors such as the unusual weather conditions and the auto industry strikes affected consumer spending in some degree. It remains to be seen, however, whether such factors were fully responsible for sluggish durables sales or whether more pervasive influences have been at work.

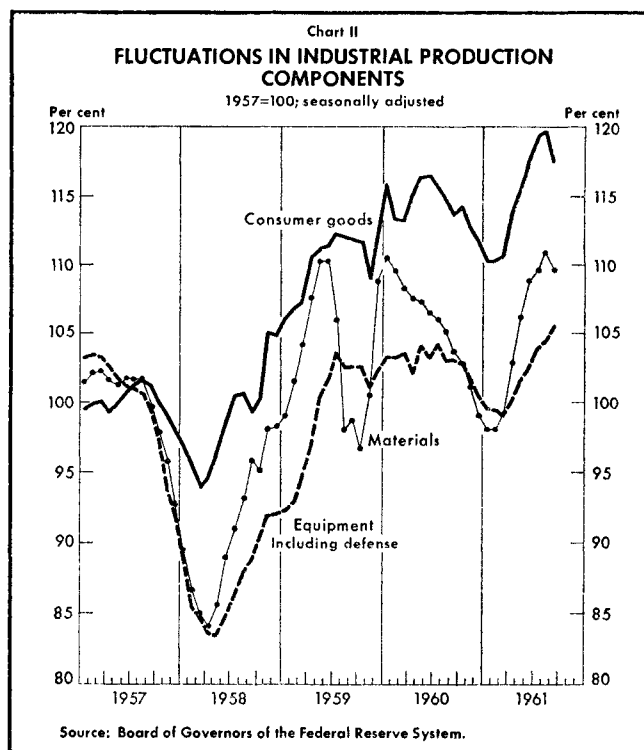
**RECENT CHANGES IN ECONOMIC INDICATORS**

In September the industrial production index slipped back about 1 per cent after having risen almost 11 per cent in six months of uninterrupted climb. The decline, however, was apparently attributable almost entirely to the work stoppages at General Motors, which in many plants lasted three full weeks, and to hurricane Carla, which hit hard at some large industrial installations in the Southwest. The GM strikes slowed not only the output of automobiles but also activity in other industries that are heavily dependent upon auto industry orders. Output in most categories that were not directly affected by the strikes or the hurricane advanced or, at worst, remained steady.

These crosscurrents in production are visible in Chart II, which shows sharp drops during September in production of both consumer goods and materials. The equipment component of the industrial production index, on

slightly less than the advance in the comparable period of upswing in 1958 (5.4 per cent). Compared with the earlier cycles, the strongest element in the current expansion—as evidenced by the percentages of rise in GNP contributed by various sectors—was business investment, both in inventories and, even more, in fixed capital. An expansion in Federal Government purchases also contributed importantly, but relatively less so than in 1958. This time, however, much more of the increase in Government outlays reflected a rise in defense spending (despite the temporary slowdown in the summer months), and undoubtedly defense orders, or expectations of such orders, caused some of the expansion in business investment also. Investment in residential construction—which during the 1960-61 recession was not the cushioning factor that it had been in earlier recessions—has also been a less important source of strength during the initial upswing.

Personal consumption expenditures accounted for a larger part of the rise in GNP than in the 1958 upswing, but for much less than in the 1954-55 recovery. Spending on durable goods alone, which is the most volatile component of consumer outlays, was in fact weaker than in



the other hand, which comprises defense as well as business items and which was probably less affected by the strikes and weather, continued to rise in September. This component has moved upward more slowly than the other two components since the recovery began, and also more slowly than in the comparable period of the 1958 upswing. It had, however, declined much less during the recent recession than during 1957-58, and by August, which was only the fifth month after the series had reached its trough, it had already passed the mid-1960 high. After the 1957-58 recession, in contrast, more than a year had been required to reattain the early-1957 high.

The effects of the automobile strike also appear to have accounted for much of the weakness in a number of other indicators of manufacturing activity during September. Thus, sales by manufacturers of durables, which previously had advanced for seven consecutive months, declined slightly. New orders received by such manufacturers, which had been moving roughly parallel to sales and had gained some 3½ per cent in August, rose less than 1 per cent in September. Apparently, an increase in orders for defense items was responsible for offsetting part of the decline stemming from the auto industry strikes. The average length of the workweek in manufacturing dropped 2 per cent after allowing for seasonal adjustment.

In contrast to the weakness evidenced in these several series, nonfarm employment in September, according to the payroll survey taken by the Bureau of Labor Statistics, edged upward for the sixth consecutive monthly rise, on a seasonally adjusted basis. The increase was only about one fourth of the August gain, but manufacturing employment rose slightly, more than offsetting the decrease that had occurred in August as a result of layoffs for model change-overs in the auto industry. Government employment, moreover, rose by almost 1 per cent. Employment increased in other sectors too, except in trade and construction where there were small reductions.

Despite a decline in wage and salary disbursements in manufacturing, which could be traced largely to the auto industry strikes, total personal income rose in September at an annual rate of \$800 million, seasonally adjusted. This increase was about the same as in August (after making allowance for the special life insurance dividend that veterans had received in July). Part of the September advance was attributable to newly effective amendments to the minimum wage and social security laws, which provided increased wages or social security benefits for a substantial number of people and expanded the coverage of both laws. The September gain in personal income pushed third-quarter disposable personal income to almost 4 per cent above the figure for the first quarter.

In October, strikes continued to have an adverse influence on production. Work stoppages at Ford plants began early in the month and lasted for about two weeks, affecting (as had the GM strikes) not only auto output but also production in steel and several other industries. Although some plants at Ford and GM were working overtime during the latter part of October, there did not seem to be a strong effort under way to make up the lost output. Nevertheless, there were also various indications of a strengthening in the underlying economic situation. Consumer spending on commodities has shown a decided improvement in recent weeks. While retail sales did not advance in September as a whole, compared with August, the latter part of the month did bring a gain in department store sales as well as in sales of automobiles. The higher level of department store sales was maintained throughout October. Although there was a mild decline in auto sales in the middle third of the month, this was attributable in some measure to shortages of Ford and GM models.

It is worth noting, too, that a recent Commerce Department survey points to a continued expansion of manufacturers' inventories. The survey indicates that manufacturers expect sales to rise substantially through the final months of this year, and that they intend to maintain approximately the existing relationship between inventories and sales during that time. This would appear to imply a continuation in the fourth quarter of the fairly vigorous, but not exuberant, pace of inventory accumulation that has prevailed at the manufacturing level in recent months. In addition, there are indications that defense orders for hard goods have started to flow in really substantial volume within the last several weeks.

#### **PRICE DEVELOPMENTS SINCE THE CYCLICAL TROUGH**

In September, wholesale prices of industrial commodities were almost ½ of 1 per cent lower than they had been seven months earlier, at the end of the recession. This contrasts with fairly sharp upward movements during the previous post-recession periods. All major components of the industrial price index have contributed to its recent stability. Prices of industrial materials, consumer finished goods, and producer finished goods in September were all somewhat below their levels at the business trough. They were also either below or approximately at the levels at which they had stood just before the recession had started. This demonstrates substantially greater price stability than in the two previous cycles.

In contrast to the decline in industrial wholesale prices between February and September, the consumer price

index moved up about  $\frac{1}{2}$  of 1 per cent. One quarter of this rise could be attributed to seasonal influences. The nonfood component of the index has advanced about 1 per cent, almost entirely because of a continuing climb in the price of services and a (partly seasonal) rise in apparel and used car prices. Even though the advance in the consumer price index was relatively small, it was nevertheless larger than that registered in the first seven months of the 1958-59 upswing and contrasted with an

actual decline in the comparable period of the preceding business upturn. However, the comparison with 1958-59 is somewhat misleading, because consumer prices rose more sharply during the 1957-58 recession than in the most recent recession. Measured over the sixteen-month periods beginning with the respective peaks in business activity (July 1957 and May 1960, respectively), prices have risen  $1\frac{1}{2}$  per cent this time, compared with  $2\frac{1}{2}$  per cent during the earlier period.

### Recent Developments in Bank Liquidity

Commercial banks have increased their liquidity markedly since the beginning of the most recent recession in early 1960. Under the stimulus of ample reserve availability, the banks have added heavily to their holdings of liquid assets, particularly short-term Government securities. This additional liquidity is available to meet credit needs in the economic expansion now under way.

An improvement in bank liquidity is characteristic of periods of recession and initial business upswings. The extent of the recent improvement is not easily assessed, however. It depends partly upon the particular liquidity concepts used to interpret recent developments, and also on the degree to which the banks' own view of their liquidity (which is partly a subjective concept) has changed as a result of changes in the economic environment. This article discusses some of the problems involved in measuring bank liquidity, and examines recent movements in several liquidity measures.

#### CONCEPTS AND MEASURES OF BANK LIQUIDITY

The relative ease with which a bank can meet its cash needs is usually termed its "liquidity position" (or "liquidity" for short). Since cash needs have a time dimension—ranging from the immediate demands of depositors making withdrawals to prospective demands of borrowers barely visible on the horizon—at least two types of bank liquidity should be distinguished. A bank's "immediate liquidity" is the relative ease with which it can meet deposit withdrawals (including those arising from new loan demands) on the near horizon. A bank's "longer run liquidity" is its potential for meeting loan demands and deposit losses over a prolonged period.

The immediate liquidity of banks is usually measured

as a ratio of short-term liquid assets (cash plus assets that can readily be converted into cash without appreciable loss) to liabilities.<sup>1</sup> One commonly used measure of this type, shown in Chart I, is defined as the sum of vault cash,<sup>2</sup> balances with domestic banks, loans to banks, loans to brokers and dealers, and Government securities maturing within one year, less borrowings, as a percentage of total deposits less cash items in process of collection and reserves held at the Federal Reserve Banks.

In assessing the banks' longer run liquidity, one measure that could be used is the ratio of short-term liquid assets plus other securities to deposits; over the longer run most of the "other securities" included in the numerator of the ratio are also a source of liquidity, since they can over time be sold or allowed to mature in order to expand the loan portfolio. Actually, the ratio customarily used to measure the longer term liquidity position of banks is the loan-deposit ratio, in which the numerator represents total *illiquid* assets, i.e., assets other than short-term liquid assets and other securities. Total illiquid assets are roughly approximated by total loans or, as in Chart II, by total loans adjusted less loans to brokers and dealers.

<sup>1</sup> Claims against a bank that represent an imminent cash drain, such as borrowing from the Federal Reserve, may be deducted from cash assets (as in the liquid assets ratio defined below) rather than added to liabilities.

<sup>2</sup> The character of vault cash as a liquid asset changed during late 1959 and 1960 as it became eligible to be counted as part of reserves. In the computation of the liquid assets ratios shown in Chart I, vault cash has been retained in the numerator of the ratio, and has not been deducted from the denominator, in order to maintain the historical continuity of the series. If vault cash were taken out of both the numerator and denominator for the period from November 1960 (when it was first fully countable as reserves), the resulting ratios during 1961 would fall below those shown in Chart I by roughly  $\frac{2}{3}$  percentage point for New York City banks and by about  $1\frac{1}{4}$  points for banks outside New York.

This ratio roughly measures the amount of long-term liquidity "used up" rather than the amount of liquidity available.

Neither the short-term liquid assets ratio nor the loan-deposit ratio has, of course, any claim to be regarded as "the" measure of immediate or longer term bank liquidity. To begin with, the list of assets included in the numerator of both measures is necessarily arbitrary in some degree. It is generally agreed, for example, that short-term Government securities should be included in the liquid assets ratio. Whether the maturity cutoff should be three months, twelve months, or perhaps longer is, however, difficult to say. Similarly, loans that are very close to maturity or which include provision for regular amortization clearly provide some degree of liquidity, although they are not customarily included in liquid assets. Some quite liquid assets (such as bankers' acceptances), moreover, are not included in the liquid assets ratio, because they cannot be identified separately in bank condition statements. For the same reason the numerator of the loan-deposit ratio, which ideally should include only illiquid assets, includes some "liquid-type" loans. Difficulties such as these are further complicated by changes over time in the liquidity of given classes of assets, arising from such developments as a broadened market for an asset, changes in the credit

standing of the issuer, and changes in loan repayment practices.

Similarly, the denominator of these liquidity measures (deposits) can never be more than a rough approximation of bank cash needs, either in the short run or in the long run. These needs will be influenced by changes in the relative importance of time deposits (which generally require smaller provision of liquidity than demand deposits); and by changes in deposit volatility, arising from such factors as changes in business conditions or shifts in deposit ownership and payments habits. Longer run liquidity needs, moreover, are heavily influenced by a bank's expectations regarding future deposit growth and loan demands, and also by the extent to which it feels committed to grant loans under lines of credit or renew old loans that come due.

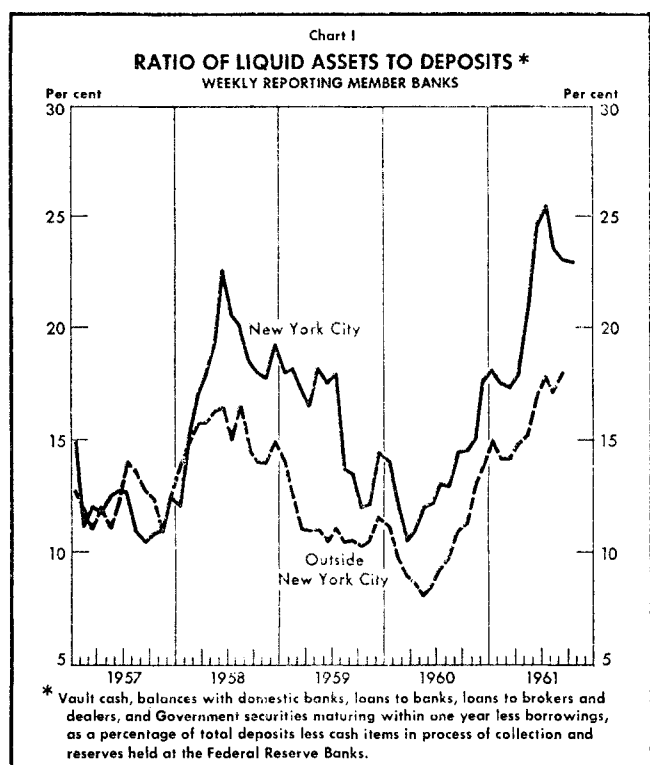
Despite an element of arbitrariness in the definition of liquidity measures, such measures are useful for judging the direction in which bank liquidity is moving. The significance of any given level of a liquidity measure, however, must be interpreted in the light of a variety of factors, including most importantly the way in which the banks themselves view it.

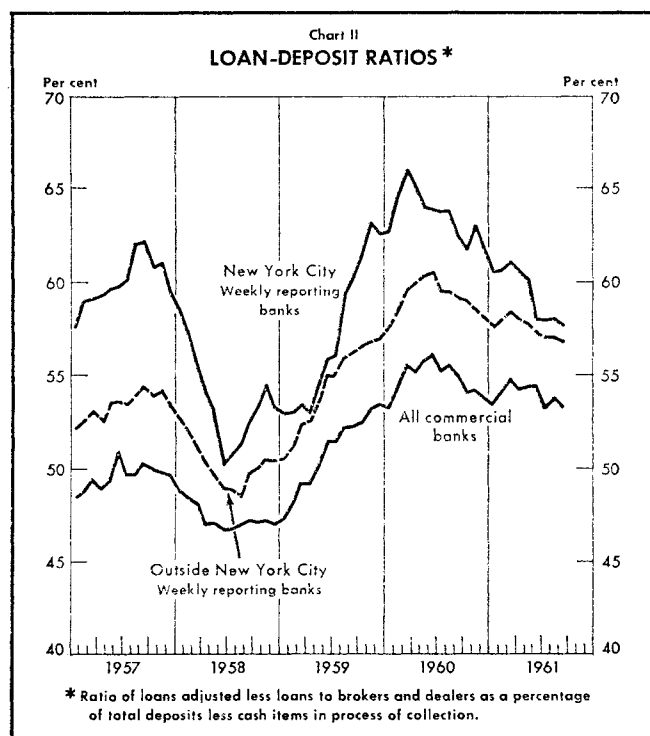
#### RECENT CHANGES IN LIQUIDITY MEASURES

Over time, the liquid assets and loan-deposit ratios broadly tend to move in opposite directions, as shown in Charts I and II. This occurs because many important portfolio changes affect them in opposite ways. For example, if bank holdings of Government securities maturing within a year increase while holdings of other assets remain unchanged, the liquid assets ratio will rise and the loan-deposit ratio will fall. (Changes in holdings of such securities are, indeed, an important factor accounting for movements over the business cycle in both series, although they normally increase the former more than they reduce the latter.)

Nevertheless, there is sufficient difference between the two concepts to permit movements in the same direction over short periods, with divergent implications for bank liquidity. Even over longer periods, furthermore, movements in the two series can be of considerably different magnitude. This, indeed, has been the case during the most recent recession and recovery.

Although both measures indicate that there has been a considerable improvement in bank liquidity since the beginning of the recession, the movement in the loan-deposit ratio has been much less pronounced than that in the liquid assets ratio. The loan-deposit ratio at New York City banks fell from a peak of 65.9 per cent in March





1960 to 57.7 per cent in October 1961, while for banks outside New York it declined from 60.4 per cent in June 1960 to 55.9 per cent in October 1961.<sup>3</sup> These were smaller declines than occurred in 1958. In October 1961 these ratios were still above their 1958 lows by a considerable margin.

The liquid assets ratio, on the other hand, moved very sharply. For weekly reporting member banks in New York City the ratio rose from 10.4 per cent in March 1960 to 25.5 per cent in July 1961 before declining to 23.0 per cent in October. For reporting banks outside New York City the ratio increased from 8.1 per cent in May 1960 to 18.1 per cent in October 1961. These increases were larger than in 1958, and the peak levels reached in 1961 were well above the 1958 peaks (the lower October level for New York City banks was still slightly above the 1958 peak). This marked buildup in immediate liquidity in large part reflected acquisitions of short-term Government securities. Holdings of Governments maturing in less than one year at all commercial banks, which had totaled \$8 billion in June 1960, rose sharply in the second half of

1960, and again in the second quarter of 1961, to reach a peak of \$26 billion in July—the highest level since 1954.

The increase in bank holdings of short-term Governments was partly at the expense of holdings in the one- to five-year range, which declined by almost \$10 billion between June 1960 and July 1961. Much of this shift from intermediate- to short-term securities could be accounted for by the passage of time. In mid-1960 banks held sizable amounts of several issues that were just over the one-year-to-maturity mark; by July 1961 these issues had moved into the less-than-one-year category. But bank acquisitions of short-term Governments through the market also were heavy. These acquisitions were stimulated by the ready availability of bank reserves and by Treasury financings that increased the market supply of these instruments. Banks, furthermore, apparently were inclined to build up their holdings of short-term securities relative to holdings of securities carrying longer maturities (during 1958, in contrast, they purchased sizable amounts of intermediate- and long-term issues). This tendency, in part, represented a means of preparing for an expected bulge in loan demands when the expansion in business activity rolled into high gear. It may also have been influenced by the experience of investors who suffered losses on long-term securities purchased in the 1958 recession.<sup>4</sup> In addition, with the loan-deposit ratio still relatively high, banks may have felt under greater pressure to build up their immediate liquidity.

#### SIGNIFICANCE OF RECENT CHANGES IN BANK LIQUIDITY

Thus, the immediate liquidity position of the banks appears to have improved more since the beginning of the recent recession than their longer term liquidity. By historical standards, at least, the latter type of liquidity position is noticeably less favorable now than was the case during comparable stages of other recent business cycles. Such historical comparisons, however, are only of limited usefulness as a guide to the future. While loan-deposit ratios are indeed high in terms of post-World War II comparisons, they might conceivably go considerably higher without placing significant restraints on the banks' willingness to grant loan accommodation. Whether this is true, and just how much higher the ratios could rise, remains uncertain.

Much depends upon the subjective viewpoint of banks regarding an appropriate loan-deposit "ceiling". Appar-

<sup>3</sup> For all commercial banks, including both nonreporting member banks and nonmember banks as well as reporting member banks, the ratio declined from 56.0 per cent in June 1960 to 53.3 per cent in September 1961.

<sup>4</sup> See "Bank Credit in Recession and Recovery", *Monthly Review*, August 1961, p. 137.

ently many banks have become conditioned to loan-deposit ratios that in earlier postwar years would have been considered unduly high. In some cases, individual judgments are influenced strongly by loan-deposit ratios of other banks in roughly similar circumstances. When venturing into unfamiliar terrain, there is great comfort in having company. The tendency of some large depositors to keep loan-deposit ratios of their banks under surveillance may also serve in some measure to keep the ratios of banks that are in direct competition with each other more or less in line. Such pressures do not prevent banks from letting their loan-deposit ratios move up together, although they may act as a brake on the rapidity of the adjustment.

The recent sharp growth in time and savings deposits (including certificates of deposit) may have made the banks generally more willing to accept higher loan-deposit ratios. Much depends, however, on their views concerning the permanence of these deposits. During prior business expansions, there were large withdrawals of time deposits for the purpose of investing in securities, on which rates had risen sharply. Many banks undoubtedly are concerned that such a pattern may soon be repeated. A loss of time deposits may mean only a rise in the *proportion* of bank deposits subject to immediate withdrawal. Total bank deposits may remain unchanged, with demand deposits rising as the public converts its time deposits to make payment for the securities. But there might also be an actual reduction in deposits; if the securities are purchased from banks, for example, the additional demand deposits are immediately extinguished.

Changes in loan-deposit ratios will, of course, be strongly influenced by factors over which the banks have little control. Perhaps the most important single influence is total deposit growth, which in large measure is subject to Federal Reserve control. Another factor is the strength and distribution of bank credit demands. In the face of persistent demand by good customers, some banks may reluctantly do what they would otherwise prefer not to do. Furthermore, the over-all loan-deposit ratio probably will

go up more if loan demands impinge largely on those banks that are not yet loaned up. Although such mechanisms as loan participations can be used to transmit demand pressures from banks that consider themselves loaned up to those that still have lending power, not all types of loan demands can be transferred through these mechanisms.

If deposit growth fails to keep pace with the growth in loan demands, so that the banks are under pressure to liquidate securities, nonbank liquidity might also exert an important influence on loan-deposit ratios. The banking system as a whole can extend loans by selling off securities only to the extent that the nonbank public is willing to acquire the securities. Corporate liquidity may be particularly important in this connection; in 1959, for example, when banks were heavy sellers of securities, the corporations were heavy buyers. If nonfinancial investment outlays by corporations during the current business expansion should reach the levels predicted by more optimistic observers, the funds available from this source for securities purchases may not be so large as in the comparable periods of some earlier business cycles.

#### CONCLUDING COMMENT

The immediate liquidity of the banks is strong, as evidenced by exceptionally large holdings of short-term Government securities. The strength of their longer term liquidity, however, depends in good part on the willingness of banks to allow loan-deposit ratios to continue notching upward. This, in turn, is influenced by a number of factors: total deposit growth, shifts in the composition of deposits, strength and distribution of bank credit demands, and the level of nonbank liquidity. Although assessment of such factors must necessarily be made within a band of uncertainty, monetary policy formulation must be alert to their influence, and to the interplay between them, in attempting to adjust the supply of money and credit to the needs of a growing economy.



## The Money Market in October

The money market was easy through most of October as midmonth firming tendencies, traceable primarily to the concentration of financing needs at the money center banks around the payment dates for the new Treasury issues, gave way to easier conditions thereafter. Federal funds traded predominantly in a 1½ to 2¼ per cent range. Dealer loan rates posted by the major New York banks rose from 1¾ to 2½ per cent early in the month to 2¾ to 3 per cent around midmonth, and declined to a 2¼ to 2½ per cent range toward the close of the month.

In the Government securities market, activity was concentrated in the shorter term area, where the Treasury successfully marketed \$2.3 billion of the reopened 3¼ per cent notes of May 15, 1963 and auctioned \$2 billion of one-year bills to replace \$1.5 billion of maturing bills and to raise another \$500 million of new money. Another \$200 million of new money was raised through additions to the regular weekly auctions of six-month bills. Bill rates moved irregularly within a narrow range over the month, although longer bills in particular tended to move lower toward the close of the period. Bond prices were generally up for the month, reflecting some feeling in the market that the business expansion might not be developing so vigorously as had been expected earlier. Prices of most short and intermediate coupon-bearing issues moved up, as that area of the market was strengthened by the favorable reception accorded the 3¼ per cent notes. Longer maturities, which attracted some demand on swaps out of corporate bonds, closed the month with gains of up to ¼¢.

### MEMBER BANK RESERVES

Market factors absorbed almost \$1.2 billion of reserves during the first two statement weeks of October, as a sharp decline in average float from the high levels reached in September combined with a heavy outflow of currency into circulation before the Columbus Day holiday. In the third statement week, a rise in required reserves, in part related to bank Tax and Loan Account payments for the reopened 3¼ per cent notes, was largely offset by net gains through other market factors. Though the level of country-wide member bank reserves thus remained about unchanged during that week, the concentration of mid-

month reserve needs at the city banks brought a sharp, though brief, rise in borrowings from the Federal Reserve Banks. Such borrowings receded during the final week, however, as the reflux of currency and the rise in float supplied some \$500 million of reserves.

System open market operations were designed to offset the effects on member bank reserves of these fluctuations in market factors. On a daily average basis, some \$1 billion of reserves was thus provided during the first two weeks of the month, while about \$430 million was absorbed during the final statement week. On a Wednesday-to-Wednesday basis, between September 27 and October 25, System outright holdings of Government securities increased by \$876 million. Holdings under one year rose

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, October 1961

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

Factor	Daily averages—week ended				Net changes
	Oct. 4	Oct. 11	Oct. 18	Oct. 25	
<b>Operating transactions</b>					
Treasury operations*	+ 18	- 30	- 31	+ 5	- 38
Federal Reserve float	- 391	- 75	+ 48	+ 325	- 93
Currency in circulation	- 61	- 213	- 124	+ 161	- 237
Gold and foreign account	- 75	+ 9	- 1	- 35	- 102
Other deposits, etc.	+ 34	- 80	+ 117	+ 39	+ 110
<b>Total</b>	<b>- 477</b>	<b>- 386</b>	<b>+ 7</b>	<b>+ 496</b>	<b>- 360</b>
<b>Direct Federal Reserve credit transactions</b>					
Government securities:					
Direct market purchases or sales	+ 626	+ 320	- 13	- 339	+ 594
Held under repurchase agreements	+ 8	+ 41	+ 68	- 92	+ 25
Loans, discounts, and advances:					
Member bank borrowings	+ 7	- 5	+ 116	- 90	+ 28
Other	-	-	-	-	-
Bankers' acceptances:					
Bought outright	-	+ 1	-	+ 3	+ 4
Under repurchase agreements	-	-	-	-	-
<b>Total</b>	<b>+ 642</b>	<b>+ 355</b>	<b>+ 172</b>	<b>- 518</b>	<b>+ 651</b>
<b>Member bank reserves</b>					
With Federal Reserve Banks	+ 165	- 31	+ 179	- 22	+ 291
Cash allowed as reserves†	- 96	- 130	+ 197	+ 45	+ 16
<b>Total reserves‡</b>	<b>+ 69</b>	<b>- 161</b>	<b>+ 376</b>	<b>+ 23</b>	<b>+ 307</b>
<b>Effect of change in required reserves‡</b>	<b>- 255</b>	<b>+ 183</b>	<b>- 292</b>	<b>- 51</b>	<b>- 415</b>
<b>Excess reserves‡</b>	<b>- 186</b>	<b>+ 22</b>	<b>+ 84</b>	<b>- 28</b>	<b>- 108</b>
<b>Daily average level of member bank:</b>					
Borrowings from Reserve Banks	34	29	145	53	66‡
Excess reserves‡	471	493	577	549	523‡
Free reserves‡	437	464	432	494	457‡

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 October 25, 1961.

by \$706 million, while those in the one- to five-year area rose by \$126 million and maturities in the over-five-year category increased by \$44 million. During the midmonth period of some firmness in the central money market, and to a lesser extent toward the latter part of the month, the System supplied some reserves to the market through repurchase agreements against Government securities. Holdings under such agreements were \$52 million on October 25, compared with none on September 27.

Over the four statement weeks ended October 25, free reserves averaged \$457 million, compared with \$550 million the previous month. Average excess reserves declined by \$65 million to \$523 million, while average borrowings from the Federal Reserve, reflecting the sharp rise in the October 18 week, increased by \$27 million to \$66 million.

#### THE GOVERNMENT SECURITIES MARKET

Interest in the Government securities market centered on the shorter maturities during the month, as the Treasury raised \$3.0 billion in new money through the sale of \$2.3 billion reopened  $3\frac{1}{4}$  per cent notes of May 15, 1963, the addition of \$500 million of one-year bills to the auction rolling over \$1.5 billion of maturing one-year bills, and the addition of \$100 million to the six-month bill issue in each of the weekly auctions of October 16 and 23. Subscription books for the reopened  $3\frac{1}{4}$  per cent notes, of which \$2.8 billion was already outstanding, were open on Monday, October 2, for payment October 11. The offering, priced at  $99\frac{7}{8}$  for an effective yield of 3.33 per cent, was given a favorable reception, mainly from commercial banks which were attracted by the privilege of making 75 per cent of payment through credits to Treasury Tax and Loan Accounts. Total subscriptions amounted to \$5.8 billion, with allotments made on a 37 per cent basis. A good demand for the notes developed in the secondary market and absorbed the rather light bank selling out of the new awards, so that the price of the notes remained firm. This favorable reception imparted a strong tone to the rest of the short and intermediate market, though some selling of long bills and some of the shorter coupon issues arose from those switching into the  $3\frac{1}{4}$  per cent notes.

Toward the middle of the month prices of intermediate issues sustained a brief decline on press discussion that an intermediate bond might be included in the Treasury's November refunding offer, but prices generally rose thereafter in reflection of some maturity-lengthening swaps and a modest volume of outright buying. The  $3\frac{1}{4}$  per cent

notes closed the month at  $100\frac{1}{32}$  bid, while most other notes and intermediate bonds were up  $\frac{2}{32}$  to  $1\frac{10}{32}$ .

The market for longer term Treasury bonds was generally quiet over the month, with price movements mixed. The sizable market supply built up in September's advance refunding operation was gradually reduced by a modest volume of demand from institutional investors, partly on swaps out of corporate issues in response to the narrowing yield spread between high-grade corporate bonds and long-term Treasury issues. Prices rose further late in the month, reflecting press discussion of a possible further cut in the British bank rate (which set off some dealer short covering) and somewhat less optimistic appraisals of the business situation.

In the Treasury bill market, rates continued to decline in early October, as a strong bank demand in an easy money market was reinforced by fairly sizable nonbank purchases and dealer expectations of a seasonal pickup in demand and continuing money market ease. The decline was reversed as the approaching October 10 auction of \$2 billion one-year bills (which was to raise \$500 million of new money) gave rise to a cautious market atmosphere, heightened by bank selling of longer bills in preparation for the October 11 payment date for the new  $3\frac{1}{4}$  per cent notes. The firmness which developed in the money market around this period, partly in connection with fund movements to pay for the two new issues, also stimulated bank selling of shorter bill maturities. As a result, a moderate but general rise in rates occurred. At these higher rate levels, a good demand developed in the regular weekly auctions on October 9 and aggressive bidding occurred in the auction for the one-year bill the following day. The average issuing rate on the new one-year bill was 2.975 per cent, compared with 2.908 per cent in the previous auction in July.

Rates turned down once more with the return of money market ease after midmonth, despite the addition of a total of \$200 million of six-month bills in two succeeding weekly auctions. Corporate demand picked up, and there were large purchases by several public funds reinvesting the proceeds of recent bond flotations. In addition, some professional buying of longer bills developed in the expectation that a reinvestment demand would arise out of the Treasury's November refinancing operation. As a result, in the final auctions of the month on October 30, average issuing rates were established at 2.280 and 2.613 per cent on the 91- and 182-day bills, respectively. By the month's close, the new one-year bill was bid at 2.90 per cent, down 8 basis points from its average issuing rate in the October 10 auction.

**OTHER SECURITIES MARKETS**

The markets for corporate and tax-exempt issues followed somewhat divergent patterns over the month. In the corporate market, with the calendar of new public offerings continuing quite light—totaling only \$330 million for the month following September's meager \$120 million and in sharp contrast to last October's \$670 million—prices moved upward over the first half of the month to the highest level for recent months. The resulting decline in yields, and particularly the narrowing of the yield spread against long-term Treasury bonds, caused some investor resistance to build up and brought some switching out of corporates, so that prices slipped somewhat over the remainder of the month. Several new A-rated utility issues marketed in the latter part of the month received only fair investor response. At the month's close, Moody's average of yields on seasoned Aaa-rated

corporates stood at 4.40 per cent, down 4 basis points.

In the market for tax-exempts, on the other hand, the volume of new flotations continued heavy, totaling \$600 million for the month following the \$650 million total last month and contrasting with only \$290 million a year ago. Prices remained steady in quiet trading over the first half of the month, as the market digested the large unsold balances of recent issues, but turned upward in more active trading around midmonth following the favorable receptions accorded several large new offerings. The largest of these new issues was a \$100 million Aa-rated State of California construction bond issue, reoffered October 18 to yield from 1.80 per cent in 1963 to 3.70 per cent in 1966, significantly below the 2.00 to 3.85 per cent range on a similar California issue marketed in September. Over the month as a whole, yields on seasoned Aaa-rated tax-exempt bonds declined by 6 basis points, to close at 3.25 per cent.