

FEDERAL RESERVE BANK OF NEW YORK



MONTHLY REVIEW

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The Business Situation

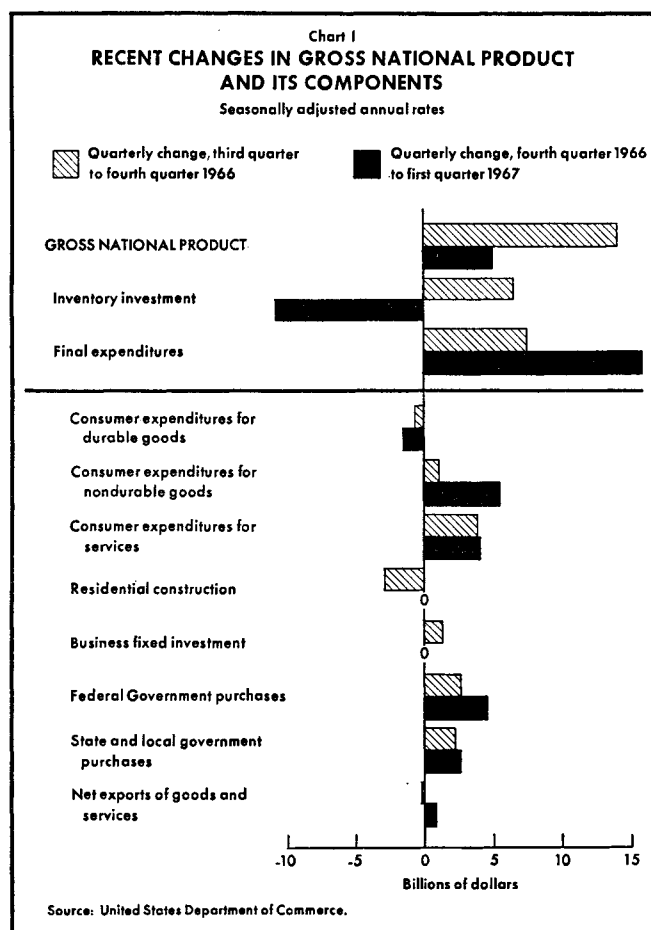
The slower growth of the economy during the early months of 1967 is reflected in the preliminary first-quarter gross national product (GNP) estimates. The rise in aggregate spending for goods and services was one of the smallest in recent years. Moreover, after allowing for the effects of higher prices, there was no change at all in the real volume of national output. The decline in the economy's pace of expansion was primarily the result of a huge cutback in the rate of inventory investment. This reduction in inventory accumulation, from the unsustainably high pace reached in the fourth quarter, went far toward offsetting a very strong overall gain in other demand components. The rise in spending was centered in consumer demand, which showed renewed vigor in the first quarter, and in government demand for goods and services.

The moderation in the overall pace of activity during the quarter resulted in some easing of the pressures on the economy's productive resources. There was a slowdown in the growth of employment and a decline in the rate of manufacturing capacity utilization. The average rate of unemployment in the civilian labor force nevertheless remained at the relatively low 3.7 per cent reached in the fourth quarter. The wholesale price index for industrial commodities held steady in March and apparently in April as well. This recent stability has been due to a further easing of industrial raw materials prices, coupled with a slowdown in the rate of increase in prices of machinery and other finished products. Agricultural prices fell off throughout the first quarter and are estimated to have dropped again in April. As a result, April will apparently see the third consecutive monthly decline in the total wholesale price index. At the consumer level, there have been no actual declines in the total price index but the rate of increase was quite modest during the first quarter. Though consumer food prices have declined in recent months, the reduction has been less steep than that recorded at the wholesale level. Other consumer prices have continued to rise, though at a slower rate than last year, with the index for services continuing to show the sharpest advance.

The most recent data on economic activity suggest that the spring opened on a relatively strong note. However, some of these data are still preliminary and, in any event, indicators for just one month cannot be treated as giving firm evidence of any basic shift in economic conditions. Nevertheless, recent weeks have been marked by a very substantial swing toward greater optimism regarding the prospects for the economy over the months ahead. Personal income growth speeded up in March and retail sales rose sharply, while the unemployment rate edged slightly lower. More broadly, the picture in March was one of stability in a number of other key business indicators whose performance had previously been weak. Industrial production, the factory workweek, and housing starts all edged up slightly, while durable goods shipments and new car sales showed somewhat stronger increases. A positive factor bearing on the economic outlook was the report during April of a survey supporting earlier indications that business capital spending in 1967 will be modestly above last year's high level. In addition, there seems to be a growing consensus that government spending this year is rising more rapidly than had previously been projected, which has made some contribution to a strengthening of sentiment regarding the economic outlook.

GROSS NATIONAL PRODUCT IN THE FIRST QUARTER

According to the Commerce Department's preliminary estimate, aggregate spending for goods and services increased in the first quarter by \$5.0 billion (see Chart I), bringing GNP to a seasonally adjusted annual rate of \$764.3 billion. This represented a sharp slowdown in the growth of total output, the first-quarter increase being only a bit more than one third as large as the rise recorded in the final quarter of 1966. The major factor underlying this slowdown was the extremely sharp reduction in the pace of inventory accumulation. During 1966, and particularly in the latter part of the year, inventories had been expanding rapidly, and by the year-end it was evident that stocks were at a very high level relative to sales.



The cutback in the accumulation rate was therefore not surprising. As in the case of the preliminary first-quarter figures for other GNP components, the estimate of inventory accumulation rests on incomplete data and is subject to revision. On the basis of the available data, the Commerce Department estimates that inventory investment dropped off to an annual rate of \$5.5 billion, nearly \$11 billion below the excessive pace of the fourth quarter. This was the largest quarterly swing, either up or down, ever recorded in the rate of inventory investment. Business sales performance, however, was generally sluggish in the first quarter, though March brought some signs of improvement. While inventory-sales ratios in manufacturing declined in March, they nevertheless remained considerably higher than they had been as recently as the fourth quarter. Thus, despite the magnitude of the recent cutback in the rate of inventory investment, it is highly probable that there will be some further downward adjustment in the accumulation rate.

The cut in inventory accumulation exerted such a heavy drag on the growth of aggregate demand in the first quarter that it tended to obscure the fact that the overall rise in other GNP components was exceptionally large. Final expenditures—that is, GNP excluding inventory investment—grew by \$15.9 billion. This was by historical standards a very strong advance. Indeed, over the course of the past decade only six quarters have witnessed a larger percentage increase in final demand.

Increased spending for goods and services by all levels of government played a prominent role in the growth of demand in this year's first quarter. Federal nondefense purchases rose appreciably, after having moved down somewhat during the course of 1966, and there was an acceleration in the continual growth of spending by state and local governments. Federal outlays for defense purposes—which are four times as large as Federal nondefense purchases—marked up another sizable gain, the rise being about equal to last year's quarterly average. The advance brought the volume of defense spending to \$68.8 billion at a seasonally adjusted annual rate, equal to 9.0 per cent of total first-quarter GNP. Two years earlier, in the first quarter of 1965—which was prior to the major expansion of the United States commitment in Vietnam—defense spending was \$20 billion lower and equal to 7.3 per cent of GNP.

The first quarter was marked by renewed strength in consumer demand. The rise in total consumption spending was almost twice as large as the relatively weak fourth-quarter increase, even though disposable income grew by the same amount in both quarters. In contrast to the final three months of last year, when there was a sharp jump in the proportion of income saved, consumers were much more prone to spend in the first quarter and there was only a slight further rise in the percentage of income saved. The pickup in consumption spending was centered in demand for nondurable goods. The latest increase in spending on nondurables was the largest in more than a year, and marked a sharp change from the 1966 pattern of progressively smaller quarterly advances. At the same time, demand for services continued to grow strongly. Price advances continued, as in 1966, to account for a large share of the rise in consumption spending on services. By comparison with their impact on outlays for services, price rises have been playing a considerably smaller role in the growth of consumption spending on goods.

Consumer buying of durables dropped off for the second consecutive quarter. The decline in home building over the past year has been one factor behind the sluggishness of durables demand through its dampening effect on purchases of household durables. A major drag has been

exerted on durables consumption by the weak performance of automobile sales. In the first quarter, sales of new domestically produced cars averaged a seasonally adjusted annual rate of 7.3 million units, down 10 per cent from the fourth-quarter pace which was, in turn, 4 per cent under the third-quarter figure. After slumping sharply last spring, sales regained some strength during the summer but then fell again through the fall and winter. Recent data, however, suggest that the decline may have been stemmed. The sales rate was only 7.0 million units in February but then increased by about 2½ per cent in March and by a further 5½ per cent in April.

Outlays on residential construction in the first quarter are estimated to have held steady at the fourth-quarter annual rate of \$21.9 billion. This stability was in marked contrast to the declines that had cut the spending rate by a total of \$6.7 billion over the course of the preceding three quarters. The stability of spending between the fourth and first quarters reflected a monthly pattern that saw spending continue to decline through the last three months of 1966 and then rise in the January-March period. This trend stems from the recovery in housing starts that began late last year. The improvement in starts, which most analysts expect will continue, points to a further strengthening in residential construction spending over the months ahead.

Another GNP component contributing to the rise of aggregate demand in the first quarter was the net export of goods and services, which registered its first increase in almost two years. Typically, a contraction in net exports tends to occur in an economy marked by high and rising levels of production, heavy pressures on productive resources, and rising prices. Over the past two years, imports have consistently grown more rapidly than exports. The resulting shrinkage in net exports has been disappointing in view of the important part played by our trade balance in the effort to move toward equilibrium in the overall balance of payments. The recent rise brought the net export of goods and services to a seasonally adjusted annual rate of \$4.9 billion, almost \$1 billion above last year's fourth quarter but still well below the 1965 average of \$7.0 billion.

BUSINESS INVESTMENT, PRODUCTION, AND EMPLOYMENT

Business fixed investment spending failed to expand in the first quarter after four years of steady quarterly increases. The preliminary estimates indicate that a rise in spending on structures was just offset by a fall in the pace of producers' investment in machinery, vehicles, and other equipment. Following several years of vigorous expansion,

the further growth of capital investment outlays in 1966 was a major factor in the excessive demand pressures that characterized the economy through most of last year. The ratio of business fixed investment to total GNP rose somewhat above the advanced level reached in the capital goods boom of the midfifties and, despite the stability of outlays in the first quarter, the ratio has edged off only very slightly.

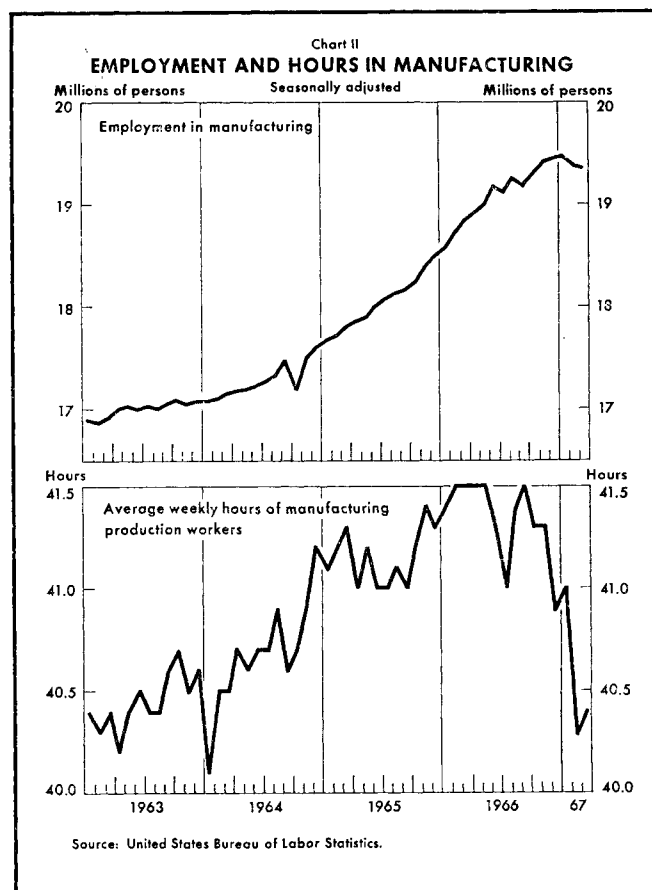
One factor working to dampen investment spending has been the suspension, as of last fall, of certain tax benefits for investment. The restoration of these benefits is now under consideration by Congress. In addition, an important influence has undoubtedly been exerted by recent trends in corporate profits and capacity utilization. Aggregate profits barely grew in last year's second quarter, then moved down a bit in the second half, and preliminary indications strongly suggest that there was a further drop early this year. At the same time, the utilization rate in manufacturing has eased, as capacity has continued to expand while output first showed a slower growth rate and then, in the first quarter, actually fell off.

A positive note in the outlook for capital investment has been provided by the most recent survey of business spending plans. This survey was conducted by McGraw-Hill in March, at a time when most businessmen had not had an opportunity to rethink their spending plans in the light of the proposed restoration of the investment tax benefits. It found that anticipated outlays for new plant and equipment in 1967 will add up to a 5½ per cent rise over 1966. The latest results thus confirm earlier findings—by McGraw-Hill in January and by the Commerce Department and Securities and Exchange Commission in February—pointing to a further, though relatively modest, advance in capital spending this year. The McGraw-Hill January survey had reported an anticipated 6 per cent advance in spending. A noteworthy aspect of the March results is that, despite the slowing of the economy in the early months of the year, McGraw-Hill did not find evidence of any major downgrading of investment plans. Between January and March, manufacturers of motor vehicles and fabricated metals made sizable cuts in spending plans, but nondurables producers generally revised their plans upward. Among the nonmanufacturing industries, utilities sharply boosted their spending estimates, but substantial reductions were made by the airlines and railroads, which are apparently affected quite severely by the tax benefit suspensions. The slowing of capital spending in the first quarter was reflected in a moderate decline in the output of business equipment in January and February, which was followed, however, by an apparent stabilization in March.

With stability in equipment output and modest gains in other production sectors, the Federal Reserve Board's seasonally adjusted index of industrial output rose a bit in March after two months of decline. Production of defense equipment showed another significant increase, while output of materials was about unchanged. Consumer goods production rose after a sizable drop in the first two months of the year, with the March advance primarily attributable to a recovery in automobile output. The March increase in auto assemblies, though strong, followed steep declines in the first two months of the year. Thus, despite the month's improvement, March output was at a seasonally adjusted annual rate of only about 6.9 million units, almost 20 per cent below the December rate. April apparently saw a further substantial rise in the auto assembly rate, even though trucking strikes during the month caused manufacturers to fall a bit behind their production schedules.

The volume of new orders for durable goods decreased a bit in March after having risen in February. The sharpest drop, more than accounting for the month's overall decline, was in orders received by steel producers. The defense-related industries, whose orders tend to fluctuate rather widely from month to month, also experienced a decline in March but increases were reported by producers of machinery and equipment. Durables shipments rose in March, on the basis of a substantial increase for the aircraft industry and modest gains for most other durables groups. With shipments once again exceeding the flow of new orders, the backlog of unfilled durables orders declined further. Over the first three months of this year, the total durables backlog shrank by about 3 per cent. In most major industries the declines were fairly moderate, but steel producers experienced a drop of nearly 25 per cent—which accounted for fully one third of the total shrinkage in the durables backlog. The slackening in the steel industry in the first quarter was attributable to the easing of demands in a number of sectors, especially in the automobile industry and in industries producing other consumer durable goods.

Developments in the labor markets have reflected the easing of demand pressures in the economy, but the employment picture has remained quite strong on balance. In the manufacturing sector, employers have recently cut back moderately on the number of production workers on their payrolls, while at the same time slowing the rate at which they add nonproduction workers. As a result, total manufacturing employment dropped off during the



first quarter (see Chart II). A much larger downward adjustment has been made in the average number of hours put in weekly by production workers. Thus, the bulk of the reduction in the number of man-hours worked in manufacturing, in response to an easing of demands, has occurred through a shortening of the workweek rather than through a cut in the number of employees.

In nonagricultural industries outside manufacturing, the employment picture was mixed in March. The number of workers on payrolls in government and the service industries continued to rise strongly, while declines were registered in trade and construction. In terms of the total civilian labor force, however, the continuation of relatively strong employment conditions in March was indicated by the slight drop in the unemployment rate, to 3.6 per cent from 3.7 per cent in the preceding three months.

The Money and Bond Markets in April

On April 6 ten Federal Reserve Banks announced reductions from $4\frac{1}{2}$ per cent to 4 per cent in their discount rates effective April 7, and by April 14 the two remaining Reserve Banks had taken similar action. The lowering of the discount rate had been preceded by sizable declines in market rates, and it touched off a round of further downward rate adjustments on short-term money market instruments. Market rates on outstanding issues of Treasury bills were bid sharply lower, and rates posted by the New York City banks on large-denomination negotiable certificates of deposit (C/D's) and on call loans to Government securities dealers were reduced. Rates on prime commercial paper, directly placed finance company paper, and bankers' acceptances declined by $\frac{1}{8}$ to $\frac{1}{2}$ of a percentage point during the early part of the month.

The money market was comfortable throughout April, as nationwide net reserve availability expanded and the Federal funds market functioned smoothly in redressing shifts in the distribution of reserves. Demands for funds in connection with April tax payments were substantial as a result of the speedup of payment schedules for corporate income taxes, withheld personal taxes, and social security contributions. As usual, these credit demands tended to converge on banks in the major money centers, which were also affected at midmonth by the payment for a new issue of New York State tax anticipation notes. The tax-related borrowings as well as the financing requirements of securities dealers were accommodated with facility by the money market. Although the city banks had a consistently large basic reserve deficiency, they were generally able to obtain their requirements through the Federal funds market at or below the discount rate.

Treasury bill rates moved irregularly lower throughout April, reflecting the comfortable atmosphere in the money market and a sustained investment demand for bills coming from corporations, commercial banks, and public funds. After being marked down sharply in response to the discount rate reduction, bill rates continued to fall over the remainder of the month.

The markets for intermediate- and long-term bonds de-

veloped a heavy tone in April, which contrasted sharply both with conditions in the short-term market and with the atmosphere of buoyancy that had prevailed during March. The deterioration in sentiment throughout the long-term area stemmed from a gradual reassessment of the prospects for a quickening in the economy and from increasing congestion in the markets for corporate and tax-exempt securities. Toward the end of March, inventories of aggressively priced recent offerings had begun to build on dealers' shelves. While the discount rate cut helped relieve this situation temporarily, investors subsequently were quite selective in taking up the heavy volume of new offerings of corporate and municipal bonds that came to market in April. In an atmosphere of developing caution, underwriters released a number of slow-moving issues from syndicate price restrictions with substantial upward yield adjustments.

BANK RESERVES AND THE MONEY MARKET

Money market conditions remained generally comfortable during April, as System open market operations provided reserves amply in the wake of the discount rate cut. Short-term interest rates fell sharply, and the money market handled very smoothly the sizable credit demands associated with the individual and corporate income tax dates at midmonth and with a heavy volume of corporate, municipal, and Federal agency financing. The money center banks, which came under considerable pressure, experienced little difficulty in covering their requirements through the Federal funds market.

The bulk of trading in Federal funds during April took place at the discount rate or below, whereas funds had frequently traded at a premium of $\frac{1}{4}$ percentage point in March. New call loans to Government securities dealers by the New York City banks were generally available at $4\frac{1}{8}$ to $4\frac{3}{8}$ per cent, compared with the 5 to $5\frac{1}{2}$ per cent range that had prevailed for some time prior to the discount rate reduction. The New York City banks sharply lowered their quoted rates on large negotiable C/D's

Table I
FACTORS TENDING TO INCREASE OR DECREASE
MEMBER BANK RESERVES, APRIL 1967

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

Factors	Changes in daily averages— week ended				Net changes
	April 5	April 12	April 19	April 26	
"Market" factors					
Member bank required reserves*	+ 2	+ 23	- 182	- 41	- 199
Operating transactions (subtotal)	- 351	- 202	+ 486	- 351	- 438
Federal Reserve float	- 216	+ 102	+ 331	- 298	- 81
Treasury operations†	+ 1	+ 48	- 191	- 290	- 432
Gold and foreign account	+ 7	- 5	+ 16	-	+ 18
Currency outside banks*	- 87	- 351	+ 185	+ 244	- 9
Other Federal Reserve accounts (net)‡	- 57	+ 3	+ 128	- 9	+ 65
Total "market" factors	- 349	- 180	+ 284	- 392	- 637
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 230	+ 81	+ 48	+ 210	+ 569
Bankers' acceptances	+ 1	+ 1	- 2	+ 3	+ 3
Repurchase agreements:					
Government securities	+ 113	- 70	- 127	+ 1	- 83
Bankers' acceptances	+ 3	+ 11	- 14	+ 20	+ 20
Federal agency obligations	+ 10	- 10	- 5	+ 2	- 3
Member bank borrowings	+ 45	- 35	+ 33	- 80	- 37
Other loans, discounts, and advances	+ 10	+ 7	+ 1	+ 4	+ 22
Total	+ 413	- 16	- 67	+ 162	+ 492
Excess reserves*	+ 64	- 106	+ 217	- 230	- 145

Member bank:	Daily average levels				
	23,391	23,173	23,572	23,383	
Total reserves, including vault cash*	23,391	23,173	23,572	23,383	23,380§
Required reserves*	22,942	22,920	23,102	23,143	23,027§
Excess reserves*	449	253	470	240	353§
Borrowings	180	145	178	98	150§
Free reserves*	+ 269	+ 108	+ 292	+ 142	+ 203§
Nonborrowed reserves*	23,211	23,028	23,394	23,285	23,230§

System Account holdings of Government securities maturing in:	Changes in Wednesday levels				
	+	-	+	-	
Less than one year	+ 711	- 365	+ 403	- 2	+ 747
More than one year	+ 68	+ 39	-	-	+ 107
Total	+ 779	- 326	+ 403	- 2	+ 854

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 April 26.

Table II
RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS
APRIL 1967

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended				Averages of four weeks ended April 26*
	April 5	April 12	April 19	April 26*	
Eight banks in New York City					
Reserve excess or deficiency (-)†	19	12	43	16	23
Less borrowings from Reserve Banks	95	47	64	-	52
Less net interbank Federal funds purchases or sales (-)	932	1,222	981	853	997
Gross purchases	1,241	1,637	1,584	1,500	1,491
Gross sales	309	414	603	647	493
Equals net basic reserve surplus or deficit (-)	-1,007	-1,258	-1,002	- 837	-1,026
Net loans to Government securities dealers	905	932	771	806	854
Thirty-eight banks outside New York City					
Reserve excess or deficiency (-)†	2	22	14	-	10
Less borrowings from Reserve Banks	46	57	64	53	56
Less net interbank Federal funds purchases or sales (-)	1,250	1,759	1,636	1,307	1,488
Gross purchases	1,884	2,343	2,235	2,081	2,136
Gross sales	634	583	599	774	1,488
Equals net basic reserve surplus or deficit (-)	-1,294	-1,794	-1,687	-1,362	-1,534
Net loans to Government securities dealers	750	1,000	903	623	819

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

* Estimated reserve figures have not been adjusted for so-called "as of" debits and credits. These items are taken into account in final data.

† 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—April 1967			
	April 3	April 10	April 17	April 24
Three-month	3.976	3.810	3.905	3.715
Six-month	3.998	3.856	3.950	3.772
Monthly auction dates—February-April 1967				
	February 21	March 28	April 25	
Nine-month	4.718	4.078	3.842	
One-year	4.696	4.074	3.832	

* 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.

during the first half of April to a range of 4 to 4¼ per cent, compared with 4½ to 4¾ per cent at the end of March. The adjustment reflected not only the discount rate change but also a preference on the part of the city banks to roll over, rather than build up, these liabilities. In the four weeks ended on April 26 the volume of C/D's outstanding at the major New York City banks declined \$257 million, whereas between mid-December 1966, when they were at a recent low point, and the end of March they had risen by \$1.4 billion. During the statement week ended on April 19, C/D's of the city banks dropped by \$212 million, and there was some tendency for C/D rates to edge slightly higher near the end of April.

Other short-term interest rates declined during April. Market rates on the three- and six-month maturities of Treasury bills dropped by 28 and 20 basis points, respectively, to 3.73 per cent and 3.86 cent over the month. In three separate steps between April 4 and April 11, the offering rate on directly placed finance company paper maturing in three months was lowered by ¾ of a percentage point to 4½ per cent. The dealers' offering rate on prime four- to six-month commercial paper was reduced in two stages by ¼ of a percentage point to 4¾ per cent, while the dealers' bid rate on ninety-day unendorsed bankers' acceptances was reduced by ⅛ of a percentage point to 4⅜ per cent.

Reserve positions of member banks were quite comfortable during April, with free reserves averaging \$203 million for the month (see Table I) compared with \$172 million (revised) in March. Average member bank borrowings from the Reserve Banks declined moderately to \$150 million from \$196 million in the preceding month. System securities transactions provided a large volume of reserves during the month, more than offsetting substantial reserve drains through "market" factors. Reserve availability tended to be reduced in the first two statement weeks by heavy currency withdrawals and, in the latter part of the month, by sharp increases in Treasury balances at Reserve Banks and in required reserves. The latter reflected the very large expansion in commercial bank deposits resulting from seasonal and tax-related increases in bank credit.

The banks in the money centers were subject to sizable pressures at midmonth as a result of the large tax payments due under accelerated payments schedules. During the statement week ended on April 19—covering the April 17 corporate and personal income tax payment date—business loans of all weekly reporting banks increased by \$646 million, more than four times the \$158 million expansion in the April 1966 tax week. Loans to sales finance companies, which had paper maturing on the tax

date, rose \$235 million, moderately less than the \$293 million increase a year earlier when there were no tax anticipation bills maturing. The volume of large negotiable C/D's outstanding at the reporting banks dropped by \$527 million in the most recent tax week, compared with a rise of \$65 million in the corresponding year-ago period. The much heavier credit demands in the latest tax week as well as drains resulting from C/D maturities were largely met through a net reduction in holdings of Government securities, entirely attributable to net sales of Treasury bills. The reporting banks' portfolio of bills fell by \$287 million over the week ended on April 19; in contrast, it had risen by \$271 million in the corresponding week of 1966.

THE GOVERNMENT SECURITIES MARKET

The market for Treasury securities provided a study in contrasts during April. Rates on Treasury bills, which had dropped sharply in March, fell even further in the wake of the cut in the Federal Reserve discount rate during early April. Yields on Treasury notes and bonds rose appreciably, however, as many participants revised upward their expectations of economic activity and as the corporate and municipal bond markets suffered increasing congestion. The yield advantage of three- to five-year issues over three-month Treasury bills, which had been 37 basis points at the end of March, rose to 93 basis points by the end of April.

The tone of the Treasury bill market was firm throughout April, reflecting the generally comfortable condition of the money market and a heavy investment demand coming from a number of sources. Commercial banks and corporations made frequent and substantial purchases of tax bills and other short issues, while states and municipalities also came to the market to invest current tax receipts. Over the month as a whole, market rates on outstanding Treasury bills declined by about 35 basis points within the three-month category and 16 basis points among issues due in six months to a year. In anticipation of the seasonal public fund buying, dealers bid enthusiastically in the regular weekly auctions of three- and six-month Treasury bills during April. Bidding was unusually aggressive in the auctions on April 10 and 24, and in the latter auction average issuing rates established on the three- and six-month issues dropped to 3.715 per cent and 3.772 per cent, respectively, the lowest such rates since the end of 1964. (For information on average issuing rates, see Table III.)

Prices of Treasury coupon issues held firm at the start of the month in rather listless trading, as the market marked time in expectation of a discount rate reduction.

Neither the announcement, which came after the close of the market on April 6, nor the simultaneous publication of statistics revealing a sharply increased level of free reserves for the first statement week ended in April generated much investment demand. Investors and professionals alike were affected by economic indicators suggesting that weakening tendencies in the economy might be abating. There was also growing concern over the developing congestion in the corporate and tax-exempt markets, evidenced by rising levels of dealers' inventories, the steady buildup in the April calendar of new offerings, and the difficulties of underwriters in distributing some new issues of corporate and municipal bonds. The intermediate area of the Treasury market was also depressed by the uncertainties surrounding the Treasury refunding of May 15 maturities, about which an announcement was anticipated near the month end, and by speculation that all other issues with 1967 maturities might be prerefunded as a part of the Treasury operation.

After drifting lower for a time, prices of Treasury coupon issues were marked down sharply around midmonth in adjustment to the higher yields established in the corporate and municipal markets after the termination of a number of syndicates. Although some investment demand did develop at the lower price levels, buying was not strong enough to offset earlier losses, and prices continued to work lower through the month end. For the month as a whole, prices of Treasury issues declined by as much as $1\frac{9}{32}$ points in the intermediate area and $3\frac{8}{32}$ points among the longer maturities.

After the close of the market on April 26, the Treasury announced an exchange offering of two new securities to holders of the five issues maturing through August 15, 1967. The maturing issues eligible for exchange include the $4\frac{1}{4}$ per cent notes due May 15, $2\frac{1}{2}$ per cent bonds due June 15, and three issues maturing on August 15: $5\frac{1}{4}$ per cent certificates, $3\frac{3}{4}$ per cent notes, and $4\frac{7}{8}$ per cent notes. Of the \$22.1 billion of the maturing securities outstanding, \$9.0 billion is held by the public. The new securities offered in the exchange are $4\frac{1}{4}$ per cent notes to mature August 15, 1968 and $4\frac{3}{4}$ per cent notes to mature May 15, 1972. Holders of the three August 15 issues that are being prerefunded, however, were permitted to exchange into the 1972 notes only. The new $4\frac{1}{4}$ per cent notes are priced at 99.95, to provide a yield of 4.29 per cent, while the $4\frac{3}{4}$ per cent notes are priced at par. Subscription books were open May 1 through May 3, and payment will be made on May 15. The market reacted favorably to the terms of the refunding, which were considered attractive, and prices of outstanding issues of notes and bonds were marked down in adjustment to yields

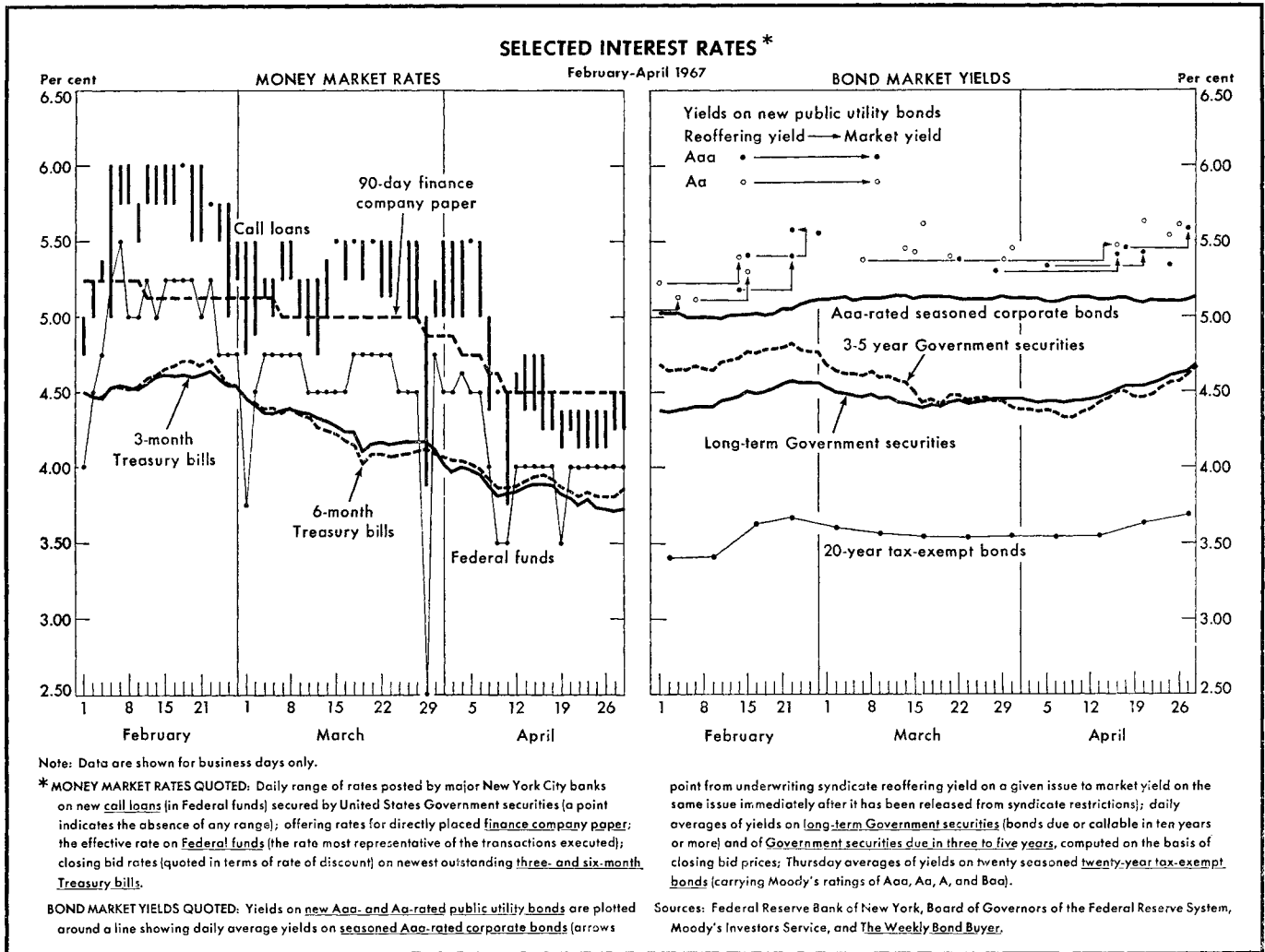
available on the new issues.

Government agency obligations were generally in good demand during April. After an initial markup following the announcement of the discount rate reduction, prices tended to follow the patterns in other sectors of the capital market. New offerings reaching the market during April totaled \$1.4 billion, and most issues received a very good investor response. The largest marketed was a \$400 million offering of Export-Import Bank participation certificates consisting of a \$250 million three-year issue and a \$150 million seven-year issue. These certificates were priced at par, with the three-year maturity yielding 4.80 per cent and the seven-year maturity yielding 5.125 per cent. In the sale, which took place on April 19, both maturities were accorded an excellent reception by investors. On April 26, the Federal National Mortgage Association offered \$300 million of two-year debentures with a coupon of 4.65 per cent and priced to yield 4.70 per cent. The offering, of which \$50 million was sold directly to Government investment accounts, was also well received.

OTHER SECURITIES MARKETS

Conditions in the markets for corporate and tax-exempt securities deteriorated considerably during April, as a steady stream of offerings of new securities, amounting to a near-record volume, failed to elicit substantial interest from investors even at rising yield levels. In part, this atmosphere reflected an overhang from the record \$2.8 billion of corporate and municipal issues marketed in the preceding month. Although the bulk of the March offerings had been taken by investors at progressively higher prices in a very buoyant market, a portion was left unsold at the month's end when signs of increasing resistance to the higher price levels became evident. As April opened, underwriters and professionals anticipated an announcement of a discount rate reduction, confident that such a move would contribute to a renewed vigor in the long-term markets. Contrary to expectations, however, the reduction of the discount rate early in the month did not aid substantially in the distribution of unsold balances. Investors tended to focus their attention on the mounting calendar of new offerings scheduled to be sold over the balance of the month. In addition, the release of current data suggesting that the economy might be on the verge of a renewed expansion led to an overall reappraisal of the outlook for interest rates.

In the corporate sector, a total of \$1.4 billion of securities was publicly offered during April at reoffering yields that moved gradually higher. Generally, those issues which sold well were large negotiated industrial issues carrying



ten-year call protection. For example, one \$200 million offering of sinking fund debentures by a large industrial corporation was accorded an excellent reception on April 26, when the market was quite lethargic. The issue, maturing in 1992 and nonrefundable for ten years, was reoffered to yield 5.34 per cent. Investors were considerably less receptive to the large flow of public utility bonds that had been awarded in competitive bidding. On April 17, four major syndicates involving about \$80 million of unsold utility bonds were terminated, resulting in upward yield adjustments of 9 to 15 basis points. (All but one of these four public utility issues had been originally reoffered in March.) Even at the higher yields, however, distribution of the issues proceeded slowly.

In the municipal market, new offerings during April

totalled \$0.9 billion. One sizable offering, a \$104.8 million New York City issue of Baa-rated various purpose bonds awarded on April 18, was accorded a good reception at reoffering yields ranging from 2.75 per cent for 1968 maturities to 4.25 per cent in 1997. (A similar offering by New York City three months earlier had carried yields that were 35 basis points higher on the shorter maturities and 35 basis points lower on the longest.) Syndicate price restrictions were terminated or relaxed during April on a number of tax-exempt offerings which were moving slowly. The largest of these was a \$100 million issue of Aa-rated State of California bonds originally reoffered on March 21 and still half unsold by mid-April. After the syndicate termination on April 18, the market yield on that issue rose by 20 basis points. The Blue List of advertised offerings

of tax-exempt issues stood at \$754 million at the close of April, compared with \$783 million at the end of March.

The average yield on Moody's Aaa-rated seasoned corporate bonds was nearly unchanged during April, closing the month at 5.13 per cent. *The Weekly Bond Buyer's* series for twenty seasoned tax-exempt issues, carrying

ratings ranging from Aaa to Baa, on the other hand, rose by 15 basis points to 3.69 per cent (see the right-hand panel of the chart). These indexes, however, are 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.

Recent Banking and Monetary Developments

The banking and financial system was strongly influenced during the first quarter of 1967 by the continuation of the move toward monetary ease that had been initiated by the Federal Reserve System late in 1966. During the three months ended in March 1967, the System provided member banks with an increased reserve base, and the nationwide net reserve position of member banks moved into surplus for the first time since early 1965. Despite a slackening of the demand pressures in the economy, the growth of bank credit and deposits accelerated.

As the supply of funds available for lending and investing grew, market rates of interest, particularly in the short-term area, continued the decline that began late last year. Commercial banks—whose liquidity positions were improving—cut the prime lending rate from 6 per cent at the start of the year to 5½ per cent by the end of March. The easier atmosphere in the financial markets was enhanced on February 28 when the Federal Reserve System announced the reduction of reserve requirements on certain types of time and savings deposits from 4 per cent to 3 per cent. By the end of the quarter, a reduction of the discount rate—the rate at which member banks may borrow from Reserve Banks—was widely anticipated, and a decrease, from 4½ per cent to 4 per cent, actually took place in early April.

Total bank credit advanced rapidly during the first quarter of 1967. Commercial bank investment portfolios grew strongly, as banks sought to rebuild their liquidity positions and employ newly available reserves. United States Government securities were taken eagerly, and other securities—such as tax-exempt state and local securities—were added in record amounts. Lending by commercial

banks, on a seasonally adjusted basis, expanded faster in the first quarter than during the latter part of 1966. In particular, business loans recovered from their relatively slow rate of advance in the second half of 1966, although increasing at a rate well below that of the hectic first half.

Both demand and time deposits rose strongly over the quarter. After falling in January, when accelerated corporation withholding and social security tax payments built up Treasury balances, the money supply increased rapidly. By midquarter, all major types of time and savings deposits at commercial banks were responding to the easier financial conditions. Passbook savings deposits, which had been at a substantial yield disadvantage compared with other savings instruments in recent periods, began to increase in mid-February. Banks found inflows of funds through large-denomination negotiable certificates of deposit (C/D's) plentiful, as market yields on competing instruments fell and, in early January, began to offer rates on new C/D's below the Regulation Q maximum of 5½ per cent. By the end of March, the most frequently quoted rate on C/D's with maturities of ninety days and over was 4.75 per cent, a full 75 basis points below the rates offered at the end of 1966. Even with these rate reductions, total large-denomination C/D's rose by over \$3.6 billion in the quarter. The decline in market yields also made small-denomination commercial bank time deposits relatively more attractive, and these deposits grew strongly.

The liquidity position of the nonbank public improved significantly over the quarter and—apart from the strike-distorted final quarter of 1964—advanced relative to economic activity for the first time in three years.

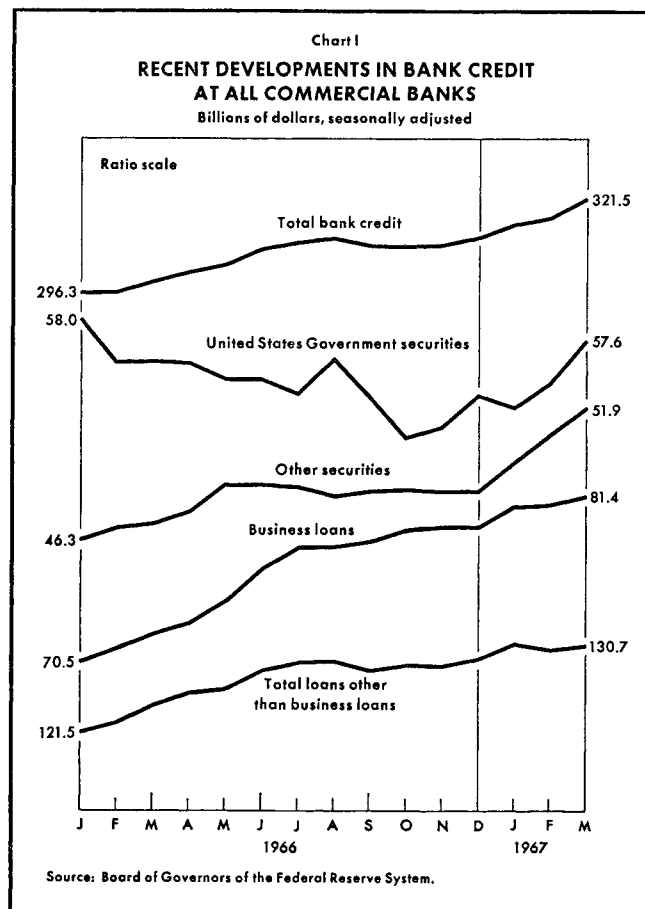
BANK CREDIT AND LIQUIDITY

Rapidly increasing nationwide reserve availability facilitated a very sharp expansion of commercial bank loans and investments during the first quarter of 1967 (see Chart I). Total loans and investments advanced at a 13.9 per cent seasonally adjusted annual rate over the quarter, compared with the 5.9 per cent rate of growth for all of 1966. Given the slow rate of increase of total bank credit in the second half of 1966 (1.9 per cent), the first-quarter acceleration brought the growth of bank credit since mid-1966 to a 6.0 per cent annual rate.

The bulk of the bank credit growth during the first quarter was concentrated in securities purchases, as banks sought to rebuild their liquidity and as the slowing of the economic expansion served to moderate loan demand. Thus, securities holdings increased at a seasonally adjusted annual rate of almost 27 per cent in the first quarter of 1967. Commercial banks added a substantial \$3.3 billion to their holdings of United States Government securities, an annual rate of increase of over 24 per cent. Part of this increase reflected a \$2.7 billion issue of tax anticipation bills in March, a substantial share of which was taken and held by banks through the end of the quarter. However, Treasury notes and bonds of one- to five-year maturities, which were seen as offering opportunities for capital gains as well as meeting bank liquidity requirements, constituted the bulk of first-quarter acquisitions by banks.

The period also saw a steady buildup in commercial bank holdings of securities other than United States Governments, mainly the tax-exempt obligations of state and local governments. Bank investments in these securities increased \$3.6 billion, the largest seasonally adjusted quarterly rise on record, and represented an annual rate of gain of almost 30 per cent. In contrast, such securities holdings had been reduced on balance in the second half of last year, and for 1966 as a whole they had advanced at a rate of only 5.0 per cent.

Total loans outstanding at commercial banks grew at a seasonally adjusted annual rate of 7.5 per cent in the first quarter, with a large part of the \$3.9 billion gain reflecting loans to business. While the pace of the business loan expansion (11.6 per cent) was above that of the previous two quarters, it was still somewhat below that of 1966 as a whole because of the exceptionally strong rise in these loans in the first half of 1966. The very small rise in gross national product (GNP) in current dollar terms in the first quarter of 1967—and particularly the sharp drop in the rate at which business added to inventories—may have restrained business loan demand. In addition, part of the heavy corporate borrowing in the capital mar-



kets undoubtedly was used to reduce indebtedness to banks. Tax borrowing, on the other hand, was high in the first quarter. A few banks cut their prime lending rate for business borrowers from 6 per cent to $5\frac{1}{2}$ per cent late in January, but most banks followed this move only part way, to $5\frac{3}{4}$ per cent. The reduction to $5\frac{1}{2}$ per cent did not become general until late in March and probably had only a limited effect on the total volume of first-quarter borrowing.

Bank lending to securities brokers and dealers and to nonbank financial institutions reflected the general easing of monetary pressures and declining interest rates. Inventories held by Government securities dealers remained high, and commercial bank securities loans were strong. On the other hand, finance companies found funds readily available in the commercial paper market. Rates on ninety-day finance company paper dropped from $5\frac{7}{8}$ per cent at the beginning of January to $4\frac{7}{8}$ per cent by the end of March, well below the prime rate at commercial banks.

Consequently, bank loans to nonbank financial institutions fell substantially over the quarter.

Real estate and consumer loans were restrained by the relatively weak conditions in the markets for housing and consumer durables. While banks were reported to be increasingly willing to grant single-family mortgage loans and while average mortgage rates were a bit below year-end figures, overall housing activity was still at low levels. Accordingly, real estate loans advanced at a seasonally adjusted annual rate of only 6.7 per cent in the first three months of 1967, below the performance of both the second half of 1966 and the year as a whole. Reflecting the relatively weak consumer demand for automobiles and other durable goods, the rise in loans to consumers was at a seasonally adjusted annual rate of only 3.1 per cent in the first quarter, well below the pace of recent past periods.

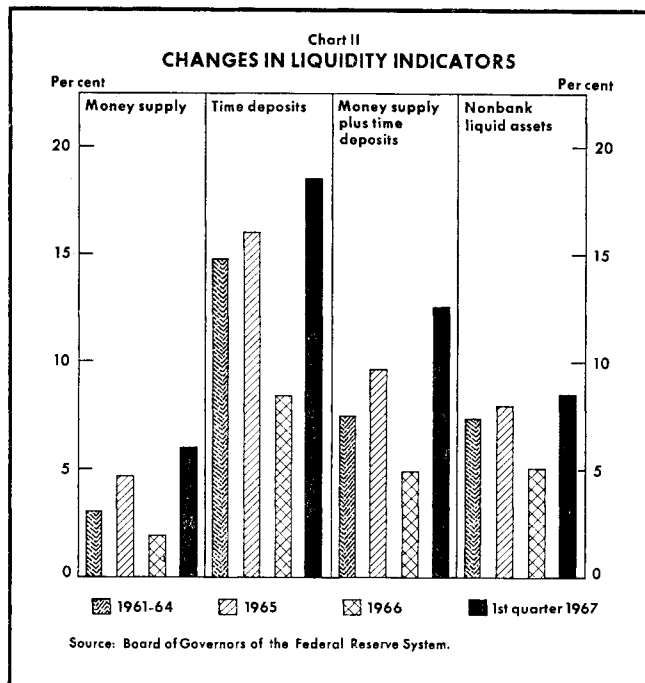
With bank deposits and securities holdings growing rapidly and loan growth moderate, bank liquidity improved over the first quarter for all major classes of banks. For all commercial banks, the aggregate ratio of loans to deposits fell 1.5 percentage points to 64.0 per cent. At New York City banks where ratios had been much higher, the drop was even more pronounced, from a December average of 79.6 per cent to 76.2 per cent in March. However, loan-deposit ratios were still very high by historical standards at the end of March.

BANK DEPOSITS, MONEY SUPPLY, AND RESERVES

As reserve availability increased over the first quarter, bank deposits and the money supply grew rapidly. The money supply—currency outside banks plus privately held demand deposits—advanced \$2.6 billion to a seasonally adjusted daily average of \$172.9 billion. The public's holdings of currency increased rapidly, and demand deposits turned up sharply to reach record levels. While this increase in the money supply equals a 6.1 per cent annual rate of growth (see Chart II), the annual growth rate over the nine months ended in March 1967 was only 1.4 per cent because the money supply declined during the second half of 1966. In the first quarter, the money supply and time deposits combined grew at a seasonally adjusted annual rate of 12.1 per cent.

Total time and savings deposits at commercial banks advanced strongly during the quarter—by \$7.3 billion. The 18.5 per cent annual rate of growth of these deposits was more than twice the gain of 1966 as a whole and exceeded the strong expansion of 1965.

Time deposits, other than savings deposits, turned up sharply during early 1967, with both large- and small-



denomination C/D's advancing strongly. The sharp contraction in the volume of negotiable C/D's in denominations of \$100,000 or more that took place in the late summer and fall of 1966 ended in December (see Chart III). The decline in Treasury bill rates during the latter months of 1966 and during most of early 1967 made C/D's a more attractive investment, and by early March total C/D's outstanding at weekly reporting large commercial banks had surpassed the previous peak level of \$18.6 billion reached in mid-August 1966. (Despite a strong upsurge in the first quarter, C/D's at New York City banks were still well below their mid-1966 high at the end of March.) For the first quarter as a whole, large-denomination C/D's at weekly reporting banks expanded almost \$3.7 billion to a record \$19.3 billion. The increased availability of C/D and other deposit funds exerted downward pressure on C/D offering rates, which at large New York City banks started to recede from the Regulation Q maximum of 5½ per cent in early January. By late January, rates at these banks on all maturities were generally below the ceiling, and by the end of March the most frequently quoted rates on all maturities, except the shortest, were down to 4.75 per cent.

During the first quarter, the gain in small-denomination "consumer-type" time deposits at weekly reporting banks was an impressive \$2.8 billion. Consumer-type time de-

posits had risen only about \$150 million in the fourth quarter of 1966. To some extent, this relatively small advance reflected the fact that the Federal Reserve System had lowered the maximum permissible rates on these deposits from 5½ per cent to 5 per cent in late September. The resumption of growth in 1967 resulted in part from lower market rates of interest and the reduced incentive to shift from these deposits into market instruments. In the first quarter, passbook savings deposits at weekly reporting banks ended their year-long decline. Although unchanged on balance over the quarter, these deposits rose by more than \$600 million between their early-February low and the end of March.

Pressures on member bank reserve positions lessened substantially during the quarter. Nonborrowed reserves increased sharply, as the Federal Reserve System attempted to supply the banking system with sufficient reserves to assure that the availability of credit would be adequate to provide for orderly economic growth. In addition to supplying reserves through purchases of securities

in the open market, the Federal Reserve System freed about \$850 million of reserves by reducing, from 4 per cent to 3 per cent, the legal reserve requirements on savings deposits, Christmas and vacation club accounts, and the first \$5 million of other time deposits at each member bank. The change came in two steps: the first, from 4 per cent to 3½ per cent, became effective on March 2, 1967, and the second, from 3½ per cent to 3 per cent, on March 16.

As a result of new reserve injections, aggregate member bank borrowings from Federal Reserve Banks were reduced and fell steadily from a daily average of \$557 million in December to \$199 million in March, the lowest monthly figure since April 1963. Excess reserves, although less volatile and less responsive to money market conditions, rose \$39 million over the quarter to \$431 million. Consequently, the net reserve position of member banks moved into surplus for the first time since February 1965. While net borrowed reserves had averaged \$165 million in December 1966, net free reserves averaged \$232 million in March 1967, the highest monthly free reserve level since mid-1963.

The effects of the easing of monetary pressures on commercial banks and the rebuilding of liquidity in the economy generally were broadly reflected in the increased holdings of liquid assets by the nonbank public in the first quarter. These assets grew \$12.8 billion in the quarter, a seasonally adjusted annual rate of 8.5 per cent or almost twice the rate of the last three months of 1966. The gain in the public's liquidity was broadly based: Holdings of currency and commercial bank demand and time deposits, share accounts at savings and loan associations, and deposits at mutual savings banks all rose strongly. In particular, share accounts at savings and loan associations grew at a seasonally adjusted annual rate of 10.2 per cent, or three times their 1966 pace. Much of the increased flow of deposits to these institutions has been used to reduce borrowing from the Federal Home Loan Banks, but mortgage acquisitions have also increased.

As the public moved strongly to restore its liquidity position and overall economic activity advanced very modestly in current dollar terms, the ratio of nonbank liquid assets to GNP rose from 78.7 per cent in the fourth quarter of 1966 to 79.3 per cent in the first quarter of 1967. Apart from the strike-distorted final quarter of 1964, this was the first increase in this measure of liquidity in three years. Despite this rise, the liquid asset-GNP ratio remains below the average 1964-66 level.

