

# FEDERAL RESERVE BANK OF NEW YORK



## MONTHLY REVIEW

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### The Business Situation

The economy has displayed considerable underlying strength in recent months, despite the adverse effects of a number of strikes. At the same time, the clearly excessive rate of increase in both wages and prices appears to be gaining further momentum. In October, the expansion of the economy equaled the longest on record, with the upswing covering eighty months.

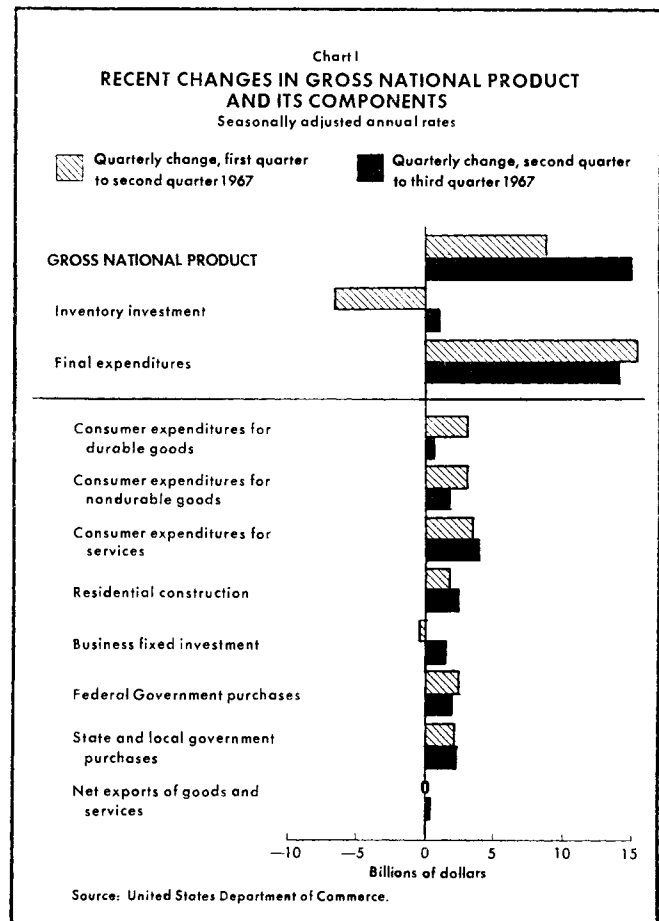
Gross national product (GNP) increased in the third quarter by an estimated \$15 billion. The gain in economic activity was widely based, with all major components of GNP registering advances. The increase in GNP was due about equally to higher prices and a larger real output. The rise in the GNP price deflator was nearly 4 per cent at an annual rate, the largest in many years. Real output in the economy increased at slightly more than a 4 per cent annual rate, up strongly from the rate of growth in the second quarter. This advance provides clear evidence of the rising pace of business activity since midyear.

In September, the effects of the various work stoppages, especially the auto strike, dampened the rise of personal income, employment, and retail sales and contributed to declines in industrial production and new orders for durable goods. The possibility of additional shutdowns in the automobile industry clouds the outlook for the economy in the remaining months of the year. Most observers nevertheless expect a continuation of the overall expansion, followed by a surge of activity when the automobile industry returns to full production. Although the President's tax surcharge proposal still awaits Congressional action and the ultimate outcome of efforts to reduce Federal spending remains unclear, economic and financial developments continue to indicate a pressing need for a program of fiscal restraint.

#### ECONOMIC ACTIVITY IN THE THIRD QUARTER

Gross national product—the measure of the nation's total output of goods and services—posted a sizable ad-

vance in the third quarter of 1967, when both price inflation and real output accelerated. According to preliminary estimates by the Department of Commerce, GNP increased by \$15.0 billion to an annual rate of \$790.1 billion (see Chart I). Although the gain was the largest since the first quarter of 1966, amounting to an annual growth rate of



8 per cent, it would have been even greater but for the effects of the various work stoppages. Indeed, according to a Commerce Department estimate, the Ford strike alone cut about \$2 billion from the quarter's GNP.

While price increases accounted for nearly half of the third-quarter gain in the market value of GNP, the growth in real output was nevertheless at a relatively strong annual rate of more than 4 per cent, compared with less than 2½ per cent in the second quarter and with a small decline in the first quarter of the year. The acceleration in the rate of increase in the overall price level, as measured by the GNP price deflator, was of disturbing proportions. The third quarter saw the deflator rise at an annual rate of 3.8 per cent, the largest advance in a decade and nearly twice the second quarter's 2.1 per cent rate of increase. To be sure, some of the third-quarter rise was due to a rash of price hikes in the construction industry and a steep run-up in food prices, and both these particular uptrends may moderate in coming months. However, the trend toward higher rates of increase in prices and costs remains apparent. Recent wage settlements—notably that at Ford which involved an increase of about 6 per cent annually in wages and fringe benefits—indicate a further escalation of wage costs, despite modest gains in productivity this year.

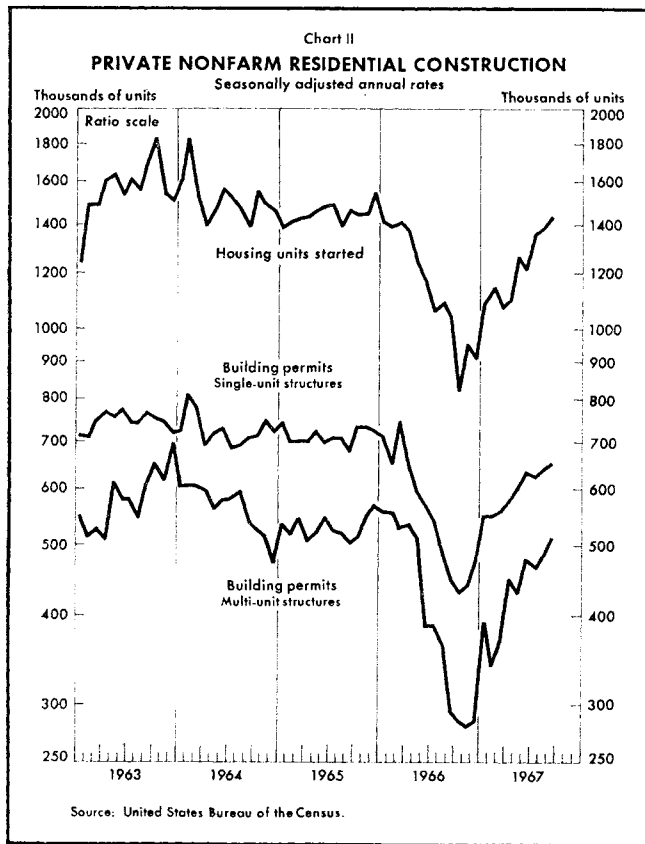
Further evidence of increasing inflationary pressure is seen in the September data on retail and wholesale prices. While the consumer price index rose only 0.2 percentage point in September, compared with a gain of 0.4 point in August, the advance in the index of all items less food was the largest this year. Prices of services mounted rapidly, as did those of used cars, apparel, and other goods. The wholesale price index also rose in September, as costs of industrial commodities increased for the second consecutive month following a half year of stability. Preliminary figures indicate that the industrial index rose again in October. Wholesale food prices appear to have declined further, however, outweighing the advance in the costs of industrial products, and the total wholesale price index apparently eased off 0.1 percentage point.

The third-quarter acceleration in the growth of GNP was due to a turnaround in the trend of inventory accumulation. During the first half of the year, when businessmen were concentrating on getting stocks into a better alignment with sales, the pace of inventory investment was sharply reduced, dropping from an excessively high \$18.5 billion annual rate in last year's fourth quarter to only \$0.5 billion in the second quarter of 1967. This slowdown put a very substantial drag on GNP growth during the first half. In contrast, the third quarter saw a pickup in inventory accumulation to an annual rate of \$1.5

billion, which contributed \$1.0 billion to the advance in GNP. The process of adjusting inventories to sales trends has brought inventory-sales ratios—especially in the trade sector—down to more acceptable levels. With the sales outlook improving, business accumulation of stocks can now be expected to proceed at a higher pace.

Consumer demand expanded only moderately during the third quarter, with consumption expenditures growing by \$6.1 billion as compared with the strong \$9.5 billion increase recorded in the preceding three-month period. Spending on services was up sharply, while growth of nondurables demand was slower than in the second quarter. The more moderate advance in consumer spending, however, was due mainly to a slowdown in automobile sales, which limited the rise in spending on durables. Consumer expenditures on durables moved up by only \$0.5 billion in the third quarter, compared with a gain of \$3.1 billion in the second quarter. Beginning in late July and continuing through most of September, car sales were hampered by shortages in several popular model lines. Sales of new domestically produced cars reached a 1967 peak in July at a seasonally adjusted annual rate of almost 8½ million units, and then dropped off in August to a rate of less than 7½ million units. The introduction of new models in late September improved the supply situation, and the sales rate moved up to a bit more than 8 million units. The precise effect on September auto sales of the strike at the Ford Motor Company is difficult to estimate. Although the company produced new cars in quantity before the strike began, many customers were apparently unaware that the new models were actually available and this fact may have discouraged potential buyers. By October, the supply of new-model automobiles, which Ford produced prior to the strike, began to run out and industry-wide sales declined to a rate of less than 7 million units.

The modest third-quarter advance in consumer spending occurred despite the strongest rise in personal income this year. The strength of the advance in income was particularly notable, since the increase in September was dampened considerably by the effect of the various strikes. The annual rate of wage and salary payments in that month grew by only \$0.9 billion, compared with gains of \$2.5 billion in July and \$3.3 billion in August. Inasmuch as disposable personal income advanced in the third quarter at a more rapid rate than consumption spending, the savings ratio moved up. Since the fourth quarter of 1966, consumers have been saving an unusually large share of their income. Uncertainty over a possible tax increase, inflation, and the Vietnam war has apparently held consumer spending down. The high savings rate of the last four quarters has resulted in a rapid expansion in the volume of financial



savings—particularly in the form of time and savings accounts at commercial banks and thrift institutions. This buildup in liquid assets, coupled with the outlook for further income gains, has placed the consumer in a strong position for a step-up in spending.

Recent surveys of consumer expectations have shown a substantial upturn in consumer buying intentions. Indeed, according to the latest survey taken by the Department of Commerce, consumers expect to spend a record amount for new cars in the coming months, and planned purchases of other durables have shown a strong rise.

Total fixed investment spending in the third quarter recorded the largest advance in over two years on the strength of increases in both business fixed investment and residential construction. The rise in business spending was centered in purchases of equipment. Outlays for business structures also edged up, however, marking the first increase in a year. The growth of business capital spending in the third quarter was consistent with the trend indicated by earlier surveys of business plans for plant and equipment

spending. These surveys have repeatedly pointed to an upturn in such outlays in the second half, following the drop in the first six months of the year.

Residential construction has continued to make a strong recovery from the steep decline experienced in 1966, and the \$2.3 billion advance in outlays during the third quarter was the largest in many years. The most recent data point to a continuation of the uptrend in home building, and the supply of mortgage funds currently appears to be sufficient for further growth. In September, housing starts rose sharply again, reaching the highest level since 1965, and building permits issued by local authorities also moved up further (see Chart II).

Turning to the public sector, the growth in the third quarter of total government expenditures for goods and services was the smallest quarterly increase in over two years. The \$2.2 billion rise in state and local spending was in line with the steady upward trend of such outlays. The advance in Federal Government expenditures slowed, however, as spending for defense purposes registered a \$1.4 billion rise, the smallest since the beginning of the buildup in Vietnam.

#### PRODUCTION, ORDERS, AND EMPLOYMENT

The volume of industrial output was dampened in September by the automobile strike, as well as by other work stoppages, and by the cutback of domestic crude oil production as shipments from the Middle East increased. The Federal Reserve Board's index of industrial production (seasonally adjusted) declined by 1.5 percentage points to 156.3 per cent of the 1957-59 average. Output of defense equipment continued to expand strongly, but production of business equipment was again about unchanged. The materials index was adversely affected not only by the reduction in oil production but also by the strike of steel truckers, which resulted in a widening number of cutbacks in steel production during September and October. Output of consumer goods was, of course, limited by the auto strike. The seasonally adjusted annual rate of new car assemblies dropped in September by almost 20 per cent to approximately  $6\frac{3}{4}$  million units, a pace which was about maintained in October. Output of other consumer goods, however, was generally strong in September. Production of television sets rose again, following a surge in August which had been preceded by months of decline as a result of both production cutbacks and a strike.

The automobile strike also contributed to a large drop in the September volume of new orders for durable goods. In the motor vehicles and parts component—where new orders are treated as essentially equal to ship-

ments—the decline amounted to over 25 per cent. On the other hand, the volatile series on new orders received by defense-oriented industries rose sharply after falling for two months. The auto strike was also a factor in the decline in shipments of durable goods. The volume of shipments was less than the inflow of new orders, and thus the backlog of unfilled orders edged up.

The labor market situation remained strong in September, although the picture provided by the employment data was clouded by the effects of the various strikes—notably those involving teachers in New York City and elsewhere and the workers at Ford. The number of persons on strike increased by more than 200,000 between August and September. Despite this, the total number of persons on the payrolls of nonagricultural establishments declined by only 100,000. The Bureau of Labor Statistics estimates that, had it not been for the rise in the number of workers involved in labor disputes, September payroll employment would have shown a gain of better than 100,000. The

BLS noted that the Ford strike did not have much secondary effect on September employment. However, the prolongation of that stoppage through most of October undoubtedly increased the strike's indirect impact, which may be reflected in October data. The average workweek of production workers in manufacturing held in September at the much improved figure of 40.7 hours reached in the preceding month.

The civilian labor force expanded in September for the fourth consecutive month. The September advance was entirely accounted for by an unusually large rise in the number of women in the labor force. Not all these additional women found employment, and the unemployment rate for them rose substantially, pushing the overall rate up by 0.3 percentage point to 4.1 per cent. The unemployment rates for men and for teen-agers were essentially unchanged, but the rate for married men, who represent the backbone of the labor force, declined to 1.8 per cent, close to its record low.

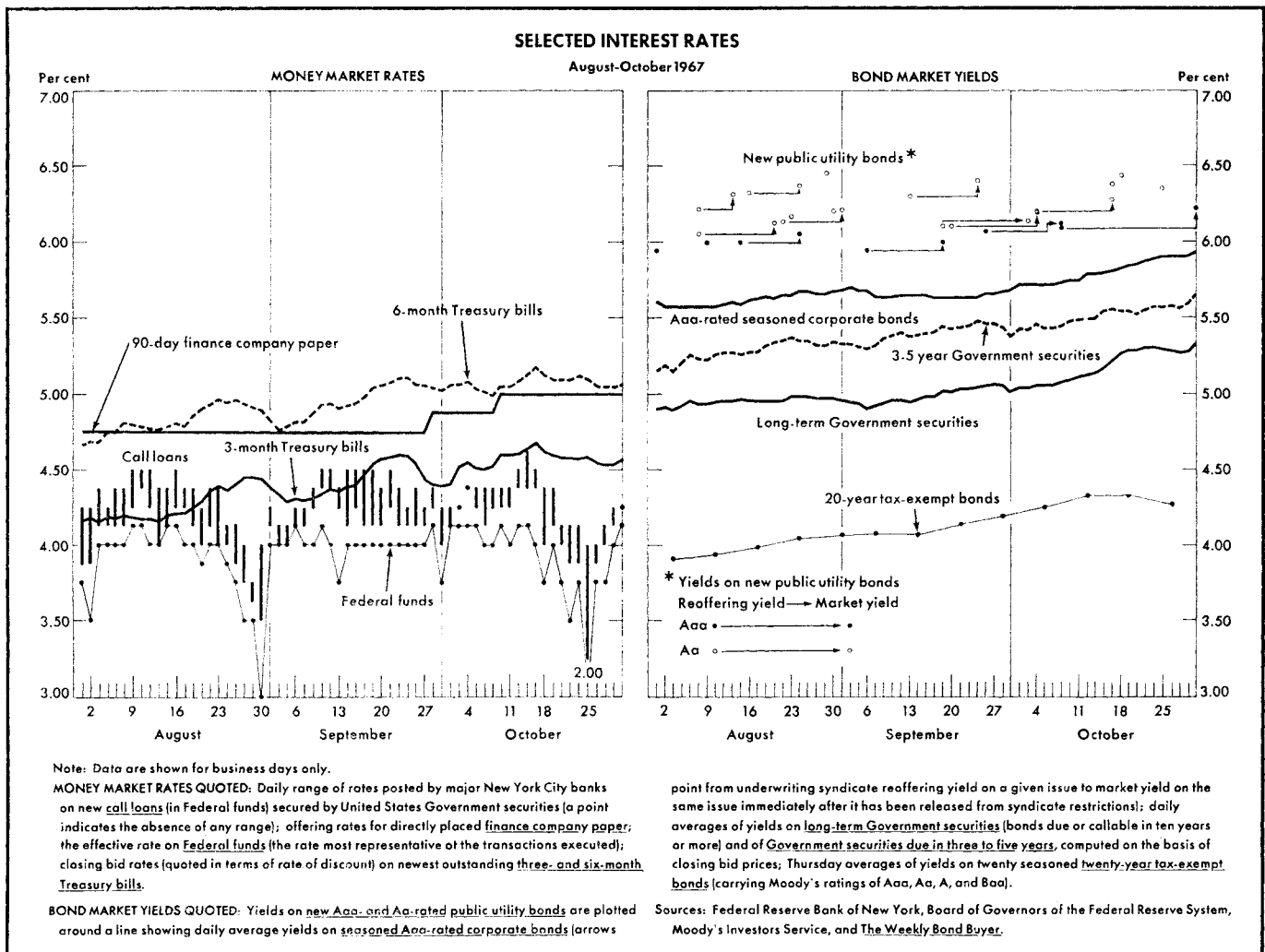
### **The Money and Bond Markets in October**

Conditions in the money market varied from moderate firmness in the first half of October to relative ease in the latter half, reflecting chiefly swings in the amount and distribution of available reserves. The average daily level of nationwide net reserve availability for the month as a whole was somewhat lower than in September. The effective rate for Federal funds was generally above the 4 per cent discount rate in the first half of the month and generally below 4 per cent thereafter. Rates posted by the New York City banks on new call loans to Government securities dealers rose considerably in the first half of October, but returned to lower levels in the second half of the period.

Other short-term rates moved higher during the month. The large New York City banks were able to replace certificates of deposit (C/D's) as they matured during October, but this required further increases in rates. Market yields on the nearest three- and six-month Treasury bill

maturities rose by 17 and 4 basis points, respectively, to 4.56 per cent and 5.06 per cent.

The upward trend of capital market yields continued during October, with only a brief interruption late in the month. Market psychology underwent a pronounced deterioration at the start of the period, after an announcement by a Congressional committee that it had set aside the President's tax proposal until a program of reductions in Federal expenditures could be agreed upon between the Administration and the Congress. The market was also unfavorably affected by the seemingly dim prospects for a settlement in the near future of the Vietnam conflict and by continuing substantial additions to the corporate financing calendar. At the close of the month, market yields on outstanding Treasury securities were about 5½ per cent in the intermediate maturity area and 5¼ per cent in the longer term area (see chart). Late in the month, the Treasury announced that it would refund \$10.2 billion



of securities maturing on November 15 and raise an additional \$2 billion of cash through an offering of two new notes, one—a seven-year maturity—bearing a coupon of 5¾ per cent, the highest for any Treasury issue in forty-six years. New issues of corporate and tax-exempt bonds were marketed during the month at progressively higher reoffering yields but, even so, most were poorly received. By midmonth, reoffering yields on corporate bonds had gone as high as 6.10 per cent on Aaa-rated bonds with five-year call protection and 6.70 per cent on A-rated bonds without call protection. Toward the end of the month, a better tone developed in the capital market and investors took up several new and slow-moving issues. This improvement proved short-lived, and bond prices dropped sharply during the last two days of the month, when it appeared that the Congress

might adjourn without acting on the surtax proposal.

Late in October, the Federal Reserve Board announced a number of proposals designed to tighten the regulations governing the use of credit in securities transactions. One of the main proposals is to extend margin requirements to loans for purchasing and carrying convertible bonds. After the announcement, prices of convertible bonds fell sharply and some previously scheduled flotations of convertible corporate securities were postponed.

#### BANK RESERVES AND THE MONEY MARKET

Free reserves of all member banks in October averaged only moderately lower than in September, but there continued to be wide week-to-week variations in overall net



reserve availability (see Table I). Reflecting the uneven distribution of reserves as well as an apparent tendency for "country" banks to keep a larger than usual amount of excess reserves, member bank borrowings from the Reserve Banks rose somewhat in the first three weeks of October before retreating to a lower level toward the end of the month. For the four statement weeks ended in October, borrowings averaged \$141 million, compared with an average of \$82 million in September.

The basic reserve position of banks in major money centers deteriorated sharply soon after the month began (see Table II), as these banks experienced seasonal outflows of reserves and some loss of funds through attrition of negotiable C/D's. An additional factor in this reserve loss was the payment by the money market banks to the Treasury on October 9 (partly by credits to Tax and Loan Accounts) for their awards of tax anticipation bills. Reflecting unexpectedly large reserve drains from movements in currency and other factors affecting the banks' aggregate reserve position, average free reserves dropped sharply to \$133 million in the second statement week of October. In the following statement week, these conditions were reversed. Daily average free reserves rose to \$341 million, and the basic reserve position of the city banks improved, partly reflecting further reductions in loans to Government securities dealers. However, uncertainties associated with the partial holiday of Columbus Day, October 12, led to unusually heavy borrowing at the "discount window" during the week. In the statement week ended on October 25, the release of a large volume of accumulated excess reserves by country banks in the Federal funds market coincided with a marked shift of reserves to the money center banks, producing comfortable money market conditions similar to those of late August.

The substantial runoff of negotiable C/D's outstanding at the New York City money market banks in September was brought to a halt during October through further upward adjustments in offering rates. By mid-month, the rate most often quoted by the city banks on new certificates maturing in one year or longer had risen to the 5½ per cent ceiling from the 5¾ per cent rate that had prevailed since early September and the ceiling rate was available on six-month certificates. The most often quoted rate on the shortest maturity C/D's was 4¾ per cent at the end of October, compared with 4¼ per cent at the beginning. On October 10, major finance companies raised their rates on directly placed paper by ⅛ percentage point to 5 per cent on paper maturing after January 1. On October 16, commercial paper dealers raised their offering rate on prime four- to six-month paper by ⅛ percentage point to 5½ per cent.

#### THE GOVERNMENT SECURITIES MARKET

Sentiment in the market for Treasury notes and bonds deteriorated further in October in response to many of the same international, fiscal, and credit factors that have weighed heavily on the market in recent months. Despite a temporary improvement in prices in the latter part of the period, price declines for the month amounted to more than 3 points in the long-term sector and 1 point in the intermediate area.

The market began the month with a feeling of disappointment over the lack of any signs of peace negotiations on the Vietnam conflict following a major policy address by President Johnson on September 29. Moreover, the outlook for the long-pending Congressional action on the President's August proposal for an income tax surcharge became more clouded, after an announcement on October 3 that the House Ways and Means Committee had decided to postpone consideration of the tax bill until an agreement between the Administration and the Congress could be reached on cuts in Federal spending. Market observers, disheartened by this development, felt that monetary policy might move toward less ease in the absence of fiscal measures to combat the strong inflationary tendencies in the economy.

Further upward pressure on Treasury yields resulted from the growing congestion in the markets for new corporate and tax-exempt bonds, which occurred despite a rising pattern of reoffering yields, and from the substantial volume of Federal agency offerings around midmonth. The market was only slightly affected by the increase in the discount rate of the Bank of England on October 18. In the latter part of the month, market attention focused on the forthcoming November 15 Treasury refunding operation, widely expected to include an additional offering of securities for cash.

Trading in Treasury coupon securities during October originated mainly in sales by investors of intermediate- and long-term issues, partly against purchases of higher yielding corporate and Treasury agency issues. Toward the end of the period, dealers pressed offerings aggressively on the market in order to divest themselves of securities taken from investors in preparation for the Treasury's November 15 refunding operation.

After the close of the market on October 25, the Treasury announced a \$12.2 billion offering of new securities: \$10.7 billion of 5½ per cent fifteen-month notes due February 15, 1969 and \$1.5 billion of 5¾ per cent seven-year notes to mature November 15, 1974. The offering was made for the purpose of refinancing the \$10.2 billion of securities maturing on November 15, of which \$2.6

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

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

Factors	Changes in daily averages— week ended on				Net changes
	Oct. 4	Oct. 11	Oct. 18	Oct. 25	
<b>"Market" factors</b>					
Member bank required reserves*	- 232	+ 95	- 323	+ 92	- 368
Operating transactions (subtotal)	- 173	- 789	+ 318	+ 447	- 197
Federal Reserve float	- 35	- 77	- 16	+ 162	+ 34
Treasury operations†	+ 67	- 105	+ 63	- 132	- 107
Gold and foreign account	+ 4	- 1	- 4	+ 12	+ 11
Currency outside banks*	- 169	- 544	+ 74	+ 258	- 381
Other Federal Reserve accounts (net)‡	- 40	- 64	+ 203	+ 147	+ 246
<b>Total "market" factors</b>	<b>- 405</b>	<b>- 694</b>	<b>- 5</b>	<b>+ 539</b>	<b>- 565</b>
<b>Direct Federal Reserve credit transactions</b>					
Open market instruments					
Outright holdings:					
Government securities	+ 524	+ 343	- 4	- 217	+ 646
Bankers' acceptances	+ 2	+ 1	- 1	-	+ 2
Repurchase agreements:					
Government securities	-	+ 237	+ 223	- 460	-
Bankers' acceptances	+ 20	- 38	- 26	- 42	- 86
Federal agency obligations	-	+ 7	+ 20	- 27	-
Member bank borrowings	+ 70	+ 1	+ 71	- 158	- 16
Other loans, discounts, and advances	-	-	-	-	-
<b>Total</b>	<b>+ 615</b>	<b>+ 551</b>	<b>+ 284</b>	<b>- 904</b>	<b>+ 546</b>
Excess reserves*	+ 210	- 143	+ 279	- 365	- 19

Member bank:	Daily average levels				
	Oct. 4	Oct. 11	Oct. 18	Oct. 25	Oct. 25‡
Total reserves, including vault cash*	24,654	24,416	25,018	24,561	24,662‡
Required reserves*	24,233	24,138	24,461	24,369	24,300‡
Excess reserves*	421	278	557	192	362‡
Borrowings	144	145	216	58	141‡
Free reserves*	277	133	341	134	221‡
Nonborrowed reserves*	24,510	24,271	24,802	24,503	24,522‡

System Account holdings of Government securities maturing in:	Changes in Wednesday levels				Net changes
	Oct. 4	Oct. 11	Oct. 18	Oct. 25	
Less than one year	+ 558	+ 672	- 399	- 479	+ 352
More than one year	+ 59	-	-	-	+ 59
<b>Total</b>	<b>+ 617</b>	<b>+ 672</b>	<b>- 399</b>	<b>- 479</b>	<b>+ 411</b>

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 of four weeks ended on October 25.

**Table II**  
**RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS**  
**OCTOBER 1967**

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Averages of four weeks ended on Oct. 25*
	Oct. 4	Oct. 11	Oct. 18	Oct. 25*	
<b>Eight banks in New York City</b>					
Reserve excess or deficiency(-)†...	24	25	27	79	39
Less borrowings from Reserve Banks	-	21	93	-	28
Less net interbank Federal funds purchases or sales(-)	3	527	293	111	234
Gross purchases	847	1,149	1,029	934	990
Gross sales	844	622	737	823	756
Equals net basic reserve surplus or deficit(-)	21	- 523	- 359	- 32	- 223
Net loans to Government securities dealers	834	682	596	698	703

<b>Thirty-eight banks outside New York City</b>					
Reserve excess or deficiency(-)†...	58	17	- 3	- 13	15
Less borrowings from Reserve Banks	51	50	39	-	35
Less net interbank Federal funds purchases or sales(-)	874	1,097	870	640	870
Gross purchases	1,922	2,188	1,956	1,844	1,977
Gross sales	1,048	1,092	1,085	1,204	1,107
Equals net basic reserve surplus or deficit(-)	- 867	- 1,130	- 912	- 653	- 890
Net loans to Government securities dealers	702	757	794	737	748

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—October 1967				
	Oct. 2	Oct. 9	Oct. 16	Oct. 23	Oct. 30
Three-month	4.514	4.564	4.676	4.597	4.542
Six-month	5.089	5.022	5.165	5.125	5.044
Monthly auction dates—August-October 1967					
	August 24	September 26	October 24		
Nine-month	5.098	5.145	5.313		
One-year	5.100	5.124	5.302		

\* 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.



billion is held by the public, and raising \$2 billion of new cash. The maturing securities are \$8.2 billion of 4½ per cent notes and \$2.0 billion of 3½ per cent bonds. Subscription books were open on October 30, and payment for the new issues, due November 15, may be made in cash or in the maturing securities. The 5¾ per cent coupon rate on the new seven-year notes is the highest interest rate on any Government security sold since June 1921.

A very good interest developed in the new issues, and there was a particularly heavy oversubscription for the seven-year notes. (On November 1, the Treasury announced that larger subscriptions would receive only 36 per cent allotments for the new 5½ per cent notes and only 7½ per cent allotments for the 5¾ per cent notes.) Shortly after the books closed, however, a very nervous atmosphere emerged in the markets, as it appeared that the Congress might adjourn before acting on the surtax proposal and as sizable additions were made to the corporate financing calendar. In this environment, investors and professionals pressed offerings of both the new and outstanding issues on the market, and prices closed the month on a sharp downward movement.

Contrasting with the weakness in the Treasury coupon market, the market for Treasury bills performed fairly well during October. The relative strength of the bill sector reflected a fairly persistent investment demand for shorter issues coming from corporations and public funds, along with some purchases by the System Open Market Account. At times, in fact, scarcities of issues maturing before the year-end developed. In this environment, a satisfactory reception was accorded the sale by the Treasury on October 9 of \$4.5 billion of tax anticipation bills maturing next April and June and continuing additions of \$100 million to the regular weekly offerings of three-month bills. Around midmonth, some caution appeared in the bill market as a result of increased bank selling of the new June tax anticipation bills, for which bidding had been relatively light, and the poor receptions accorded two newly marketed Federal agency issues. Consequently, bidding in the regular weekly auction of three- and six-month bills held on October 16 resulted in average issuing rates of 4.676 per cent and 5.165 per cent, respectively, up 11 and 14 basis points from rates established in the previous weekly auction (see Table III). Subsequently, the market steadied, and yields at the end of the month were only slightly higher than at the close of September. Bidding in the regular monthly auction of nine-month and one-year Treasury bills held on October 24 resulted in average issuing rates of 5.313 per cent and 5.302 per cent, respectively, the highest levels since November 1966.

Five new Federal agency obligations totaling \$1.4 billion were offered to investors around the middle of October, wholly to replace maturing issues. Two issues of Federal Land Bank bonds, priced on October 10 to yield 5¾ per cent on a two-year maturity and 5½ per cent on a five-year maturity, were accorded a poor reception although the available yields were 11 basis points higher than those quoted in the secondary market on similar maturities. Initial trading in the new issues took place at prices ¾ point lower than the original reoffering prices. Similarly, only a fair investor response was accorded two Federal Home Loan Bank issues offered a few days later, even though pricing of the later offerings had been adjusted in light of the poor performance of the earlier agency flotation.

#### OTHER SECURITIES MARKETS

Corporate and tax-exempt bond yields rose to successive new highs for the year through the latter part of October under the impact of a substantial increase in the volume of flotations, sizable additions to the November financing calendar, and other unfavorable influences working on the long-term markets generally. In this market environment, investors tended to ignore new issues as they were reoffered by underwriters, confident that they could acquire the same bonds in the secondary market at discounts from original reoffering prices. Briefly toward the end of the period, a better atmosphere emerged and some initially slow-moving recent offerings were sold out. On the final two days of the month, however, the market weakened again on news of substantial additions to the calendar.

In the corporate market, the volume of public offerings mounted to \$1.3 billion in October from \$0.8 billion in the previous month. Most issues that had been awarded in competitive bidding met with an unenthusiastic response from investors, and a number of offerings with unsold balances were freed from syndicate price restrictions. The extent of the upward yield adjustment over the month is illustrated by the performance of three public utility offerings of similar size, all rated Aa by Moody's and carrying five-year call protection. The first two of these offerings, marketed on October 4 and 17, moved slowly at reoffering yields of 6.20 per cent and 6.375 per cent, respectively, while the third, reoffered on October 18, sold out quickly at a yield of 6.44 per cent. The largest single offering of the month was a \$250 million industrial issue of Aaa-rated debentures marketed on October 25. This issue, maturing in 1997 and nonrefundable for ten years, sold out rapidly at a reoffering yield of 6 per cent, equal to the peak rate on comparable offerings in 1966. Late in

the month, a major steel company announced plans to sell \$225 million of bonds in November, thus adding further to that month's already heavy calendar. The average yield on Moody's Aaa-rated seasoned corporate bonds rose to 5.94 per cent at the end of October from 5.68 per cent at the close of the preceding month.

On October 20, the Federal Reserve Board announced a number of proposals to broaden the coverage of its regulations governing the use of credit in securities transactions. If adopted, these proposals will be implemented through amendments to Regulations T and U and through a new Regulation G. The main proposals include one to extend margin requirements to loans for purchasing and carrying convertible bonds and one to extend margin requirements to unregulated lenders—individuals and firms other than domestic banks and brokers—who make loans for purchasing and carrying securities.

The announcement produced an immediate reaction in the convertible bond market, but left other bond markets largely unaffected. Prices of outstanding issues of convertible bonds were marked down by as much as 13 points on the day following the announcement, and two corporations postponed scheduled flotations of new convertible

securities. Recently, the volume of convertible issues has risen in proportion to total corporate debt offerings, from 9 per cent in 1965 to 25 per cent in the third quarter of this year, reflecting attempts by corporations to hold down borrowing costs in a period of rapidly rising capital market yields.

In the tax-exempt sector of the bond market, most new issues marketed during the month, even though relatively small in size, were accorded poor receptions, and several scheduled offerings were postponed. The largest offering of the month, a \$119 million Baa-rated New York City issue of various-purpose bonds, was awarded on October 17 at a net interest cost of 4.91 per cent, the highest for this borrower in thirty-five years and 15 basis points above the cost on the last previous borrowing by the city in October 1966. The bonds, maturing in 1969 through 1998, were reoffered at yields ranging from 4 per cent to 4.90 per cent. Distribution of this issue proceeded well in the improved market atmosphere that was developing at the time of sale. *The Weekly Bond Buyer's* average yield series for twenty seasoned tax-exempt bonds carrying ratings ranging from Aaa to Baa stood at 4.27 per cent at the end of October, compared with 4.19 per cent a month earlier.

## Banking and Monetary Developments in the Third Quarter of 1967

Credit demands in the economy were very strong in the third quarter of the year, when massive Treasury borrowing was added to the increased needs of private borrowers. Bank credit remained readily available and expanded over the quarter at an exceptionally fast pace. Despite this expansion, overall credit demands continued to press against supply, and interest rates rose considerably further.

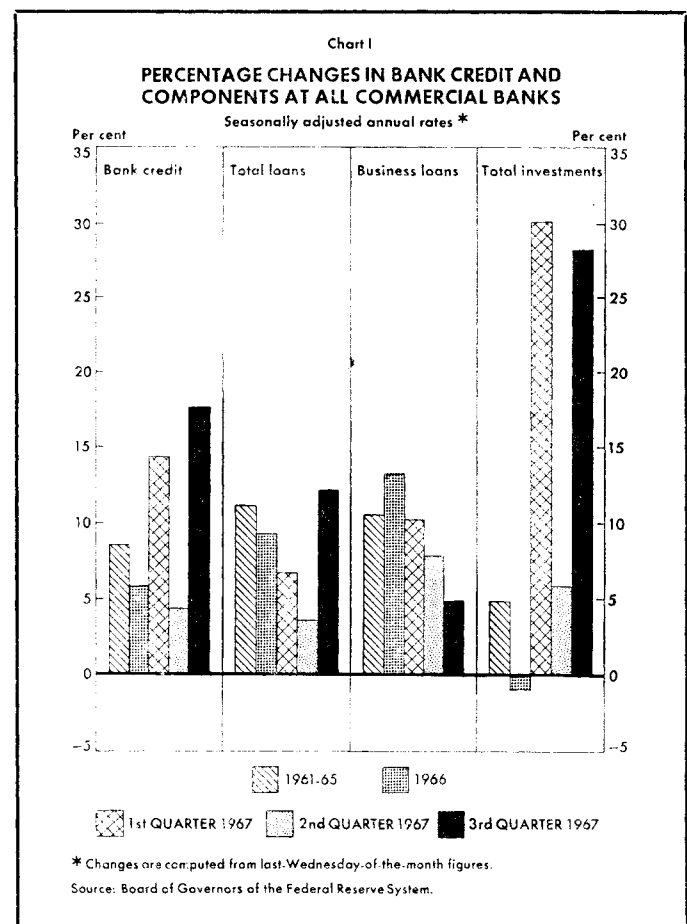
The third-quarter banking expansion reflected the important role of commercial banks in financing the sharply higher Treasury borrowing requirements. Of the seasonally adjusted \$14.4 billion expansion of bank loans and investments over the period, almost half was accounted for by bank acquisitions of United States Government securities and bank financing of the enlarged positions of Government securities dealers. Business loans at banks increased at only half the rate of the first six months of the year, but the total of all other loans expanded more strongly than in the first half year.

The heavy credit flows of the third quarter were associated with a substantial increase in the outstanding volume of liquid financial instruments. Treasury borrowing was primarily short term, adding to the liquid holdings of commercial banks and the nonbank public. Financial intermediation was again strong, giving rise to substantial further increases in liquid deposit claims against commercial banks, savings and loan associations, and mutual savings banks.

### BANK CREDIT AND LIQUIDITY

Unusually strong overall financing demands in the economy, coupled with continued comfortable bank reserve positions, gave rise to a sharp expansion of commercial bank loans and investments during the third quarter of 1967 (see Chart I). Total loans and investments of all commercial banks advanced at a 17 $\frac{3}{4}$  per cent seasonally adjusted annual rate over the quarter, up very strongly from the 4 $\frac{1}{2}$  per cent rate of growth in the previous three months. The major portion of bank credit growth during the third quarter was concentrated in holdings of securities, especially of United States Government obligations.

Holdings of Government securities expanded \$5.8 billion, accounting for about 40 per cent of the total increase in bank credit. All the third-quarter gain in holdings of Treasury obligations occurred in July and August, as banks acquired substantial amounts of tax anticipation bills—payable with full Tax and Loan Account credit—as well as a large volume of additional Treasury securities in the mid-August refunding and the late-August sale of new 3 $\frac{1}{2}$ -year Treasury notes. In September, holdings of Gov-



ernment securities fell by \$0.2 billion at all commercial banks, a typical development in periods immediately following major Treasury financings. At such times, some banks begin redistributing a part of their recently acquired securities.

In the third quarter, the rate at which other than United States Government securities were acquired moderated somewhat from the unusually rapid pace of the first six months. While some banks appeared to be interested in attractively priced participation certificates and selected intermediate-term municipal obligations, the ability to obtain relatively high yielding and more liquid short-term Treasury issues apparently contributed to dampening interest in tax-exempt securities.

Total bank loans outstanding grew at a seasonally adjusted annual rate of 12¼ per cent in the third quarter, up strongly from a 3½ per cent increase in the second quarter. However, the rate at which business loans increased—about 5 per cent—was only half the pace of the previous six months and little more than one third the rate of expansion in the third quarter of 1966. Reduced tax payments following the completion of the earlier acceleration of business tax payment schedules, coupled with record heavy borrowing by corporations in the bond market, apparently reduced business need for shorter term bank accommodation. Business demands for bank financing were noticeably lighter than usual over the mid-September tax and dividend payment date.

Bank loans other than business loans rose substantially faster in the third quarter than in the second quarter. Among the other loan categories, loans to securities brokers and dealers expanded very rapidly, in line with greatly increased Treasury financing activity. Real estate and consumer loans also advanced further over the third quarter, paralleling a continued advance in housing starts and retail sales, and agricultural loans picked up. On the other hand, outstanding bank loans to finance companies fell over the quarter, as these companies experienced some decline in the need for funds, due partly to reduced financing requirements of retail automobile dealers. At the same time, finance companies continued to find funds readily available in the commercial paper market. Although yields on ninety-day finance company paper rose from 4.40 per cent in June to 4.76 per cent at the end of September, these rates remained well below the prime lending rate at commercial banks.

Bank liquidity generally improved during the third quarter. For all commercial banks, the aggregate ratio of loans (excluding securities loans) to deposits fell 2.0 percentage points to 62.8 per cent. At New York City banks, where ratios had been much higher, the drop was somewhat less

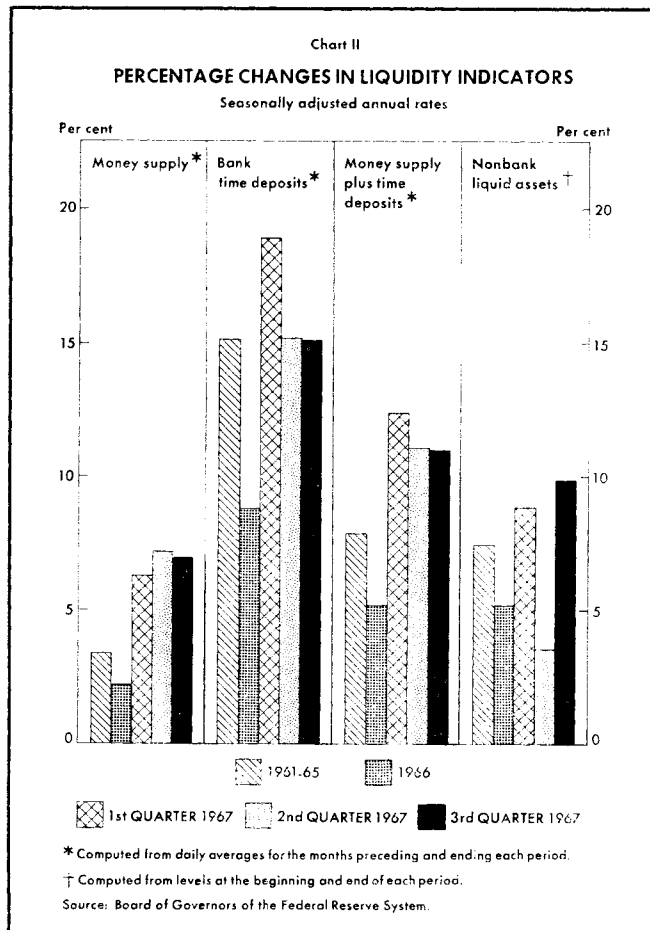
pronounced, from a June average of 76.2 per cent to 74.7 per cent in September. However, loan-deposit ratios at the end of September still remained high by recent standards.

#### **MONEY SUPPLY, BANK DEPOSITS, AND RESERVES**

Bank deposits and the money supply expanded during the third quarter at approximately the same rapid pace as in the second quarter (see Chart II). The seasonally adjusted money supply—currency outside banks and privately held demand deposits—rose \$3.0 billion over the quarter, or at an annual rate of 7 per cent. The advance occurred mostly in July and August, and there was only a modest further rise in September. The September slowdown was probably partially related to the midmonth corporate tax payments, which resulted in a shift of funds from private demand deposits to public accounts. Government demand deposits increased strongly in September.

Total time and savings deposits at commercial banks also continued to expand rapidly in the third quarter, rising by \$6.5 billion or at an annual rate of over 15 per cent. This brought the advance for the year through September to an annual rate of 17 per cent, roughly twice the rate of expansion in 1966 and above the strong average growth rate for 1961-65. Data from large weekly reporting commercial banks indicate that, over the third quarter, savings deposits grew at about the same moderate pace as in the first half of the year and other time deposits, excluding large negotiable certificates of deposit (C/D's), continued to post substantial advances. These developments indicate that commercial banks were able to compete effectively with rising yields on marketable securities and to maintain their competitive positions relative to other deposit-receiving institutions.

The volume of outstanding large C/D's increased slightly over the quarter. After remaining essentially unchanged from March through June, as large accelerated tax payments limited the ability of corporations to acquire such assets, C/D's began to increase sharply immediately after the June tax date. This increase reflected higher rates offered by banks as well as the improved liquidity positions of corporations. Posted offering rates on C/D's moved up in all maturity brackets, and in many cases banks were willing to pay more than their posted rates for large blocks of money. However, following a sharp expansion of C/D's in July and August, there was a substantial runoff in mid-September, when many corporations required funds for dividend and tax payments. On balance, for the quarter as a whole, total outstanding C/D's increased by \$0.7 billion. In addition, commercial banks substantially increased their



of liquid assets was a sharp \$2 billion rise of short-term United States Government securities held by the nonbank public, following a net decline of such holdings in both the first and second quarters. The growth of currency and demand deposits, as noted earlier, was 7 per cent, about the same as the rapid rate of the previous three months. Total personal-type time and savings accounts at commercial banks, savings and loan associations, and mutual savings banks rose at a rapid pace of nearly 12 per cent per annum, slightly above the gain of the preceding quarter. The substantially higher level of rates on marketable securities in the third quarter does not, therefore, seem to have adversely affected the deposit performance of either commercial banks or the nonbank savings institutions, even though interest rates offered on deposits appear to have remained essentially unchanged in the third quarter.<sup>1</sup> This suggests that the competitive position of banks and other deposit-issuing savings institutions may have undergone an improvement since 1966, when large amounts of deposits were shifted into open market investments at interest rates comparable to those recently prevailing.

Growth of deposits at nonbank thrift institutions expanded by 10½ per cent (seasonally adjusted annual rate), slightly faster than the 9½ per cent gain in the second quarter, and savings and loan associations and mutual savings banks were able not only to continue rebuilding their liquidity but also to increase their mortgage lending substantially. Mortgages held by these two types of institutions increased at an 8.0 per cent annual rate in the third quarter, extending the steady recovery of their mortgage lending that has been apparent since the fall of 1966.

borrowings of Euro-dollars—foreign-owned dollar balances—during the third quarter.

Conditions in the money market remained generally comfortable during the third quarter. Nationwide free reserves averaged \$282 million on a daily average basis during the quarter. Nonborrowed reserves increased at a rapid rate, and borrowings by member banks from the Federal Reserve fell to the lowest level since the third quarter of 1962. Total reserves rose substantially faster than required reserves, and excess reserves—the difference between total and required reserves—rose to their highest level since the first quarter of 1965.

#### NONBANK LIQUIDITY

Liquid assets held by the nonbank public increased at an annual rate of about 10 per cent during the third quarter, substantially above the rapid pace in the first half of 1967 (see Chart II). The major source of the faster gains

<sup>1</sup> On September 21, President Johnson signed into law a one-year extension of the statute authorizing the regulatory authorities to set the interest rates financial institutions pay on deposits. In addition to extending existing ceilings on commercial banks (for details, see this *Review*, October 1966, page 221), the new law incorporates changes which became effective on July 1 in the maximum payments that could be made by mutual savings banks insured by the Federal Deposit Insurance Corporation (FDIC) and savings and loan associations affiliated with the Federal Home Loan Bank System (FHLBS). Thus, the current ceilings for these institutions are now (1) 5 per cent on all savings deposits in mutual savings banks insured with the FDIC and (2) 4¾ per cent maximum on all passbook savings in savings and loan associations in the FHLBS and up to 5¼ per cent on certificate accounts held for at least six months, with three major exceptions: (a) institutions paying more than 4¾ per cent prior to September 22, 1966 may pay up to 5 per cent on passbook savings and savings certificates, (b) institutions in California, Nevada, Alaska, and Hawaii may pay up to 5¼ per cent on certificates held for three years or more and 5¾ per cent on savings certificates if the funds were received prior to September 22, 1966, and (c) institutions in areas where the average interest rate on mutual savings bank deposits exceed 4¾ per cent may pay as high as 5 per cent on savings accounts.