FEDERAL RESERVE BANK OF NEW YORK

MONTHLY REVIEW

FEBRUARY 1967

Contents

Some Economic Problems of 1967—
An Address by Alfred Hayes 23

The Business Situation 27

Recent Banking and Monetary
Developments 31

The Money and Bond Markets in January.... 35

Volume 49 No. 2

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Some Economic Problems of 1967 *

By ALFRED HAYES
President, Federal Reserve Bank of New York

As we emerge from the difficult year of 1966 and face the uncertainties of the new year, it is not too much to hope that the stresses and strains will be less severe, and the problems less perplexing, than in the year we have just lived through. I shall not burden you with anything more than a brief and therefore oversimplified reference to last year's difficulties in the areas in which you as bankers, and I as a central banker, are especially interested.

The balanced business expansion of 1961-64 gave way in mid- or late 1965 to an overheated economy, mainly because a greatly expanded war effort in Vietnam was superimposed on a peacetime economy marked by growing capital expenditures and nearly full utilization of labor resources and plant capacity. As a result, prices and costs came under increasing pressure, bringing to an end the fine price-cost record of the early 1960's. In a situation in which a combination of fiscal restraint and monetary restraint was clearly needed, monetary policy had to carry the major share of the burden of counteracting the inevitable inflationary pressures that followed from these circumstances. As many of us in the Federal Reserve System have often pointed out, the penalty of having monetary policy carry this heavy burden is usually the development of almost unbearable strains in financial markets, with excessive increases in interest rates—and last year's experience amply proved the point.

Much has changed, of course, since last summer. Above all, the domestic economy has cooled off perceptibly; and, while credit demand has remained high, it has been less insistent than in earlier months, market rates have declined sharply, and market expectations have undergone a fundamental change. Last month's termination of the Federal Reserve statement of September 1, 1966 on business loans and on discount administration was widely regarded as evidence of a significantly less restrictive System attitude. The President's proposal for a 6 per cent surcharge on taxes appears to me to be a constructive move toward providing a better mix of fiscal and monetary policies to meet the new conditions we will face this year. The relation of these policies to the unfolding economic and financial scene will undoubtedly be a matter of continuing importance and interest to all of us in 1967.

While 1967 is bound to be different from 1966, I think it would be unwise to assume that we can relax and expect that the nicely balanced and vigorous expansion of the early 1960's will be automatically restored. In fact, as we enter 1967, I am impressed by the seriousness of some of our unsolved economic problems. Perhaps this is a good time to take stock of our position and, without attempting a forecast, to suggest where some of these problems are most likely to develop as we seek to achieve our basic economic goals. Those goals, as you know, are maximum sustainable economic growth, high employment of resources, substantial price stability, and near-equilibrium in our international payments.

Doubts as to whether we shall see an adequate rate of economic growth seem to be a major source of public concern at present. There is a good deal of talk among economists, both in and outside the Government, about the possibility that we are on the verge of a recession. They cite such items as the probably much slower gain in business outlays on plant and equipment in 1967 than in 1966, with a dim profit outlook as a strong causal factor; the probability of an inventory correction following the recent tendency for inventories to accumulate at an excessive pace; and the prospect of somewhat lower automobile sales, on top of already sharply depressed housing construction.

* An address before the thirty-ninth annual midwinter meeting of the New York State Bankers Association, New York City, January 23, 1967.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

It would, of course, be foolish to dismiss out of hand the possibility of recession. Nevertheless, I find the case for recession decidedly unconvincing. Our Bank endeavors to keep in close touch with a representative cross section of businessmen, and most of them look for considerable sales gains in 1967, though profit prospects are much less certain. And even the most pessimistic forecasts seem to envision a sizable growth in GNP in the current year. Above all, it is hard for me to conceive of a recession developing in the face of the advance in Federal defense expenditures that seems probable in the light of Vietnam. Admittedly, this is an area full of uncertainties—but the probabilities seem to favor continued significant expansion of Federal spending. Also, outlays of state and local governments are likely to increase by an amount no less expansive than last year's record gain.

Perhaps the argument about the danger of "recession" is more a matter of semantics than of substance. I have a feeling that many of those who use the term are thinking more of a drop in the rate of growth of the economy than of an actual contraction. Of course the economy's rate of growth has slowed. It was quite natural to expect such a slowdown as the slack of unused resources in our economy was absorbed; and, indeed, it was necessary to encourage the slowdown through official policy in order to prevent a disorderly scramble for scarce resources and even greater price increases than actually occurred.

In periods of high employment, such as 1966, real growth potential is closely dependent upon net additions to the labor force as determined by population trends. Moreover, in such periods productivity gains also tend to slow down—as clearly occurred in the past year—further reducing the economy's potential for real growth. In this setting, it seems reasonable that our goal with respect to growth should be more modest in the next year or two than in the early 1960's. Perhaps a real growth rate of around 4 per cent would be a reasonable objective under current circumstances, although it might be necessary to accept temporarily a slightly slower growth rate as a means of achieving a satisfactory degree of price stability. In any case, I see no reason why a growth rate of this general magnitude should be a prelude to genuine recession. On the contrary, at this stage an orderly stepping-down to a sustainable growth rate is much less likely to lead to recession than would a resumption of excessively rapid and unbalanced growth.

It would, of course, be desirable not just to avoid a recession but to bring about a further decline in unemployment. But, it is pretty generally recognized that further substantial reduction of unemployment is a longer run matter, and must depend primarily on the gradual effects of structural improvements which may result from programs to improve training, labor mobility, and general standards of education and health. There are still severe shortages of many types of skilled labor, so that any effort to reduce unemployment further merely by stimulating aggregate demand would probably do much more harm than good.

One of the disturbing aspects of the present economic debate is the apparent willingness of too many people to accept considerable cost and price increases as inevitable in the coming year. To some extent, of course, excessive demand always has lagged effects on prices and costs, and we are seeing such effects now even after the cooling of the economy which I have mentioned. For one thing, the wage structure is under mounting pressure as a consequence of earlier increases in the cost of living. If the large number of major wage negotiations scheduled for 1967 tend to follow or exceed the recent 5 per cent pattern, they will be far in excess of any likely national productivity gains and will therefore add to inflationary pressures. The tendency toward cost-of-living escalator clauses is likewise disturbing.

It is one thing to say "some degree of inflation is inevitable but let us try to limit its extent", and it is quite another thing to say "inflation will happen anyway and we can do nothing about it". Both private and public policies can be of great value in restraining the degree of upward cost and price pressures, and appropriate policies—not only in the monetary and fiscal area, but also in the wage and price decisions of labor and management—are likely to be sorely needed this year. To put it in another way, in my judgment, the risk of inflation over, say, the next twelve months, still outweighs the risk of recession by a substantial margin. And, as I have pointed out on other occasions, ground lost to inflation is usually lost permanently.

So far I have said very little about developments in the area of credit and financial markets. There appears to have been a net decline in bank credit in the three-month period of September through November, at least if our seasonal adjustment factors did not go badly astray. This was certainly more than we had looked forward to. To some extent, this sharp reversal was perhaps a natural counterpart of excessive fears and consequent overborrowing in the earlier months of the year and of the speedup of corporate tax payments in the second quarter. But it also reflected a greater reluctance of banks to lend in the light of the significant reduction in bank liquidity. In any event, it is gratifying to note that the figures for December and early January point to a resumption of bank credit expansion.

So far, most of the curtailment in credit expansion dur-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ing the fall months seems to have been due more to necessitous rationing by the lenders than to any weakness in credit demand. I have the impression that bankers continue to look for rather strong loan demand in the coming months. In many instances, however, their liquidity position will probably induce continued caution in the rate of expansion of their lending operations. On the other hand, the decline in market rates over the past couple of months has placed the banks in a greatly improved position with respect to retention or expansion of time deposits. Other savings institutions have also experienced a vast improvement in their flow of funds. Demands in the capital market from both corporate and municipal borrowers remain heavy, and while passage of the President's new tax proposals will limit the demands of the Federal Government, these will still be substantial. While I shall not be so rash as to attempt any forecast of interest rates, I think it is well to bear in mind that rates are the result of many varied forces operating on both the demand and the supply side of the market.

No review of the problems we face can neglect our balance of payments and our international position generally—an area which is a matter of deep concern. In any review of the past year's experience, it is obvious that Vietnam has been an important adverse factor. Without trying to set a figure on this influence, I would point out that in addition to the direct military outlays abroad there are a variety of indirect effects, including of course those reflecting the overheated condition of our domestic economy in 1966. After so many years of continuous deficit and so many high-level assurances to the world that our payments would be brought into balance, I think it essential that this goal receive urgent attention from all elements in this country, private and public, which are capable of contributing to a remedy.

Unfortunately, achievement of balance in our external accounts will be anything but easy. Our biggest hope lies in the expansion of the trade surplus. Perhaps we can reasonably look for an improvement on the import side, provided that the expansion of the domestic economy does not become excessive, but we should not overlook the fact that some of the foreign countries that are our major export customers are also tending to grow at a more moderate pace, and this may have implications for our export prospects. In general, I think it is fair to say that our world competitive position has been well sustained, but must be made even stronger. The cost and price pressures currently in prospect must, therefore, be strongly combated if we are to avoid undermining our international trade position.

Turning to international capital flows, we find a variety of crosscurrents, but on balance we benefited greatly in 1966 from tight credit conditions in this country and the resulting high interest rates. We can hardly hope for benefits of similar magnitude in 1967. Indeed, whereas the inflow of private foreign short-term funds brought a small surplus in our official settlements account last year, we shall be lucky this year if some reflux of these funds does not develop. In general, even the slackening of credit pressures and the decline in interest rates which we have seen already in the United States may have appreciable adverse effects on net capital flows, unless there is an equivalent reduction of credit pressures and interest rates in major foreign countries. To some extent such a parallel reduction of credit pressures has occurred so far, but it cannot necessarily be counted on. Under these circumstances, I think it was inevitable and highly desirable that the voluntary credit restraint program should be continued and indeed modestly strengthened for the year 1967. Regardless of this program, however, excessively easy domestic credit conditions could have a disturbing effect on our balance of payments.

I am quite aware that artificial restraints on international capital flows are in principle undesirable. But, as I view the alternatives, artificial restraints are a lesser evil, required for the time being to prevent a greater evil in the form of weakening of confidence in the dollar. Certainly measures of this kind are not suitable permanent components of a desirable system of international financial payments. Thus, it behooves us, and all the other major industrial nations, to continue our efforts to achieve means of adjustment that are of an expansive rather than of a contractive nature. For the United States this means, above all, continued emphasis on the achievement of a larger current account surplus.

Naturally, it is hard for our industrialists to accept any restriction on their freedom to invest wherever in the world they see interesting profit possibilities. We often hear expressed the view that any interference with direct American investment abroad (i.e., investment in plant and equipment or working capital of subsidiaries or branches) must be wrong, in view of the splendid returns earned consistently on the aggregate of such investments in recent years. It is also true that the United States, because of the sheer size of its economy and of its national savings, and the high efficiency of its financial institutions, should be a natural supplier of capital to the rest of the world, especially the less developed countries.

As for the attitude of the recipient countries toward inflows of American capital, it is impossible to generalize. In some countries the desire to obtain the most up-to-date American machinery and technical methods runs head

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

on into the familiar argument that too much of the country's industry is falling under American domination. Reluctance of some countries to accept American investment has been tempered by the realization that, if obstacles are created, the American concern in question will probably carry out the same plans in a neighboring country. Thus, the first country may ultimately feel all the competitive effects of the new plant's establishment without receiving any benefits that accrue from having the plant located on its own soil. I should not overlook the feeling of many large American corporations that expansion abroad is an absolute must if the corporation is to retain an adequate degree of dynamism and can also be of great benefit in helping to sustain exports from American plants. Just to complete this picture of confusion, I might mention also the attitude of some of the foreign Finance Ministers and central bankers who may regard such American investment, at the time it is made, as an unwanted source of additional foreign exchange and an unwanted contributor to inflationary pressures in the economy of their country.

Having sketched the problem, I suppose I should have some solution to offer. Unfortunately, however, I do not think there are any easy solutions. Perhaps the relationship between a free flow of American investment abroad and the reserve policies of foreign monetary authorities deserves further study. More broadly, it seems to me that possibly the most challenging problem which this country faces in the sphere of international economics is how to reconcile equilibrium in our balance of payments with the fulfillment of our vitally important role as a supplier of capital, both private and Government, to other parts of the world.

Perhaps I have said enough to indicate that 1967 is not likely to be an easy year for policy makers or for anybody else. Quite to the contrary. The task to be faced by monetary policy will hinge not only on the pace of the economy, on cost-price pressures, and on international payments developments, but also on the role of the Federal budget in adding to our burdens or helping to alleviate them. It seems to me that on balance a less stimulative Federal budget has been needed for some time, and I welcome the President's proposal for a temporary but general tax increase. While, currently, the need to restrain an overheated economy is somewhat less pressing than earlier, the size of the projected Federal deficit is such that an increase in revenues seems much in order. We could easily discover in the months ahead that the economic expansion was again accelerating. In view of the rather lengthy period that is usually needed to translate a proposal to raise taxes into actual legislation, I think it highly prudent to have a proposal already on the table and under active consideration. Admittedly, however, this is an area in which others have responsibility and special competence. The only reason I speak of it at all is because of the close relationship with our own activities and my fervent belief that monetary and fiscal policy must work together for the solutions of the nation's economic and financial problems. I am rather confident that, on the strength of the lessons learned in the past year, the nation will succeed in achieving a much more orderly progress in the coming year. But this will require the keenest vigilance on the part of all of us, and I am sure we would all agree that the goal is worthy of the effort.

And I know that, as I have sketched the problems our economy may face in the coming year, you have been thinking of how those problems—and our efforts to deal with them—will affect you and your institutions. Many of you faced great difficulties last year as insistent credit demands found you with inadequate funds to satisfy all your creditworthy and long-established customers. Moreover, you watched with some apprehension as your loan-deposit ratios rose and your liquidity dwindled. I would like to suggest that, if efforts to keep the economy fully employed and growing at something near its full potential are successful, you will continue to face similar problems. You will have to continue to make sound judgments when allocating the resources available to you. If you make those decisions in ways which promote the best long-term interests of your community and the nation, the problems ahead will be less difficult than they would be otherwise. In short, there is a job for all of us to tackle, and I solicit your cooperation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Business Situation

Demand pressures at the close of 1966 were distinctly more moderate than was the case earlier in the year. A year ago, personal consumption expenditures, business capital outlays, and defense requirements were all rising rapidly, threatening to reach levels well in excess of the practical limits of available labor and capital resources. In such circumstances, it was to be expected that inflationary pressures would be set in motion, as clearly happened in the first half of 1966. By the year-end, however, efforts to combat inflationary excesses had succeeded in dampening the rate of growth of overall private demand, thus helping to make available the resources necessary for increased defense production while at the same time providing some measure of relief in the overall call made on the nation's production capacity.

Although recent estimates of gross national product (GNP) in the fourth quarter of 1966 indicate a rate of gain higher than that of the third quarter, this development primarily reflected a sharp increase in the rate of inventory accumulation. Final expenditures—GNP less inventory investment—actually grew more slowly in the fourth quarter than in the third. Defense expenditures expanded a little less rapidly but still accounted for about one fourth of the advance in total GNP. Increases in capital spending by business, although still considerable, took a smaller share of the total expansion of output than in earlier quarters of the year. Consumer spending advanced relatively little, despite a substantial increase of disposable personal income, and residential construction outlays dropped further. In the meantime, however, there are indications that the residential construction decline may soon bottom out.

Total industrial production rose from the third to the fourth quarter of the year at a comparatively modest annual rate of 2¾ per cent. At the same time, the rate of utilization of manufacturing capacity, while remaining at a high level, edged off slightly in the fourth quarter. The average workweek in manufacturing also shortened somewhat in December.

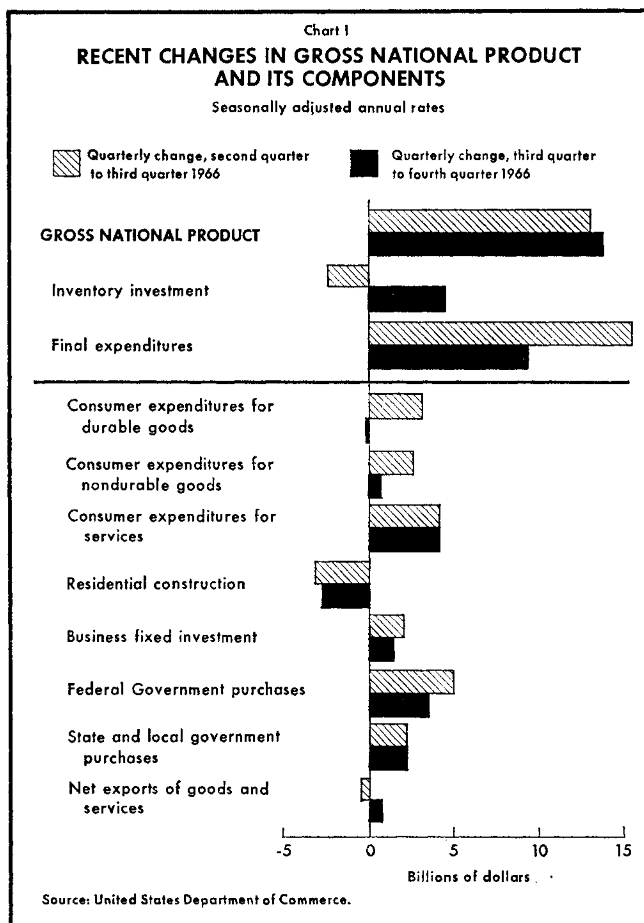
Despite some reduction in overall demand and supply pressures, production costs continue to increase and presently show little prospect of easing. Unit labor costs in manufacturing are estimated to have risen at a 6 per cent annual rate from July to December. Moreover, the GNP deflator—the broadest measure of price changes in the economy—rose at an annual rate of more than 3 per cent during the fourth quarter, somewhat less rapidly than the 3¾ per cent rate registered earlier in the year but almost twice as fast as in 1965.

GROSS NATIONAL PRODUCT IN THE FOURTH QUARTER OF 1966

The nation's total output of goods and services increased by $13.8 billion in the final quarter of 1966, to a seasonally adjusted annual rate of $759.1 billion, according to preliminary estimates by the Department of Commerce. This sizable advance—at an annual rate of 7½ per cent—was somewhat larger than that of the preceding three-month period, although it fell well short of the outsized increase recorded during the first quarter of 1966. Of the $13.8 billion added to GNP during the fourth quarter, however, only some $8 billion constituted a real increase in goods and services produced; the remaining $5¾ billion reflected merely higher prices. Nevertheless, even when adjustments are made for price rises, the growth in GNP was at a strong annual rate of nearly 4½ per cent, compared with 4 per cent in the third quarter, 2 per cent in the second, and 6 per cent during the exceptional first quarter of 1966.

About one third of the increase in GNP during the fourth quarter was due to inventory accumulation (see Chart I). Inventories are estimated to have risen at an unusually high annual rate—$14.4 billion—with sharp rises recorded in work-in-process inventories held by durables manufacturers, notably in the machinery and transportation equipment industries. But manufacturers' inventories of finished goods also increased rapidly, as did wholesale and retail trade inventories. In contrast, final expenditures

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



—total GNP less inventory investment—rose by a relatively modest $9.3 billion, which was considerably below the $15.4 billion increase recorded in the preceding quarter.

The consumer sector showed a distinct lack of buoyancy during the fourth quarter, and the $4.5 billion increase in total outlays for consumption was only half the gain of the preceding quarter. In real terms, the fourth quarter's advance in total consumption expenditures was negligible—$0.2 billion, as against a $6.9 billion gain in the third quarter. Consumer spending for durable goods declined fractionally during the fourth quarter, and was actually slightly less than in the opening months of 1966. Outlays for automobiles and parts, although virtually unchanged from the third-quarter level, were significantly lower than at the start of the year. Expenditures on nondurable goods did increase, but the advance was the smallest in three years and was more than accounted for by higher prices. Consumers increased their expenditures for services by as large a dollar amount as in the third quarter, but almost two thirds of the increase went simply to pay for higher costs.

The slowing of consumer spending seems not to have reflected a general lack of funds. Indeed, disposable personal income in the fourth quarter expanded at a very rapid $10.4 billion seasonally adjusted annual rate, compared with a $7.9 billion gain in the preceding quarter. At the same time, while outstanding consumer credit advanced less rapidly in the fourth quarter than in the third, the availability of such credit appears to have been maintained, if not increased a bit. The recent small increases in consumer outlays on goods and services have apparently resulted from a number of causes, including a growing uneasiness among the general public, prompted by uncertainty regarding the economic outlook, price developments, the war in Vietnam, and the possibility of a tax increase. It should also be stressed, however, that the slower rise of consumption than of disposable personal income in the fourth quarter may simply have reflected the desire of consumers to increase the proportion of their income saved. During most of the current expansion, consumers have been saving an unusually small share of their disposable incomes. This development, which in the last year or two probably reflected in good part efforts to maintain an advancing standard of living in the face of rapidly rising prices, had brought the savings rate down to an exceptionally low level by the third quarter of 1966. In the fourth quarter, however, the savings rate returned to a figure more in line with the long-term average.

Residential construction expenditures again fell sharply in the fourth quarter—by $3 billion—to a level one-fourth below that of the first quarter of 1966. At the same time, however, housing starts and other indicators of prospective home-building activity improved somewhat during the period, leading many observers to conclude that the decline in home building might be nearing an end.

Business fixed investment outlays increased less in the fourth quarter than in the third, but the $1.4 billion advance nevertheless remains large by historical standards. The survey of plant and equipment expenditures taken last November by the Department of Commerce and the Securities and Exchange Commission had already revealed that capital spending was increasing at a lesser pace during the fourth quarter, and indicated that further slowdowns in such spending were likely in the current and following quarters. There are a number of factors behind this leveling off. Perhaps the main one is that the pace of economic activity has begun to moderate, while the pressure on capital resources is easing slightly as new capacity created by past spending comes into use. The Federal Reserve Board's index of capacity utilization edged off by 1 percentage point during the fourth quarter, to the still very

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

high level of 90 per cent. At the same time, profit margins have come under progressively stronger pressure as labor costs per unit of output mount rapidly.

National defense expenditures rose steeply in the fourth quarter, by $3.5 billion, following an even sharper upsurge of $4.9 billion in the preceding quarter. By the end of the year, defense spending was $13 billion higher than in the fourth quarter of 1965, while for the full year 1966 the advance over the preceding year amounted to $10 billion. Federal Government purchases of nondefense goods and services, on the other hand, did not rise during the fourth quarter.

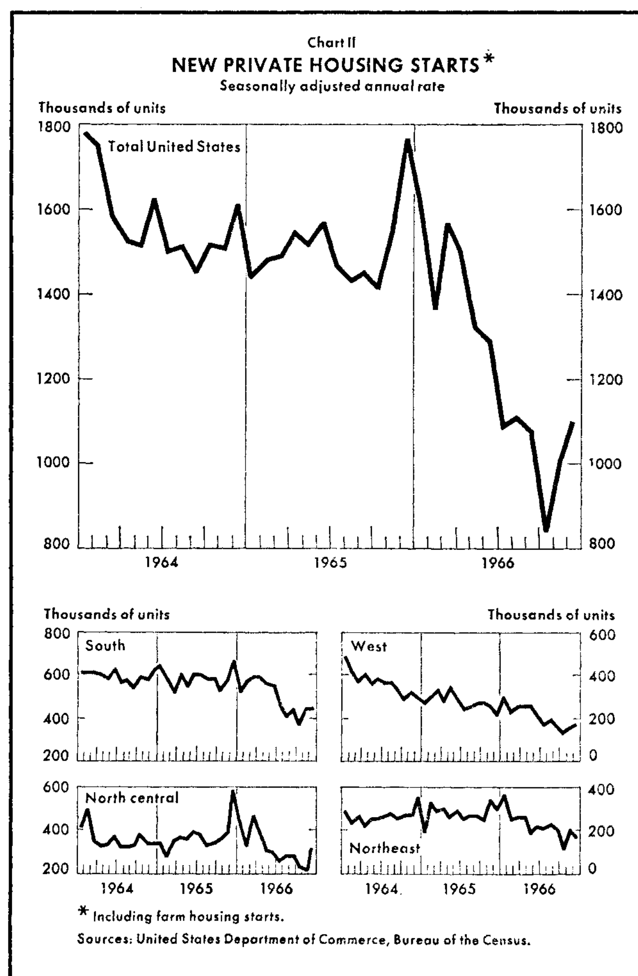
The budget recently submitted to Congress calls for further substantial increases in Federal Government purchases of goods and services. In his *Economic Report,* the President stated that defense expenditures would rise by another $10 billion during calendar year 1967, while all other Federal purchases would increase by $1½ billion. Because of the stimulus of Government spending and a basically strong private demand situation, the Council of Economic Advisers expects that the economy will continue to move ahead in 1967 and will gather strength after midyear. This projection assumes, it might be noted, that Congress will act favorably on the President's budget plans, including the proposed imposition of a 6 per cent surcharge on both corporate and personal income taxes. The surcharge would be introduced on July 1 and, according to the President, would "last for two years or for so long as the unusual expenditures associated with our efforts in Vietnam continue".

RECENT DEVELOPMENTS

According to the preliminary estimate, industrial output remained virtually unchanged in December. The Federal Reserve Board's index edged up by 0.1 percentage point, to 158.7 of the 1957-59 average, after having eased by 0.2 percentage point in November. As in the past few months, there was a substantial decline in iron and steel production but large increases in the output of business and defense equipment. Automobile production, on the other hand, remained at a seasonally adjusted annual rate of 8½ million units in December but declined to a 7¼ million unit level in January. Mining output rose substantially, reflecting primarily a sharp recovery in coal production, while utilities production also increased.

Manufacturers' shipments, which had declined slightly in November, rose more than 2 per cent, or by $1.0 billion, in December. Considerable strength was apparent in both the durables and nondurables components. Equipment and defense producers, as well as manufacturers of consumer nondurables, had particularly large increases in sales. Along with the strong performance of shipments, the increase in manufacturers' inventories moderated substantially in December, amounting to $0.8 billion after seasonal adjustment, as against a $1.1 billion advance in November. The rise in durables manufacturers' inventories, in particular, slowed to $0.6 billion from $1.0 billion in the preceding month. The overall inventory-sales ratio in manufacturing declined slightly in December for the first time in seven months, but remained high in comparison with earlier levels.

The volume of new orders received by durables manufacturers rose $0.9 billion to $23.9 billion in December, following two consecutive months of decline that totaled $2.2 billion. More than half of the December increase reflected the movement of defense orders, as had been the



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

case for the bulk of the earlier decline. Unfilled orders of durables manufacturers remained virtually unchanged in December.

Personal income, which had risen exceptionally rapidly from July to November, grew more slowly in December. Nevertheless, that month's $3.0 billion advance was close to the high average advance recorded in the first half of 1966. Wage and salary disbursements were up by a substantial $2.3 billion, while transfer payments rose by fully $1.0 billion. Dividend receipts, on the other hand, fell sharply—by $1.4 billion—presumably reflecting declines in the profits of some corporations and the need to conserve cash. Consumer credit outstanding increased in December by the smallest monthly amount in almost five years, primarily as a result of a very modest advance in outstanding automobile credit.

Many of the series bearing on the outlook for residential construction have improved somewhat in recent months. Seasonally adjusted residential building contracts, which by October had fallen 43 per cent from their March high, rose by 13 per cent in the following two months. Over the same period, building permits for new private housing units dropped by 44 per cent through October, but then rose 8 per cent by December. Private housing starts between October and December recouped more than one third of their 46 per cent decline from March to October. The upturn in starts, moreover, was broadly based geographically (see Chart II). In assessing these developments, however, it should be recognized that the starts series is highly erratic and that more than two months of data are necessary to establish a trend in any of the statistics mentioned. The housing contraction in 1966 undoubtedly resulted primarily from a shortage of mortgage funds at those institutions specializing in this market. Recently, however, a significantly larger volume of funds has flowed into mortgage lending institutions. In addition, the Federal Home Loan Bank System has made available $1.5 billion of credit to member savings and loan associations for mortgage lending. To encourage member associations to avail themselves of the released funds, the interest rate charged on the bulk of these advances has been reduced to 5¾ per cent. With the basic demand for housing apparently remaining strong, the easing in the mortgage market is likely to lead to a marked improvement in home building. Still, some time will be needed before the rise in housing starts is reflected in actual outlays. Even though the present indications do not suggest an immediate return to the high levels of residential construction prevailing before the 1966 slump, even a modest improvement of housing outlays would remove a major drag on the overall growth of GNP.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Recent Banking and Monetary Developments

Commercial banks, which had experienced strong liquidity pressures in the summer months of 1966, found conditions significantly easier in the final quarter of the year. The Federal Reserve System acted during the period to relieve pressures in the money markets so that bank credit growth might resume. As short-term interest rates fell, the ability of commercial banks to attract and retain time deposit funds gradually improved, and by December the expansion of total bank credit and deposits began to pick up markedly. The net reserve position of member banks in the aggregate eased during the quarter, as borrowings at the Federal Reserve Banks declined appreciably and excess reserves remained roughly unchanged.

During the first three quarters of 1966, pressures on banks had progressively increased, reflecting both intensifying loan demand and diminishing reserve availability. Banks responded to this development in several ways: they liquidated large amounts of securities, raised the prime rate to their business borrowers, increased other lending rates, tightened compensating balance requirements, and sought to scale down loan requests. At the same time, many banks attempted to raise funds by competing more aggressively for both large- and small-denomination certificates of deposit (C/D's), some borrowed heavily in the Euro-dollar market, and some increased their borrowings at the Federal Reserve Banks. In the fourth quarter, however, the combination of firmer control over lending at commercial banks and a slowing in some sectors of the economy operated to reduce substantially the growth of business loans, thereby alleviating one of the key sources of pressure on bank portfolio and reserve positions. Indeed, business loans grew less rapidly in the fourth quarter of 1966 than in any quarter since early 1961.

Less pressure on reserve positions and the moderation in business loans made it possible for banks in November and December to increase their holdings of United States Government securities sufficiently to offset heavy October liquidations. Also, holdings of other securities held steady in the fourth quarter, following a small net reduction on a seasonally adjusted basis in the preceding three months. The expansion of total loans remained at the reduced pace of the third quarter of the year.

The money supply declined slightly further in the fourth quarter, and total time and savings deposits at commercial banks rose by only a small fraction of their gain earlier in the year. There was a widespread improvement in time deposit growth in December, but for the quarter as a whole smaller denomination "consumer-type" time deposits issued by banks advanced noticeably more slowly than in the preceding nine months, and large C/D's and passbook savings again declined.

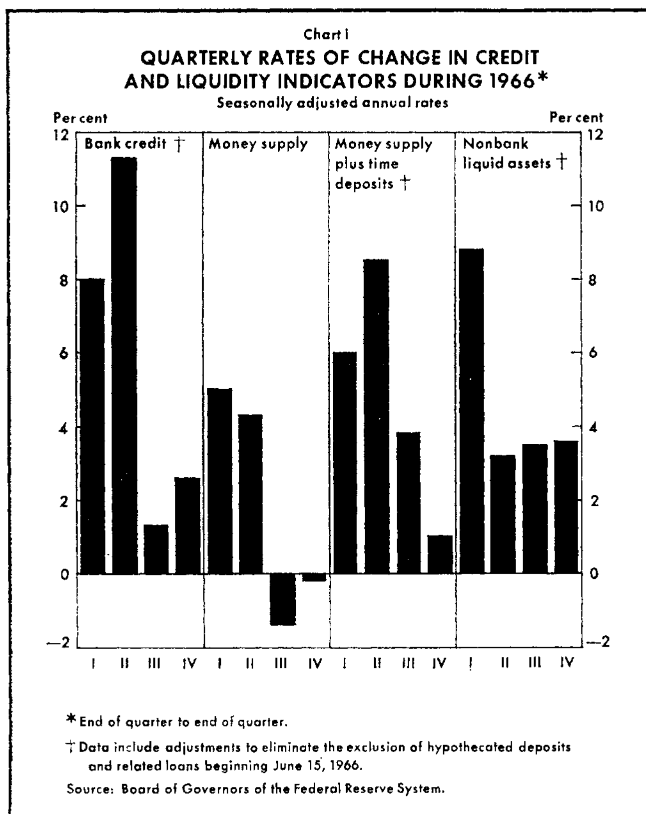
BANK CREDIT AND LIQUIDITY

Despite a strong December gain, total loans and investments of commercial banks[1] expanded during the final three months of the year at a modest 2.6 per cent seasonally adjusted annual rate (see Chart I). The decline in seasonally adjusted total bank credit that showed up in the statistics for September continued into the early part of the fourth quarter. However, the changed pattern of corporate tax payments and tax borrowing—a development not accounted for in the seasonal adjustment factors—may have contributed to this abrupt decline. For the year as a whole, total bank credit grew 5.9 per cent —much more in line with real economic activity than the 10.2 per cent gain of 1965 (see Chart II).

Total loans less securities loans at all commercial banks grew at a 3.0 per cent seasonally adjusted annual rate during the fourth quarter, bringing the rate for the entire year to 10.0 per cent, one-third below the 1965 pace. Loans to brokers and dealers for purchasing and carrying securities, however, expanded strongly in the fourth quarter—especially in December—as nonbank United

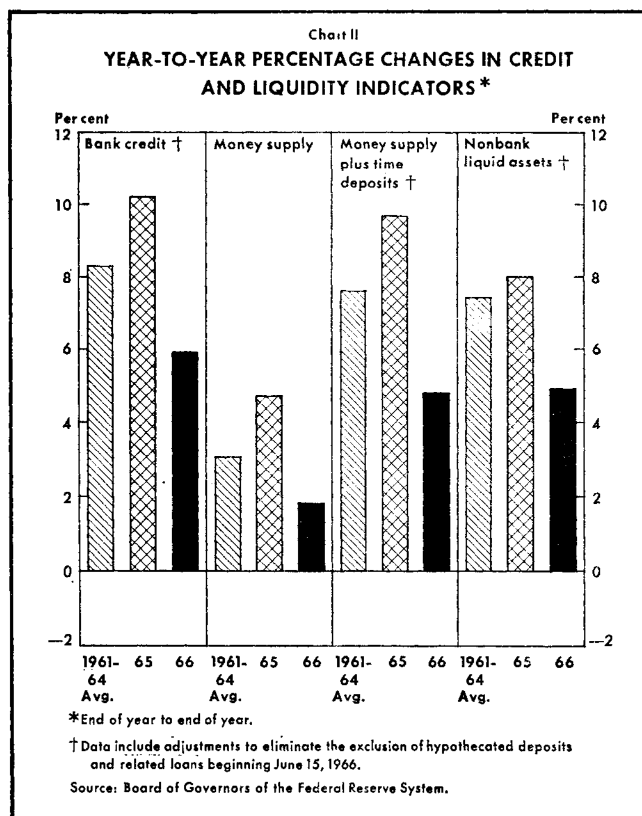
[1] The data for bank credit and relevant components have been adjusted to eliminate the effects of the exclusion of loans related to hypothecated deposits and the reclassification of participation certificates, both beginning June 15, 1966.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



Commercial banks in December expanded their holdings of United States Government securities by $1.4 billion (seasonally adjusted), in an apparent attempt to rebuild their liquidity positions. For the quarter as a whole, however, holdings of Governments at all commercial banks were unchanged on a seasonally adjusted basis, with the November and December increases offsetting the heavy October liquidation. Holdings of other securities by commercial banks remained steady during the fourth quarter, on a seasonally adjusted basis. For the year as a whole, other securities—which mainly consist of tax-exempt obligations of state and local governments and issues of United States Government agencies—were higher by $2.5 billion, the smallest increase since 1960. Holdings of Government securities declined by the same amount in 1966 as in 1965—$3.4 billion.

The loan-deposit ratio of commercial banks in the aggregate remained virtually unchanged at 65.5 per cent during the fourth quarter. At New York City weekly reporting banks, however, where negotiable C/D's declined over the quarter, the loan-deposit ratio moved up 2.0 percentage points to an average of 79.6 per cent in December. Outside States Government securities dealers took advantage of lower financing costs to rebuild their depleted inventories in anticipation of higher market prices in the new year.



The fourth-quarter weakness in bank lending was especially apparent in the performance of business loans. The 4.6 per cent annual rate of increase of these loans was less than one half of the third-quarter pace, and was far below the exceptional 20.2 per cent first-half rate. The further slowing of business loans in the fourth quarter extended the downward trend that first began to show up after midyear, following especially heavy business tax borrowing in the second quarter. The continued high cost and limited availability of bank loans may have resulted in greater reliance by businesses on alternative sources of funds during the fourth quarter. Overborrowing earlier in the year, reflecting fears of a future shortage of loanable funds, also could have been a factor in the slowdown of business loan expansion later in the year. Reduced business loan growth in the second half of the year brought the expansion for the entire year to 14.3 per cent, down from the exceptionally strong 18.5 per cent expansion of 1965.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

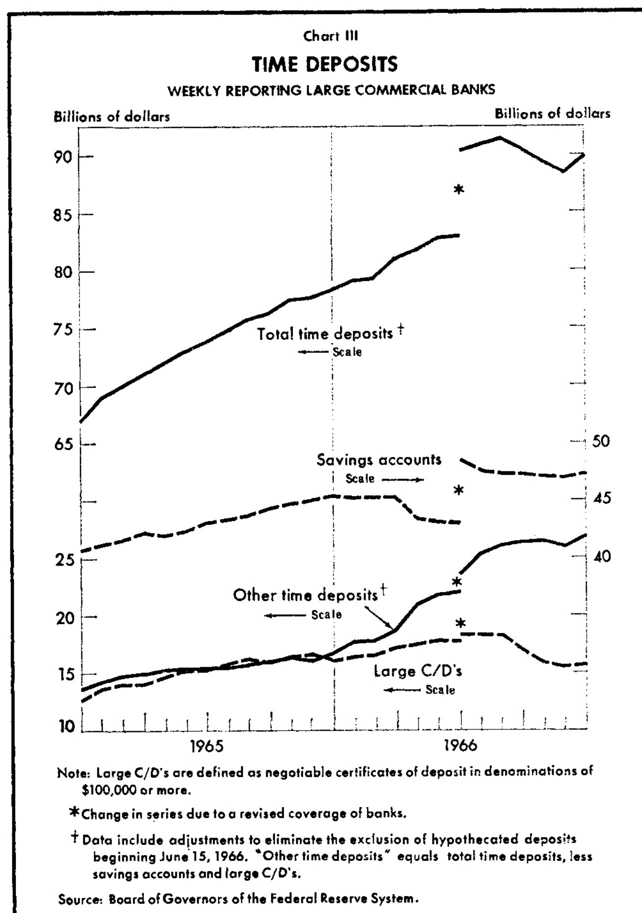
New York City, the ratio at weekly reporting banks declined fractionally to 69.1 per cent.

Member bank reserve positions were under decreasing pressure in the closing months of 1966. During the fourth quarter, nonborrowed reserves fell slightly on a seasonally adjusted basis, but required reserves were reduced somewhat more. As reserve availability improved during the quarter, banks were able to reduce their borrowings at Federal Reserve Banks, from a daily average of $766 million in September to $557 million in December. Net borrowed reserves dropped sharply from a daily average of $431 million in October to $161 million in December.

MONEY SUPPLY, BANK DEPOSITS, AND LIQUID ASSETS

The slowdown in bank credit growth in the second half of 1966 was accompanied by a slowing of the growth of the total of money supply plus commercial bank time deposits (see Chart I). This series grew at a seasonally adjusted annual rate of only 1.0 per cent in the fourth quarter,[2] well below the already modest pace of the third quarter. For the entire year, the money supply plus time deposits expanded by 4.9 per cent, approximately one half that of 1965. The money supply—privately held demand deposits plus currency outside banks—declined at an annual rate of 0.2 per cent in the fourth quarter, following a 1.4 per cent per annum rate of decline in the third quarter. In both quarters, the decline reflected a drop in privately held demand deposits; currency in circulation outside banks continued to rise. The growth of the money supply for the entire year, at 1.9 per cent, was less than half the 1965 rate, and well below that of the 1961-64 period (see Chart II).

The attraction of high yields on competing forms of financial investment, reinforced to some extent by the reduced maximum permissible rate of 5 per cent on consumer-type time deposits put into effect on September 26, made it difficult for commercial banks to obtain and keep time deposits during the first two months of the quarter. Thus, despite some net gains in December, total time and savings deposits, on a seasonally adjusted daily average basis, rose only 2.3 per cent in the quarter, well below the 9.6 per cent pace of the previous quarter. For the year as a whole, these deposits expanded 8.3 per cent



Note: Large C/D's are defined as negotiable certificates of deposit in denominations of $100,000 or more.

*Change in series due to a revised coverage of banks.

† Data include adjustments to eliminate the exclusion of hypothecated deposits beginning June 15, 1966. "Other time deposits" equals total time deposits, less savings accounts and large C/D's.

Source: Board of Governors of the Federal Reserve System.

as compared with a 16.0 per cent rate in 1965.

One of the major reasons for the modest growth in time deposits during the fourth quarter was the continued runoff in large-denomination C/D's outstanding. These deposits fell by $1.3 billion at weekly reporting banks over the three months as a whole, about the same as in the third quarter (see Chart III). Faced with an interest rate ceiling of 5½ per cent on large C/D's, commercial banks in October and November continued to find it difficult to compete with higher yielding market instruments. However, in December, as rates on some competing money market investments declined, weekly reporting banks experienced a $180 million increase in large C/D's, the first such increase since May. By the end of January, the further expansion of these deposits had brought the level of outstanding C/D's back three fourths of the way to the peak of last August.

Another important reason for the diminished growth in total time deposits was the small fourth-quarter rise in

[2] The time deposit data have been adjusted to eliminate the effects of the exclusion of hypothecated deposits beginning June 15, 1966.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"other time deposits", which consists primarily of small-denomination savings certificates. After growing rapidly during the first three quarters of 1966, these deposits advanced at weekly reporting banks by only $148 million in the final three months. This development was associated with attractive deposit rates at other savings institutions, coupled with the September reduction to 5 per cent (from 5½ per cent) in the ceiling rate on commercial bank time deposits under $100,000.[3]

According to preliminary estimates, holdings of liquid assets by the nonbank public, seasonally adjusted, moved up in the fourth quarter, but at a relatively low 3.6 per cent annual rate, just slightly above the already reduced rates of the second and third quarters (see Chart I). Growth for the entire year, at 4.9 per cent, was far below the 8.0 per cent rate of last year. The major factor limiting the rise of liquid assets in the final three months of 1966 was a sharp decline in holdings of United States Government securities with maturities of one year or less. Apparently, declining yields on short-term Government issues since mid-September made these somewhat less attractive to nonbank investors. Deposit growth at savings and loan associations and mutual savings banks improved in the final quarter of the year, however, and the November and December deposit gains were quite strong.

Because gross national product advanced in the fourth quarter almost twice as fast as liquid assets, the ratio of the nonbank public's holdings of liquid assets to GNP dropped to 78.9 per cent, the eighth consecutive quarterly decline in this broad-gauge measure of liquidity.

[3] See this *Review* (October 1966), page 221, footnote 2.

New Publications

The Federal Reserve Bank of New York has published a 234-page book, *Central Bank Co-operation: 1924-31,* by Stephen V. O. Clarke. In the foreword, Mr. Hayes, President of the Bank, states that the book deals with "the efforts of American, British, French, and German central bankers to reestablish and maintain financial stability in 1924-31 and the frustration of those efforts during the financial crisis at the end of that period". The author has used the historical records of this Bank and unpublished papers of various prominent Americans to bring new insight to an important period of central bank history. Copies are available at $2.00 each. Educational institutions may obtain quantities for classroom use at $1.00 per copy.

Money, Banking, and Credit in Eastern Europe, written by George Garvy, Economic Adviser, was published late last year by the Federal Reserve Bank of New York. The 167-page book examines the role of banking and credit policy in seven communist countries and focuses on developments arising from recent changes in economic policy. Copies are available at $1.25 a copy and at a special rate of 65 cents a copy to educational institutions on quantity orders.

These books may be ordered from the Public Information Department, Federal Reserve Bank of New York, New York, N. Y. 10045, at the prices indicated, plus New York City sales tax, where applicable.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Money and Bond Markets in January

Prices rose considerably further in the bond markets in January, and most short-term interest rates declined appreciably. The State of the Union message on January 10, in which the President requested a tax increase and expressed the Administration's intention to strive toward the attainment of lower interest rates, bolstered confidence throughout the financial markets and was followed by a sharp rise in the prices of stocks and bonds. Some caution appeared in the bond market around the time of the budget message on January 24, when the market also awaited the terms of the Treasury's February refinancing which some thought might be broadened to include a pre-refunding of issues maturing later this year. When the Treasury announced on January 25 a routine cash refunding of the February maturities through the sale of two new notes, bond prices rose. The advance accelerated after the cut in the British bank rate and in the prime lending rate of United States commercial banks. A more restrained tone developed toward the end of the month, but yields on Treasury notes and bonds were down over the month as a whole by approximately 20 basis points in the three- to five-year maturity area and by 15 basis points in the long-term area. As a result, yields for most coupon issues reached their lowest levels since late in 1965. A good demand was evident in the markets for corporate and tax-exempt bonds in January. The relatively heavy volume of new flotations was readily absorbed, and prices of new and seasoned bonds continued to advance during most of the period.

In the money market, the month was highlighted by the steady downward movement of short-term interest rates, climaxed by reductions in the prime lending rate of commercial banks announced late in the period. Treasury bill rates declined further during the month, while rates on various other short-term money market instruments—including time certificates of deposit (C/D's), bankers' acceptances, and commercial paper—and dealer loans were all reduced over the period. On January 30, new three-month Treasury bills were sold at an average issuing rate of 4.486 per cent, the first time since last June that this rate was below the discount rate. While nationwide reserve availability expanded somewhat in January, the reserve positions of banks in the leading money centers moved into substantial deficits in the first half of the month, partly as a result of a sharp rise in their loans to United States Government securities dealers. Subsequently, reserves again shifted back toward the money centers, contributing to an easier tone in the money market.

THE MONEY MARKET AND BANK RESERVES

The money market remained comfortable in January. Most Federal funds trading took place in a 4 to 5½ per cent range, compared with the 5 to 5½ per cent range which had predominated in December. Treasury bill rates continued to edge downward while, by the close of the month, dealers in bankers' acceptances were quoting a 4⅞ per cent (bid) rate on ninety-day unendorsed acceptances, ¾ of a per cent lower than a month earlier. Offering rates on prime four- to six-month dealer-placed commercial paper declined by ⅝ of a per cent over the month to 5⅜ per cent, while rates on various maturities of directly placed finance company paper fell by ⅝ to ¾ of a per cent. In addition, New York City banks lowered their offering rates on large new C/D's from the 5½ per cent ceiling at which such rates had held since last August. By January 25, the most frequently quoted offering rate on various maturities of new certificates had declined to 5⅜ per cent, and some banks were posting rates as low as 5¼ per cent. In addition, the volume of C/D's outstanding at commercial banks expanded dramatically during the month. The reporting banks throughout the nation experienced a $2.2 billion rise in their outstanding certificates over the four weeks ended January 25, and thus had recouped by late January approximately three fourths of the dollar amount of the certificates lost from midsummer through late 1966.

Nationwide reserve availability increased moderately in January from the average level in December, while average member bank borrowings from the Federal Reserve Banks contracted (see Table I). Despite the apparent easing of reserve pressures in the nation as a whole, the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1967

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

Factors	Changes in daily averages—week ended				Net changes
	Jan. 4	Jan. 11	Jan. 18	Jan. 25	
"Market" factors					
Member bank required reserves*	— 539	+ 412	+ 320	+ 46	+ 239
Operating transactions (subtotal)	+ 190	— 497	+ 214	+ 53	— 40
Federal Reserve float	— 284	— 276	— 106	— 85	— 751
Treasury operations†	— 27	— 107	— 58	— 135	— 327
Gold and foreign account	— 13	+ 24	— 7	— 25	— 21
Currency outside banks*	+ 475	+ 10	+ 452	+ 361	+ 1,298
Other Federal Reserve accounts (net)‡	+ 40	— 148	— 69	— 63	— 240
Total "market" factors	— 349	— 85	+ 534	+ 99	+ 199
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 434	+ 303	— 203	+ 109	+ 643
Bankers' acceptances	+ 2	+ 9	— 2	— 1	+ 8
Repurchase agreements:					
Government securities	— 152	+ 42	— 408	— 106	— 624
Bankers' acceptances	+ 17	— 5	— 87	— 40	— 115
Federal agency obligations	+ 1	— 22	— 5	—	— 26
Member bank borrowings	+ 17	+ 20	— 368	+ 321	— 10
Other loans, discounts, and advances	— 10	—	—	— 1	— 11
Total	+ 307	+ 348	—1,073	+ 282	— 136
Excess reserves*	— 42	+ 263	— 539	+ 381	+ 63
	Daily average levels				
Member bank:					
Total reserves, including vault cash*	24,662	24,513	23,654	23,989	24,205§
Required reserves*	24,267	23,855	23,535	23,489	23,787§
Excess reserves*	395	658	119	500	418§
Borrowings	565	585	217	538	476§
Free reserves*	— 170	73	— 98	— 38	— 58§
Nonborrowed reserves*	24,097	23,928	23,437	23,451	23,728§
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	— 66	+ 93	— 120	+ 297	+ 204
More than one year	—	—	—	—	—
Total	— 66	+ 93	— 120	+ 297	+ 204

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

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JANUARY 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended				Average of four weeks ended Jan. 25
	Jan. 4	Jan. 11	Jan. 18	Jan. 25	
Eight banks in New York City					
Reserve excess or deficiency(—)*	19	30	16	22	22
Less borrowings from Reserve Banks	201	255	3	—	115
Less net interbank Federal funds purchases or sales(—)	945	1,222	940	440	887
Gross purchases	*1,266*	*1,648*	*1,753*	*1,256*	*1,481*
Gross sales	*321*	*426*	*812*	*815*	*594*
Equals net basic reserve surplus or deficit(—)	—1,128	—1,446	— 927	— 419	— 980
Net loans to Government securities dealers	1,210	1,114	918	1,111	1,088
Thirty-eight banks outside New York City					
Reserve excess or deficiency(—)*	28	15	9	27	20
Less borrowings from Reserve Banks	232	187	82	396	224
Less net interbank Federal funds purchases or sales(—)	643	1,467	1,853	1,398	1,340
Gross purchases	*1,473*	*2,024*	*2,353*	*1,932*	*1,946*
Gross sales	*831*	*558*	*501*	*533*	*606*
Equals net basic reserve surplus or deficit(—)	— 846	—1,639	—1,925	—1,767	—1,544
Net loans to Government securities dealers	396	849	1,040	818	776

Note: Because of rounding, figures do not necessarily add to totals.
* Reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In per cent

Maturities	Weekly auction dates—January 1967			
	Jan. 9	Jan. 16	Jan. 23	Jan. 30
Three-month	4.818	4.716	4.680	4.486
Six-month	4.890	4.686	4.662	4.460

Maturities	Monthly auction dates—November 1966-January 1967		
	November 23	December 27	January 24
Nine-month	5.552	4.920	4.656
One-year	5.519	4.820	4.576

* Interest rates on bills are quoted in terms of a 360-day year, with the discounts from par as the return on the face amount of the bills payable at maturity. Bond yield equivalents, related to the amount actually invested, would be slightly higher.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

major money market banks experienced steadily deepening basic reserve deficits during the first half of the month, partly reflecting a very sharp rise in their loans to Government securities dealers. In the two weeks ended January 18, the forty-six major reserve city banks had aggregate deficits averaging approximately $3 billion, the highest on record (see Table II). These banks were able, however, to fill the bulk of their reserve needs in the Federal funds market, where excess reserves were readily available at rates generally lower than in December. Consequently, borrowings by these banks from their Federal Reserve Banks remained moderate during this period. In the latter part of January, the basic reserve positions of banks in the central money market—and to a much lesser extent in reserve centers outside New York—improved when the nationwide distribution of reserves shifted more in favor of the money market banks.

THE GOVERNMENT SECURITIES MARKET

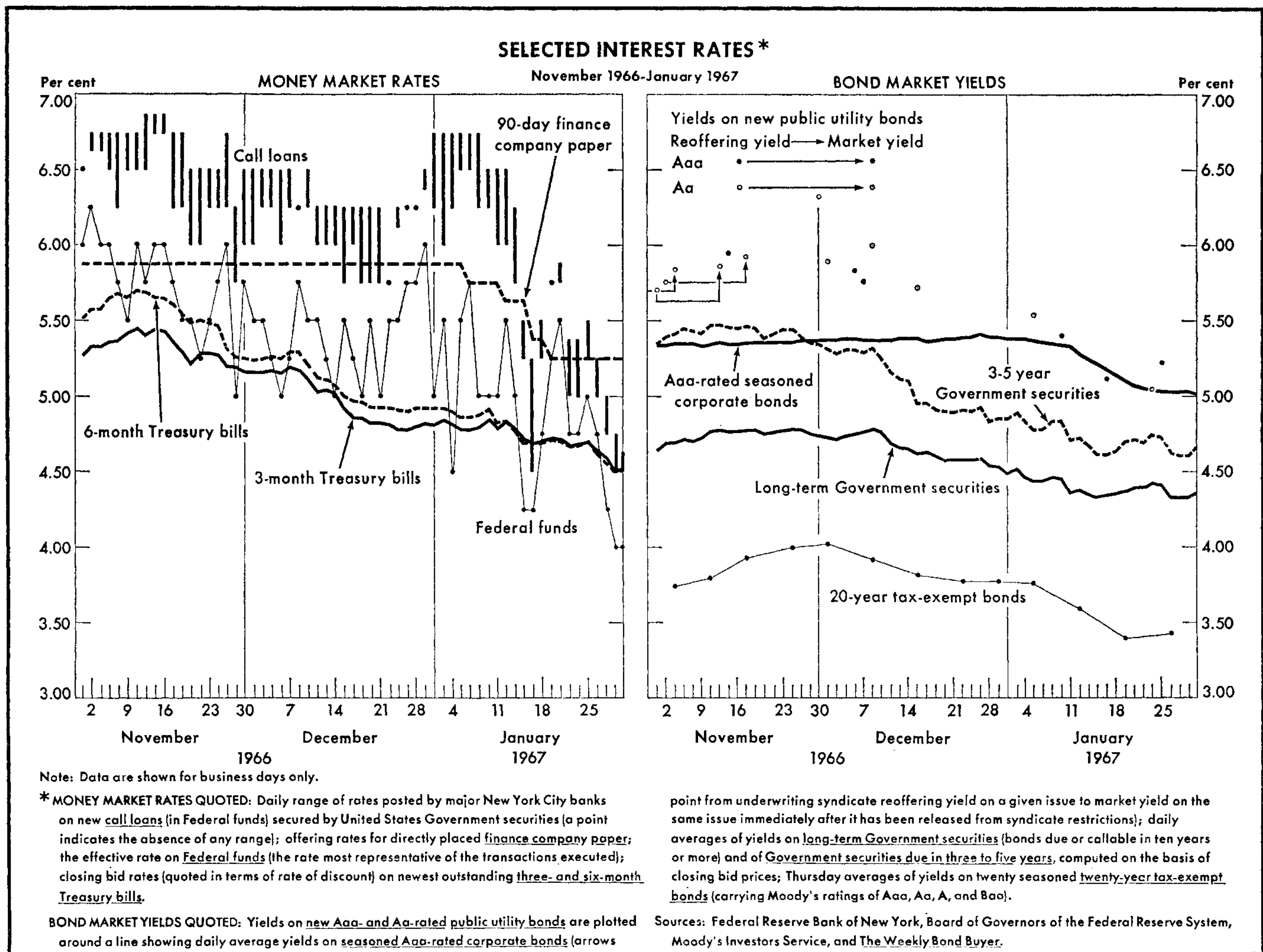
The rising trend in prices, which had prevailed in the market for Treasury notes and bonds in December, generally persisted in January. As the new year opened, most market participants continued to feel that, with some relaxation of monetary policy, the financial tides were shifting and the outlook for lower interest rates was improving. Over the first third of January, prices of coupon issues fluctuated irregularly and activity contracted as traders awaited the details of the President's State of the Union address. During this period, the coupon sector reacted cautiously to reports (subsequently confirmed) that the Export-Import Bank was planning to offer between $400 million and $500 million of participation certificates in February. At the same time, however, bond traders were encouraged by the excellent investor receptions being accorded both to an offering of participation certificates by the Federal National Mortgage Association and to a large telephone company bond flotation.

Prices of Treasury notes and bonds rose sharply, following the President's January 10 State of the Union message. Although some observers foresaw strong Congressional opposition to the President's request for higher individual and corporate income taxes, most market participants viewed the proposal as constructive and interpreted the President's general remarks on interest rates as improving the price outlook for various debt instruments. As a result, price quotations for Treasury notes and bonds rose ¼ of a point to almost 2 full points in initial trading on January 11.

Subsequently, a basically confident atmosphere persisted in the coupon sector, but prices of notes and bonds reacted unevenly to several developments. Market sentiment was buoyed by the bullish attitudes expressed in several market advisory letters, by the continuation of comfortable conditions in the money market, by talk of further peace moves in Vietnam, and by news that the United States and four major European nations had agreed to make cooperative efforts toward achieving lower interest rates. Activity gradually contracted, however, as participants awaited the terms of the Treasury's forthcoming February refunding operation. In this environment, some caution reemerged following reports that considerable resistance was developing in Congress to the President's surtax proposal, and in reaction to indications in the President's budget message that substantial public offerings of participation certificates were in prospect for fiscal 1968. From January 12 through January 25, prices of Treasury notes and bonds maturing in five years moved irregularly while prices of longer term issues declined. Although some profit taking on the part of dealers and investors appeared during this period, the underlying tone of the market remained fairly confident.

On January 25, the Treasury announced the terms of its February refunding. Its offering consisted of approximately $5.5 billion of new 4¾ per cent fifteen-month notes maturing in May 1968, priced to yield about 4.85 per cent, and $2 billion of new 4¾ per cent five-year notes maturing in February 1972 and priced to yield about 4.84 per cent. Subscription books were open only on January 30 for the new notes which will replace $2.4 billion of 3⅝ per cent notes and $5.2 billion of 4 per cent notes coming due on February 15. The market responded quite enthusiastically to the refunding announcement and to the fact that a pre-refunding was not included. In addition, the subsequent news that the British bank rate had been reduced from 7 per cent to 6½ per cent and that the prime lending rate of most United States commercial banks had been lowered from 6 per cent to 5¾ per cent (one major bank cut its prime rate to 5½ per cent) considerably strengthened market sentiment. In reaction, prices of intermediate- and long-term coupon issues moved sharply higher until late in January. In the closing days of the month, offerings expanded somewhat—partly reflecting sales of notes and bonds by investors switching into the new refunding issues—and prices edged lower. Over the month as a whole, prices of outstanding issues maturing within five years ranged from 2/32 to 1 4/32 points higher, those of five- to ten-year obligations ranged from 20/32 to 1 6/32 points higher, while quotations on longer term issues rose by 26/32 to 2 10/32 points. (The right-hand panel of the chart illustrates the movements in yields which accompanied these price changes.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis



Note: Data are shown for business days only.

* MONEY MARKET RATES QUOTED: Daily range of rates posted by major New York City banks on new call loans (in Federal funds) secured by United States Government securities (a point indicates the absence of any range); offering rates for directly placed finance company paper; the effective rate on Federal funds (the rate most representative of the transactions executed); closing bid rates (quoted in terms of rate of discount) on newest outstanding three- and six-month Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new Aaa- and Aa-rated public utility bonds are plotted around a line showing daily average yields on seasoned Aaa-rated corporate bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and of Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields on twenty seasoned twenty-year tax-exempt bonds (carrying Moody's ratings of Aaa, Aa, A, and Baa).

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, and The Weekly Bond Buyer.

On February 1, the Treasury released the results of the refunding operation. Subscriptions up to $100,000 for the new notes of May 1968 will be allotted in full, while larger subscriptions will be subject to a 10 per cent allotment (but assured of an allotment of at least $100,000 per subscription). Subscriptions up to $50,000 for the new notes of February 1972 will be allotted in full, with larger subscriptions subject to a 7 per cent allotment (but assured of a minimum allotment of at least $50,000 per subscription). All subscriptions from official and other governmental accounts were allotted in full.

A confident tone was also evident in the market for Government agency obligations in January, and prices of most issues rose on balance during the period. For the month as a whole, new public offerings by agencies totaled approximately $2 billion and were accorded good investor receptions. Early in the period, market attention focused on a $600 million public offering by the Federal National Mortgage Association of five-, ten-, and fifteen-year participation certificates. (An additional $500 million of certificates was sold directly to Treasury trust accounts.) The new participation certificates—the first to be issued since June of last year—were priced at par to yield 5.20 per cent and attracted considerable investor interest. Later in the period, the Export-Import Bank confirmed reports that it would offer $500 million of participation certificates on February 7.

In the market for Treasury bills, where yields had fallen sharply in December, rates receded further in January. During the first third of the month, bill rate declines were

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

held in a narrow range. Although investment demand for Treasury bills remained fairly extensive during this period, the relatively high dealer loan rates being posted by New York City banks had some restraining effect on professional participants and commercial banks expanded their sales of shorter term bills. The President's State of the Union remarks about interest rates and tax policy buoyed the bill sector, and rates fell sharply on January 11. The demand for bills subsequently expanded, dealer financing costs eased, and bill rates edged irregularly lower from January 12 through the end of the month (see the left-hand panel of the chart). At the regular monthly auction of new nine- and twelve-month bills on January 24, average issuing rates were set at 4.656 per cent and 4.576 per cent, respectively, 26 and 24 basis points below average rates set a month earlier (see Table III). At the final regular weekly auction of the month on January 30, average issuing rates were set at 4.486 per cent for the new three-month bills and 4.460 per cent for the new six-month issue, 34 and 45 basis points, respectively, below average rates at the comparable auction a month earlier.

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, prices continued to advance on balance in January. (Note the comparable sharp drop in yields illustrated in the right-hand panel of the chart.) Underwriters generally bid aggressively for the substantial volume of new corporate and tax-exempt bond flotations during the month. Investor interest in the new issues proved strong, with commercial bank demand for tax-exempt bonds especially significant during the period.

In the corporate sector, the largest new bond offering in January consisted of $250 million of Aaa-rated 5½ per cent American Telephone and Telegraph Company debentures that reached the market on January 10. The obligations, which are due to mature in 1997, carry five-year call protection. The issue, reoffered to yield 5.40 per cent, was accorded an excellent reception by investors and quickly advanced in price. The pricing of this issue was in sharp contrast to that of a comparable telephone company bond flotation last August, which was reoffered to yield 5.58 per cent and traded later that month at yields as high as 5.82 per cent. On January 17, a $40 million Aaa-rated power company utility issue, maturing in 1997 and carrying five-year call protection, was reoffered to yield 5.12 per cent, 28 basis points below the original reoffering yield on the January A.T.&T. issue. Later in the month, a relatively small Aa-rated utility issue, maturing in 1997 and carrying five-year call protection, was reoffered to yield 5.05 per cent and encountered some investor resistance.

In the tax-exempt sector, the largest January bond flotation consisted of $114 million of New York City various-purpose bonds which were reoffered to yield from 3.10 per cent in 1968 to 3.90 per cent in 1997. The bonds, which were Baa-rated by Moody's, attracted a fairly good investor interest. In October 1966, reoffering yields on a New York City bond issue ranged from 4.50 per cent to 4.60 per cent for bonds maturing in the 1968 to 1971 interval and from 4.55 per cent to 4.50 per cent for bonds maturing from 1972 to 1997.

Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds fell by 37 basis points to 5.02 per cent. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying ratings ranging from Aaa to Baa, dropped sharply by 34 basis points to 3.43 per cent (see the right-hand panel of the chart). These indexes are, however, based on only a limited number of seasoned issues and do not necessarily reflect market movements fully, particularly in the case of new and recent issues.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis