

FEDERAL RESERVE BANK OF NEW YORK



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The Business Situation

Economic activity scored widespread gains in April, and further advances appeared to be indicated for May. Final demand has also continued to show strength—particularly in the consumer sector. Retail sales and the number of housing units started both advanced again in April following their sharp spurts a month earlier, and in May automobile and department store sales pointed toward new highs. Information on consumer spending plans, moreover, suggests further advances in the months ahead—unless, of course, such plans are adversely affected by weakness in the stock market. These developments suggest that the improvement in consumer spending which began in March was more than a temporary reaction in the wake of a disappointing winter season.

Despite these gains, the over-all pace of economic advance is still moderate. Moreover, the latest survey of business plans for plant and equipment outlays in 1962 shows no increase in scheduled expenditures from those reported by the same group of firms in February. Unemployment—though down slightly in May—remains high, and the economy clearly has a considerable way to go before it can reach satisfactory levels of capacity utilization.

The pronounced weakness in the stock market during May contrasted markedly with the evidence of improvements in the business situation. Price-earnings ratios for many stocks had, however, been unusually high by historical standards, so that some re-evaluation of stock prices might well have been expected. It seems likely that recent developments in the market may, to an important degree, have reflected a belated recognition of the emergence of a noninflationary environment.

GAINS IN PRODUCTION AND EMPLOYMENT

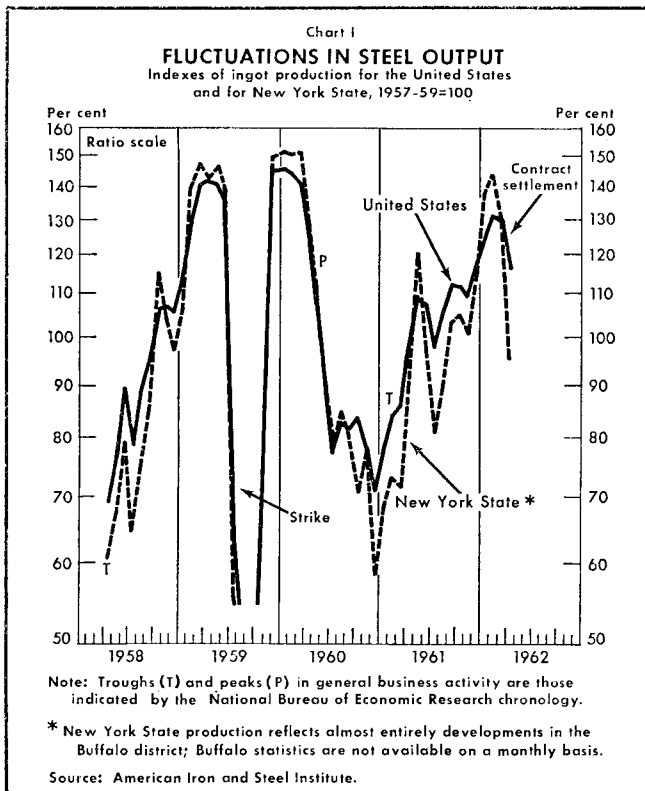
Industrial production rose by 1 percentage point in April to 117 per cent of the 1957 average. The increase was somewhat more pronounced than that recorded in the preceding months, and reflected advances in output in a wide range of industries. The largest push came from automobile production, as 617,000 cars rolled off the assembly line; seasonally adjusted, this was 8 per cent more than in March. A further, larger-than-seasonal in-

crease in auto output was scheduled for May, and actual production exceeded the target.

The April increase in total production would have been even larger had it not been for the drag exerted by the steel industry (see Chart I). As steel-using industries filled part of their needs from the excess inventories that had been accumulated earlier in anticipation of a strike, iron and steel output in the United States as a whole fell by about 5 per cent (seasonally adjusted) during the month, with further declines registered in May. At steel mills in some parts of the country, the decline in production was even more pronounced. Steel production in New York State, for example, which typically fluctuates more widely than in the nation as a whole, fell sharply in recent weeks (Chart I). As the over-all industry operating rate receded to around 55 per cent of capacity, utilization in the Buffalo area—where most of New York's steel production is concentrated—fell below 40 per cent. Industry reports suggested that large inventories combined with normal seasonal factors would continue to exert downward pressure on total steel production for several months more.

The rise in industrial production during April and an increase in construction activity were the major factors in the increase in the number of persons at work in the nonagricultural sector of the economy. A particularly sharp gain was scored by manufacturing industries where seasonally adjusted employment rose by 138,000 persons, according to the Bureau of Labor Statistics; this was the largest advance since May 1961. Moreover, average weekly hours tallied by production workers in manufacturing reached the highest level in more than five years on the strength of a third successive monthly increase. In durable goods industries such increases have, in the past, preceded an expanded rate of hiring.

Nonfarm employment continued to rise in May, according to the Census Bureau's household survey, and pushed up seasonally adjusted total employment by 432,000 persons to 67.9 million. At the same time, unemployment declined slightly, in spite of a substantial increase in the civilian labor force, and unemployment as a percentage of the civilian labor force moved downward again, after a pause in April, reaching 5.4 per cent in May. The increase in the labor force may well mark the



beginning of a significantly larger-than-usual influx of young people into the labor market which could compound the seriousness of the unemployment problem in the months ahead.

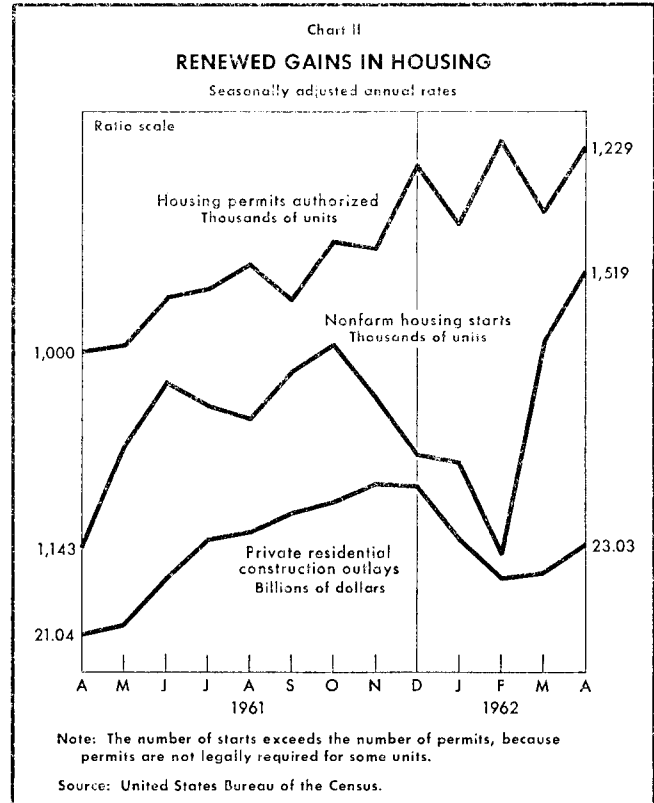
EXPANSION IN DEMAND

The impetus for the recent gains in activity has, to an important extent, come from greater strength in consumer spending. Retail sales again rose sharply in April, following the spurt recorded a month earlier. Durable goods sales were particularly strong and, whereas the March advance had been highly concentrated in automobile sales, the April gains were dispersed among a number of categories. The strength in some of these categories, including household appliances, lumber, and hardware, may be due in part to recent increases in spending for housing, including outlays for alterations and additions to houses. In May, consumer outlays seem to have risen further. Automobile sales during the first two thirds of the month appeared to be consistent with industry forecasts of some continued advance, while the strength of department store sales implied gains in other components of consumer spending.

According to the Federal Reserve Board's April survey of buying intentions, the number of consumers who plan purchases of durables in coming months has increased since three months ago. These more optimistic buying plans have been supported by continued gains in personal income, which provide both immediate purchasing power and the basis for increases in credit purchases. Extensions of consumer credit have accelerated recently, but their ratio to consumers' incomes has remained below historical highs.

The housing sector has also contributed importantly to recent gains in activity. The volume of residential outlays rose by more than \$1 billion (seasonally adjusted annual rate) in both April and May, following a smaller rise in March (see Chart II). Further increases appear to be indicated by the dramatic 34 per cent jump in housing starts over the March-April period. Moreover, despite this sharp increase in starts, the backlog of unused building permits has remained at a high level. The mortgage market, meanwhile, has continued to make credit available on easy terms, partly owing to heavy acquisitions of mortgages by commercial banks.

The steady rise in consumer spending may help accelerate business outlays for fixed investment as the over-all



business expansion progresses. So far, however, the monthly data on spending for machinery and transportation equipment and for commercial and industrial construction have shown only moderate increases. Moreover, the survey of business capital spending taken in late April and early May by the Commerce Department and Securities and Exchange Commission found that actual outlays in the first quarter were somewhat smaller than had been

planned. While spending plans for the current quarter were larger than reported last February, second-half plans were about what had been reported at that time. For the year as a whole, business plans still called for the same 8 per cent increase over 1961 as had been indicated in the February survey, in contrast to the 11 per cent increase which showed up in the intervening, but not entirely comparable, McGraw-Hill survey.

The Money Market in May

The money market was relatively easy during most of May, although country-wide reserve availability was much the same as in the March-April period when the atmosphere had been firmer. The easier conditions which prevailed during the month were traceable in part to heavy Treasury deposits in money market banks and the relatively slow rate of withdrawal of these deposits. The effective rate on Federal funds generally fluctuated within 2-2¾ per cent. During the period, rates posted by the major New York banks on loans to Government securities dealers moved within a 2¼-3¼ per cent range.

Treasury bill rates continued to move narrowly over the month, as a persistent investor demand absorbed the enlarged issues marketed by the Treasury. The market for intermediate- and long-term Government securities, after taking in stride the massive Treasury refunding in early May and registering further price gains through about mid-month, turned relatively weaker until near the end of the period when considerable strength re-emerged. The continued decline in stock prices contributed to the strength of both the Government and corporate bond markets early in the period and again to Treasury obligations toward the close of the month. Prices of corporate bonds rose on balance during May. Many seasoned issues reached their highest historical levels around May 10, but prices declined late in the period. The steady rise in prices of tax-exempt bonds since last December was reversed, as a heavy volume of new issues added to the already large inventories in dealers' hands.

MEMBER BANK RESERVES

A substantial quantity of reserves was absorbed by "operating transactions" in May, while required reserves declined on balance. The largest reserve drains stemmed

from a seasonal decline in float. System Account open market operations largely offset these reserve losses over the month as a whole. From the last statement week in April to the final week in May, System Account average outright holdings of Government securities increased by \$678 million, while average holdings under repurchase agreements declined by \$151 million.

Over the five statement weeks ended May 30, free reserves averaged \$434 million, as against \$427 million in the four statement weeks ended April 25. Average excess reserves declined by \$6 million to \$495 million, while average borrowings from the Federal Reserve Banks contracted by \$13 million to \$61 million.

THE GOVERNMENT SECURITIES MARKET

Prices of Treasury notes and bonds continued to rise during the first half of the month, but fell during most of the second half on news of advances in important business indicators. The decline in prices was also influenced by the unprecedented accumulation of recently issued tax-exempt securities in dealer inventories, as well as by military developments in Southeast Asia.

As the month began, interest in the market was focused on the Treasury refunding operation, announced April 26, on which the books were open from April 30 to May 2. A firm tone prevailed, as offerings of issues carrying "rights" were light and the new securities attracted a substantial demand. Only \$680 million of maturing issues, constituting 7.2 per cent of public holdings, was redeemed for cash. This outcome was about in line with expectations, tending to confirm confidence in the existing level of prices. Subsequently, the market strengthened further in response to sharp declines in stock prices and renewed advances in prices of corporate obligations.

Toward midmonth, prices of notes and bonds retreated in the face of offerings from both investment and professional sources in anticipation of the May 15 settlement of the Treasury's refinancing. The downward pressure on bond prices was augmented by reports of gains in industrial production and in personal income during April and by a temporary rise in the stock market. Moreover, uncertainty generated by the crisis in Southeast Asia contributed to the hesitant atmosphere which began to take hold. In this atmosphere, dealers were very cautious and prices moved irregularly lower as demand tapered off. Toward the end of the month, the lower level of prices and the fresh declines in the stock market generated new investor interest and bond prices moved moderately higher. Over the month as a whole, prices of Treasury

notes and bonds moved from $\frac{6}{32}$ higher to $\frac{2}{32}$ lower.

In the market for Treasury bills, rates continued to move in a relatively narrow range, as broad demand was satisfied in part out of dealers' positions and enlarged offerings by the Treasury. Short issues were in particular demand in a comfortable money market, and rates on these issues declined during the month. At the beginning of the month, demand from professional and commercial bank sources was stimulated by the easier conditions that emerged. Some reinvestment demand also appeared from sellers of issues involved in the refunding. In this context, aggressive bidding developed in the regular auction on May 7, with average issuing rates set at about 2.720 per cent and 2.816 per cent on three- and six-month bills, respectively, in both cases 3 basis points below those of the previous week. Bill rates moved lower in the following week also, and in the auction on May 14 average issuing rates were set at 2.646 per cent and 2.744 per cent on three- and six-month bills, each down about 7 basis points from a week earlier. For three-month bills this was the lowest average issuing rate of 1962.

For a few days following the May 14 auction, Treasury bill rates rose somewhat, as demand—particularly by commercial banks—contracted at the low rate levels. In addition, the Treasury announced that it would raise \$100 million of new cash by increasing its offerings of 91-day bills in the regular auction on May 21.

The rate advance soon lost momentum. Average issuing rates in the regular auction on May 21 were up about 5 basis points on both three- and six-month bills, to 2.700 per cent and 2.795 per cent, respectively, but then moved down to 2.656 per cent and 2.743 per cent in the final auction of the month on May 28—the lowest of the year for six-month bills. Over the month as a whole, three- and six-month bill rates declined 4 and 6 basis points. Toward the end of the month, the Treasury announced that it would increase its bill offering by \$200 million in the regular auction on June 4, adding \$100 million to both the three- and six-month bill issues.

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MAY 1962

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

Factor	Daily averages—week ended					Net changes
	May 2	May 9	May 16	May 23	May 30	
Operating transactions						
Treasury operations*	- 77	+ 110	- 38	- 60	+ 77	+ 12
Federal Reserve float	- 149	- 106	+ 31	+ 391	- 476	- 309
Currency in circulation	+ 112	- 135	- 139	+ 79	- 4	- 87
Gold and foreign account	- 33	- 15	- 29	- 40	+ 29	- 88
Other deposits, etc.	- 7	- 4	- 10	- 121	- 15	- 157
Total	- 155	- 149	- 185	+ 248	- 389	- 630
Direct Federal Reserve credit transactions						
Government securities:						
Direct market purchases or sales	+ 211	+ 374	+ 44	- 170	+ 219	+ 678
Held under repurchase agreements	- 56	+ 72	- 146	- 21	-	- 151
Loans, discounts, and advances:						
Member bank borrowings	- 22	- 17	+ 18	- 17	+ 39	+ 1
Other	-	+ 1	- 1	-	-	-
Bankers' acceptances:						
Bought outright	- 1	- 3	- 1	-	-	- 5
Under repurchase agreements	- 1	-	-	-	-	- 1
Total	+ 131	+ 427	- 86	- 208	+ 258	+ 522
Member bank reserves						
With Federal Reserve Banks	- 24	+ 278	- 271	+ 40	- 131	- 108
Cash allowed as reserves†	+ 14	- 294	+ 234	- 26	+ 63	- 9
Total reserves†	- 10	- 16	- 37	+ 14	- 68	- 117
Effect of change in required reserves†	- 82	+ 17	+ 65	+ 29	+ 77	+ 106
Excess reserves†	- 92	+ 1	+ 28	+ 43	+ 9	- 11
Daily average level of member bank:						
Borrowings from Reserve Banks	63	46	64	47	86	61‡
Excess reserves†	458	459	437	530	539	495‡
Free reserves†	395	413	423	483	453	434‡

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

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for five weeks ended May 30, 1962.

OTHER SECURITIES MARKET

Prices of seasoned corporate and tax-exempt bonds held generally steady during the first half of May. After midmonth, however, prices of tax-exempt securities, particularly longer term issues, were marked down under the pressure of a mounting supply of unsold bonds. These price concessions were apparently insufficient to evoke any substantial demand until the offering of two large state issues near the end of the month. These issues were well received and gave the market a somewhat better tone,

although heavy inventories of other issues still exerted a restraining influence. In the final trading sessions of the month, tax-exempt issues came under heavy selling pressure and prices declined appreciably. The market for corporate bonds, after retreating temporarily around mid-month, remained fairly steady during most of the remainder of the month, and then weakened somewhat toward the close of the period when the stock market was subjected to further waves of selling. Over the month as a whole, Moody's average yield on seasoned Aaa corporate bonds fell by 3 basis points to 4.28 per cent while the average yield on similarly rated tax-exempt issues rose by 11 basis points to 3.04 per cent.

New state and local securities floated during May totaled approximately \$867 million, compared with \$868 million in April 1962 and \$553 million in May 1961. The

volume of new corporate bond issues reaching the market in May was only \$240 million, however, as against \$640 million in April 1962 and \$665 million in May 1961. The Blue List of advertised dealer offerings rose to \$680 million on May 17, the highest level on record, before subsiding to \$606 million at the end of May; this compares with \$546 million at the end of April. The largest new tax-exempt bond issue of the month was a \$95 million Aaa-rated state issue. Reoffered to yield from 1.55 per cent in 1963 to 3.15 per cent in 1987, this issue was quickly sold. The largest new corporate offering was a \$40 million Aa-rated 4¼ per cent utility issue maturing in 1987. Reoffered at par, the issue met some initial investor resistance. Another similarly rated \$25 million utility issue maturing in 1992, reoffered later in the month to yield 4.20 per cent, met a listless investor response.

Time and Savings Deposits in the Cycle*

The growth rate of total commercial bank interest-bearing deposits, consisting of both time and savings deposits, has undergone marked countercyclical swings during the last decade. In sharp contrast to earlier recoveries, however, when the growth rate contracted sharply as the economy began to turn up, these deposits continued to expand rapidly through most of 1961. In early 1962 the growth rate jumped further—indeed, to record proportions—as many banks increased the interest rates paid on time and savings deposits following the upward revision by Federal regulatory agencies in maximum allowable rates. Between the recession trough in February 1961 and April 1962, interest-bearing deposits grew by \$13 billion, several times the increase in demand deposits.

Analysis of the factors underlying movements in aggregate interest-bearing deposits is handicapped by the fact that only limited data are available on time and savings deposits separately. The statistics cited in this article all refer to the total of time and savings deposits.¹ Never-

theless, it is clear that these two components have quite different characteristics. Time deposits are similar to securities in having a specified maturity and are often held by large investors sensitive to yield differentials on alternative investments. Savings accounts, by contrast, are frequently of small size and are generally held by individuals who may have limited investment alternatives.² Time deposits apparently are much more volatile over the business cycle, and the factors underlying this volatility have thus left a dominant imprint on total interest-bearing deposits. Such factors as the total volume of personal savings and the relative attractiveness of savings and loan shares and deposits at mutual savings banks are a less important influence on cyclical swings in total interest-bearing deposits, although they may have a considerable impact on the savings deposit component.

This article examines the factors underlying cyclical swings in aggregate time and savings deposits during the past decade, the special circumstances operating in the current business expansion, and the relationship of the recent strength in interest-bearing deposits to the relative weakness in demand deposits.

* Richard G. Davis and Jack M. Guttentag had primary responsibility for the preparation of this article.

¹ Note that the term "time deposits" is frequently also used to describe the aggregate of time and savings deposits. To make clear that reference is to the combined series, this aggregate is here described as "interest-bearing deposits" at commercial banks, even though it includes a small volume of deposits on which no interest is paid.

² For a detailed discussion of these two types of deposits and the factors affecting decisions to hold them by different groups of depositors, see "Time and Savings Deposits at Member Banks", *Monthly Review*, July 1960, pp. 118-23.

INTEREST-BEARING DEPOSITS AND MARKET RATES

Cyclical swings in the growth rate of commercial bank time and savings deposits during 1953-61 have usually been in the opposite direction from swings in short-term market interest rates (see Chart I). The principal exception to this pattern was the period from mid-1955 to the end of 1956, when the growth rate of these deposits rose somewhat despite a sustained rise in open market rates.

There appear to be two reasons why the rate of growth in interest-bearing deposits generally tends to decline as market rates rise. The first is that a rise in rates on open market instruments tends to widen rate differentials against time deposits. Although rates on time deposits may adjust to movements in open market rates, the response is often sluggish. Banks are reluctant to make frequent changes in these rates, while upward rate flexibility is also limited by legal rate maximums. At the same time, many investors, such as foreigners, business firms, banks, and governments, find time deposits attractive substitutes for such open market instruments as Treasury bills when rate differentials are favorable.

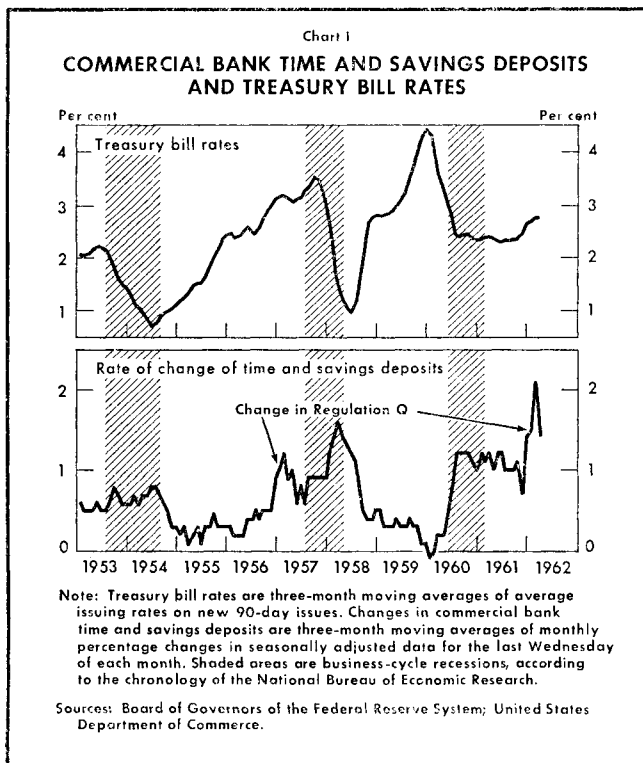
Upward movements in open market rates thus depress the growth of time deposits, as interest-sensitive depositors

withdraw their funds to take advantage of higher yields obtainable from open market instruments. Similarly, declines in open market rates stimulate the growth of time deposits by encouraging investors to switch out of market instruments.

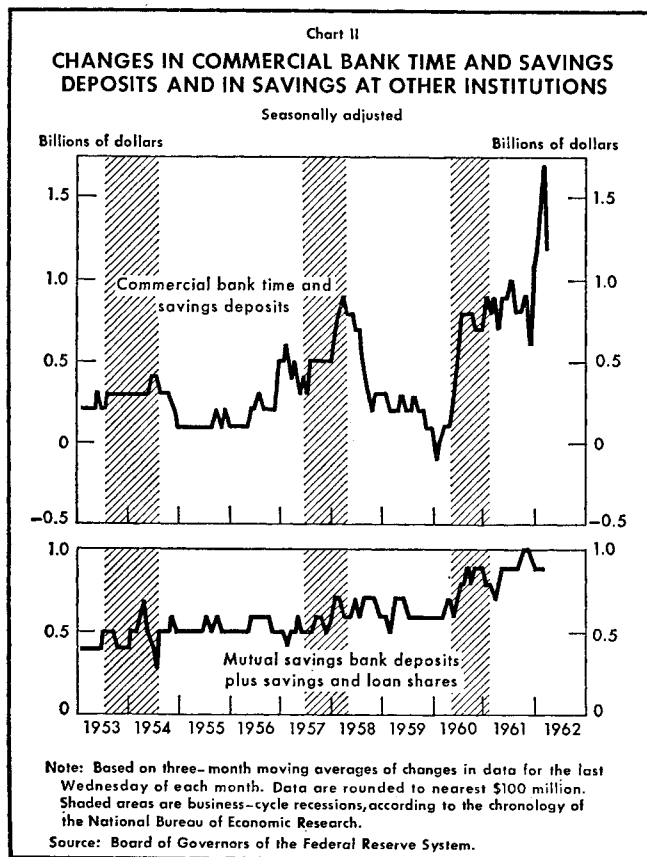
Savings deposits, which are restricted by law to individuals and certain nonprofit institutions, are less sensitive to changes in open market rates than are time deposits. Holders of small savings accounts may have limited investment alternatives, either because they are unwilling to undergo a risk of capital loss or because their savings fall short of the minimum amounts required for investment in marketable securities. Nevertheless, some shifting between savings deposits and open market outlets undoubtedly does take place. The very high returns available on many Treasury issues in the fall of 1959, for example, particularly on the widely heralded "magic fives", appear to have had a depressing effect on the growth of savings deposits at that time, while the sharp increase in these deposits early this year may partly have stemmed from sales of securities (including stocks as well as bonds) in response to increases in savings deposit interest rates.

The second reason why the growth of interest-bearing deposits tends to slacken when market rates rise is that rate increases generally have occurred during periods of expanding economic activity when the demand for money is rising. Heavier cash requirements tend to depress the growth of these deposits directly, to the extent that direct switching to demand deposits occurs; and indirectly, to the extent that securities sales by those switching into demand deposits raise market interest rates, thereby encouraging holders of interest-bearing deposits, in turn, to switch into securities.³ (The potential importance of the direct impact on interest-bearing deposits of swings in the demand for money may have increased in the recent past with the greatly expanded use of negotiable time certificates of deposit. These instruments have proved attractive to corporations, an important source of cyclical swings in the demand for money.)

On the other hand, there is little evidence that cyclical swings in interest-bearing deposits at commercial banks have been much affected by the relative attractiveness of



³ The rising demand for money balances needed to carry on an expanded volume of business activity apparently swamps any countertendency for higher interest rates to reduce the demand for money. Indeed, the growth of demand deposits has not displayed the "countercyclical" tendency shown by time and savings deposits. Whereas interest-bearing deposits have grown substantially faster during recessions than during expansions, the reverse has been true of demand deposits. During the last three recessions, demand deposits have grown at an annual rate of only 1.3 per cent, compared with a rate of 2.4 per cent during periods of expansion (beginning March 1951).



savings at mutual savings banks and at savings and loan associations. Of course, the long-term growth trend of interest-bearing deposits at commercial banks—especially the savings deposit component—has been influenced by the trend of interest rates paid and of services offered at these institutions. Furthermore, at particular times and in particular parts of the country, sharp changes in the differentials paid by these three types of institutions have had an immediate and pronounced effect on the relative volume of their savings inflows. As indicated in Chart II, however, the growth of total interest-bearing commercial bank deposits, on a nation-wide basis, has fluctuated much more widely than the growth of savings at mutual savings banks and savings and loan associations, and often in the same direction.

RELATION TO CREDIT DEVELOPMENTS

Cyclical switches between interest-bearing deposits, on the one hand, and money and marketable securities, on the other, are of course part of a broader complex of credit developments over the business cycle. Periods of

expansion are generally marked, not only by rising interest rates and a slowdown in the growth of time and savings deposits,⁴ but also by an intensification of credit demands. At the same time, the banking system may find it increasingly difficult to meet these demands on the basis of freshly created deposits. As a result, banks in part tend to meet loan demands by selling securities, thereby increasing the market supply available to investors switching out of interest-bearing deposits. As Chart III shows, periods of relatively slow growth in these deposits are usually periods when the banks are reducing their holdings of securities.

In addition, the volume of newly created securities will usually increase during periods of business expansion. Securities purchased by investors switching out of time and savings deposits during expansions thus have their counterpart in both bank securities sales and a relatively large volume of new offerings. Bank sales of securities and enlarged offerings in turn place upward pressure on interest rates, providing the inducement for investors to acquire securities through reductions in interest-bearing deposit holdings.

Periods of recession, on the other hand, when interest rates are relatively low and the rate of growth of interest-bearing deposits is high, are accompanied by an ebbing of credit demands. During such periods, the sale of securities by investors switching into these deposits has its counterpart both in market purchases by banks possessing ample reserves but faced with reduced loan demands, and in a smaller volume of newly created market instruments. The resulting downward pressure on interest rates thereby helps create the incentive for investors to relinquish marketable securities in order to hold interest-bearing deposits.

Monetary policy is, of course, an integral part of this mechanism. In general, a countercyclical monetary policy tends to accentuate cyclical swings in interest-bearing deposits. For example, monetary ease designed to cushion a decline in business activity adds to downward pressures on market rates stemming from the reduced demands for money, and thus further encourages holders of securities to transfer into interest-bearing deposits.

INTEREST-BEARING DEPOSITS AND AGGREGATE SAVINGS

Although interest-bearing deposits have generally moved in the opposite direction from short-term market interest rates, they have not shown any clear relationship to the volume of consumer savings, corporate savings, or gross

⁴ The most recent period, which has been an exception, is discussed in detail below.

national savings. This does not necessarily imply, however, that changes in current savings have not influenced the growth of time and savings deposits. Detailed analysis of this relationship is handicapped by the fact that only limited information is available on time and savings deposits separately. Consumer savings, for example, may well have a significant influence on savings deposit growth. Yet, because of the greater volatility of the time deposit component, this influence may leave a clear imprint on the statistics for all interest-bearing deposits only at times when the movement in personal savings is very pronounced. One such instance may have been the 1955-56 experience noted earlier, when the rise in consumer savings was exceptionally sharp. Similarly, data are not available to evaluate the influence of total corporate savings on corporate holdings of time deposits, although this influence could increase as corporations come to hold a larger share of their new savings in the form of certificates of deposit.

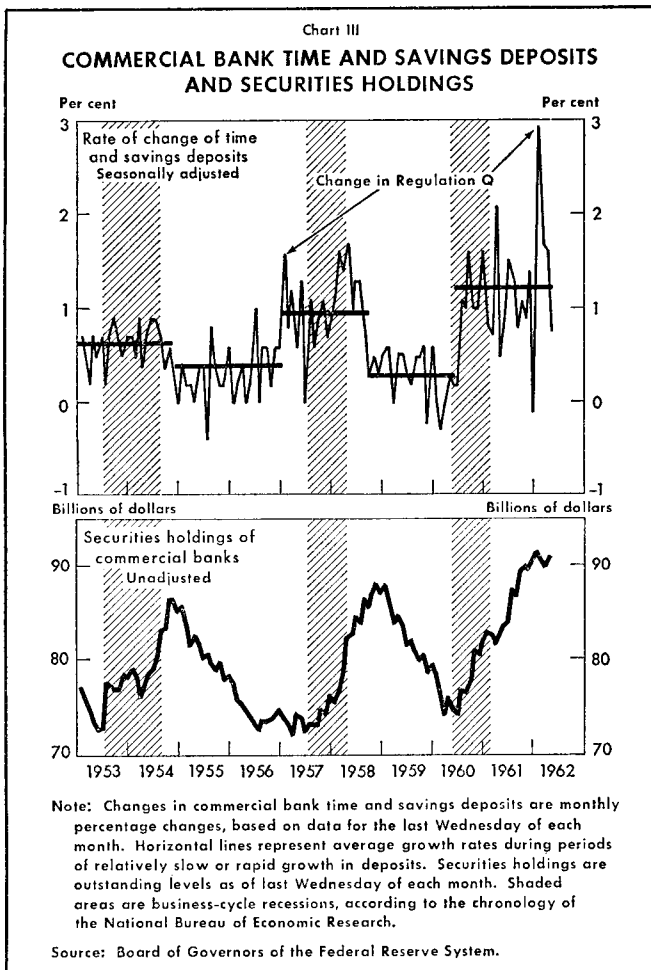
Changes in the proportion of current income that individuals wish to save may influence interest-bearing deposits, not only through their impact on the actual volume of total savings, but also—indirectly—by affecting business activity. The decision to save a smaller proportion of income, for example, is equivalent to a decision to spend a larger proportion on goods and services, and, if other things are equal, this results in a rise in the demand for these goods and services, in income, and therefore in general economic activity. The associated rise in the demand for money and in interest rates on marketable securities will tend, as noted earlier, to result in a less rapid growth of time and savings deposits.

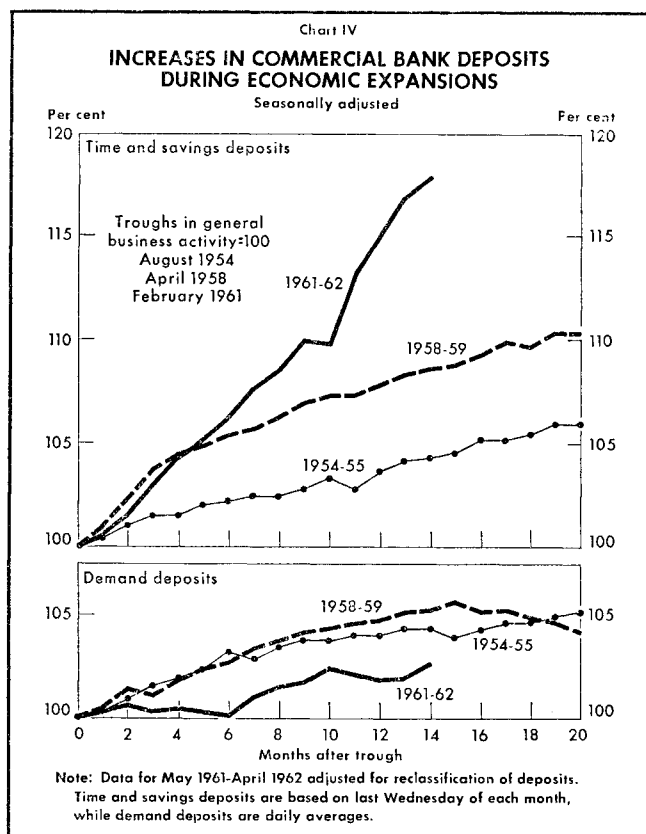
These direct and indirect effects of a change in the proportion of income individuals wish to save may tend to be offsetting, or they may reinforce each other. A decline in the *proportion* of income individuals wish to save, for example, tends to increase incomes, so that the total *volume* of savings may rise. In such an event, part of the increase in total savings may find its way into time and savings deposits, tending to offset the depressing impact on interest-bearing deposits of higher interest rates and a rising demand for money. On other occasions, the volume of total savings might decline as income rises, thereby tending to reinforce the depressing effect of rising business activity on time and savings deposit growth.

RECENT EXPERIENCE

As noted earlier, time and savings deposit growth in the current expansion has contrasted with earlier experience. The rate of increase remained near recession peaks through most of 1961 and then accelerated to record levels in early 1962 following the change in Regulation Q, effective January 1. By April 1962, the total increase since the February 1961 trough had amounted to about 18 per cent, as against 8½ per cent during the comparable months of the 1958-59 business expansion and about 4 per cent in the recovery of 1954-55 (see Chart IV).

The relative stability of open market interest rates has undoubtedly been an important factor sustaining the continued rapid growth in interest-bearing deposits during the recent recovery. Underlying this stability of interest rates, of course, has been a complex of influences, including the comparatively moderate pace of the business expansion. This has somewhat dampened the cyclical rise in the demand for money and made it possible to continue a policy of monetary ease. Thus, the banks have been able to increase substantially their holdings of earning assets and, with loan demands relatively weak, much of the expansion has been in holdings of securities.





The increase in the volume of personal savings since the 1961 business-cycle trough has not been significantly greater than in the comparable period of expansion after the 1958 trough in business activity, when the growth of interest-bearing deposits fell sharply. The tendency for consumers to save a relatively high percentage of their income may, however, have contributed to the moderate pace of the business expansion, and therefore to the stability of interest rates. The rise in the volume of corporate savings also has been relatively moderate during the current upswing, but the emergence of negotiable certificates of deposit, as noted earlier, has increased the share of corporate savings placed in interest-bearing deposits.

Although negotiable certificates of deposit had been available earlier on a limited scale in some parts of the country, New York banks issued them for the first time in February 1961, and banks in other money centers soon followed suit. This development was due in part to the banks' desire to attract time deposits from domestic corporations, which might otherwise hold not-immediately-needed funds in Treasury bills or other open market instruments. (Until last year, some large banks had been

unwilling to provide any type of interest-bearing deposit account to domestic corporations.) Outstanding negotiable certificates of deposit at major New York City banks rose through most of 1961 and early 1962, reaching a level of \$1.4 billion by the end of May 1962.

In early 1962, time and savings deposits received an additional boost as the result of the rise in maximum allowable rates (effective January 1, 1962). Commercial banks were permitted to pay up to 4 per cent on savings deposits of one year or more and up to 3.5 per cent on other savings deposits, compared with the previous maximum rate (in effect since January 1, 1957) of 3 per cent on all savings deposits. Maximum rates were raised to 3.5 per cent on time deposits with maturities of six months to one year, and to 4 per cent on deposits of one year or longer. A survey taken in mid-January indicated that about two fifths of all member banks had raised rates on savings deposits in the first half of that month above the old 3 per cent ceiling. Increases in maximum rates quoted on time deposits were even more widespread.⁵

Interest-bearing deposits rose by a dramatic \$2.4 billion (seasonally adjusted) in January and showed further large gains of \$1.4 billion in both February and March. By April, however, at least some of the immediate impact of the rate increases appeared to have spent itself, although the deposit increase in that month was still a substantial \$0.7 billion. Judging from the increases registered during the previous six quarters of rapid deposit growth, which averaged about \$2.4 billion per quarter, half or more of the \$5.2 billion January-March increase may have been attributable to the effects of the higher rate schedules initiated at the beginning of the period. (When legal maximum rates were raised at the beginning of 1957, the impact was somewhat smaller, probably because many large banks took no immediate action to increase rates.)

RELATIONSHIP TO DEMAND DEPOSITS

While the growth of interest-bearing deposits during the period since the February 1961 business trough has been exceptionally large, the growth of demand deposits has lagged relative to earlier periods (see Chart IV). How closely related are these facts? Have demand deposits increased less because interest-bearing deposits have increased more?

It is certainly true, as already indicated, that individual transactions which increase time and savings deposits fre-

⁵ See Caroline Cagle, "Interest Rates on Time Deposits, Mid-January 1962", *Federal Reserve Bulletin*, February 1962, pp. 147-51.

quently involve declines in demand deposits. This is the case when there is a direct transfer from demand to interest-bearing deposits. It is the case, moreover, when the public obtains funds for investment in interest-bearing deposits by selling securities to purchasers who pay by drawing down their demand deposits. Similarly, when time and savings deposits are acquired through a transfer of funds out of mutual savings banks and savings and loan associations, demand deposits will decline unless the institutions losing funds replenish them by selling assets to commercial banks.

Furthermore, from the standpoint of aggregate deposits, a given increase in total interest-bearing deposits implies a specific reduction in demand deposits, if total commercial bank reserves and excess reserves are unchanged.⁶ A similar mechanical relationship holds with regard to any given rate of growth of reserves. Thus, given the actual growth of reserves during the recent expansion and assuming that the growth of interest-bearing deposits had been only 8½ per cent, as in 1958-59, rather than the 18 per cent actually registered, it follows that demand deposits would have increased by about 5 per cent instead of the 2½ per cent that was in fact recorded.

The assumption that the growth of reserves would have been the same had interest-bearing deposits grown less rapidly represents a vast oversimplification, however. In reality, the willingness of the Federal Reserve to supply reserves may be influenced by some of the same factors that affect the growth of demand deposits and interest-bearing deposits.

For example, if the recent expansion in business activity had been very much stronger than in fact it was, the rise in the demand for money probably would have been larger, and the rise in the demand for interest-bearing deposits might have been more moderate. Had such been

the case, however, the different business situation *might* have called for a less easy monetary policy and a correspondingly less rapid growth in reserves. As a consequence, the increase in demand deposits might well have been less than the 5 per cent derived in the above example. Alternatively, the demand for interest-bearing deposits might have risen less rapidly if special influences, such as the rise in the legal rate ceilings on interest-bearing deposits, had not been at work. This might possibly have had different implications for monetary policy and hence for the rate of growth of reserves.

The extent to which the growth of interest-bearing deposits has been at the expense of demand deposit growth, therefore, cannot be determined in a mechanical fashion but requires an examination of all the factors that have affected the deposit mix and an assessment of their possible influence on monetary policy.

SUMMARY

The general countercyclical behavior of aggregate interest-bearing deposits during the last decade appears to have resulted primarily from two factors: shifts between interest-bearing deposits and open market paper in response to changes in short-term interest rates, and changes in the demand for money. Cyclical changes in interest-bearing deposits have not been closely related to changes in the volume of savings at mutual savings banks and at savings and loan associations, or to the growth in the aggregate volume of current savings, although these factors have probably had an important long-run influence on time and savings deposits. The unusual strength of interest-bearing deposits during the present recovery has been due in part to factors related to the moderate pace of the business expansion, and in part to such special influences as the expanded use of negotiable certificates of deposit and the rise in interest rates paid on these deposits. In assessing the significance of the recent behavior of interest-bearing deposits, these different influences on the deposit mix—which may have divergent implications for the economy—must be taken into account.

⁶ A \$100 rise in interest-bearing deposits will increase required reserves by \$5 (the reserve requirement against interest-bearing deposits is 5 per cent) and, other things being equal, will thereby reduce demand deposits by about \$33. By the same token, a \$100 rise in demand deposits will increase required reserves by about \$15 (the reserve requirement against demand deposits averages close to 15 per cent) and will reduce interest-bearing deposits by about \$300.