FEDERAL RESERVE BANK OF NEW YORK

MONTHLY REVIEW

JUNE 1968

Contents

The Business Situation 107

The Money and Bond Markets in May 110

Foreign Liquid Assets in the United States, 1957-67 117

Volume 50 **No. 6**

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

The Business Situation

The growth of economic activity moderated in April, in part owing to the disorders that followed the murder of Dr. Martin Luther King, Jr. More recently, the pace of expansion appears to have accelerated again, and it is likely that the second-quarter rise in aggregate demand will at least equal the first quarter's sharp gain. Industrial production was unchanged in April, but probably increased in May when automobile assemblies rose substantially. The April rise in personal income was less than half the average gain of the preceding two months, when incomes were swelled by the minimum wage increase and the rise in social security benefits. Retail sales declined somewhat in April, following the extremely sharp gains in the first three months of the year. On the other hand, the erratic housing starts series moved up strongly in April, although building permits declined. Nonfarm payroll employment showed a modest gain over March, in large part attributable to the return of striking workers, and the overall unemployment rate edged down. Given the strength of aggregate demand and the generally tight labor market, cost and price pressures remain very strong.

OUTPUT, ORDERS, INVENTORIES, AND RESIDENTIAL CONSTRUCTION

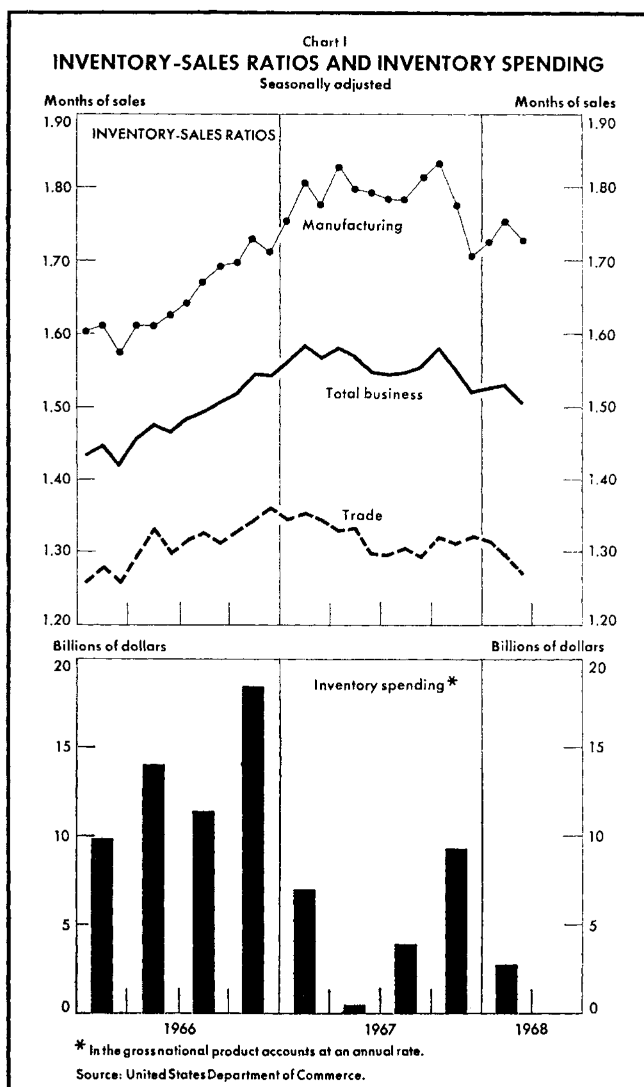
Industrial output in April held at the record March level, despite the civil disorders which cut into activity early in the month. The Federal Reserve Board's seasonally adjusted index of industrial production held at 162.7 per cent of the 1957-59 base, as virtually all major components were unchanged. Within the manufacturing sector, a decline in production of motor vehicles and parts was offset by a gain in primary metals and by the recovery in the clay, glass, and stone industry following the settlement of the seven-week glassblowers' strike. Automobile output was curtailed temporarily by the events following the death of Dr. King. While some of the lost production was made up later in the month, output for April as a whole fell 3½ per cent from the high March level to a seasonally adjusted annual rate of 8.6 million units. Preliminary figures for May, however, indicate that the assembly rate rose strongly, to a rate of 9.4 million units. Output of primary metals increased sharply in April, on the strength of a partial recovery in the copper industry following the April 8 strike settlement as well as in response to a continued heavy demand for steel inventories in anticipation of a possible steel strike this summer. This step-up in the rate of accumulation began late last fall, and stocks have reached a record level. According to preliminary reports, steel production continued at a high level in May.

The volume of new orders received by manufacturers of durable goods fell to $25.3 billion, $1.0 billion below the high March level. The decline was almost entirely due to a drop in orders for civilian aircraft, which followed an unusually large rise in March. Orders received in the machinery and equipment and in the primary metals industries, however, rose in April. The total volume of new orders continued to exceed durables shipments, and the orders backlog advanced to a new peak of $80.9 billion.

A step-up in the pace of inventory building may buoy industrial production in the near term. In an effort to offset an apparently unintended slowdown in the rate of inventory accumulation in the first quarter, businesses can be expected to raise their rate of inventory spending, although the size of this increase may be limited by a further growth of consumer demand. The behavior of inventory spending has been a key factor in the performance of the economy over the last eighteen months. By the final quarter of 1966, it was apparent that business expectations of a rapid expansion in consumer demand had resulted in a buildup in stocks which far exceeded the requirements of the sluggish sales levels that materialized in the latter

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

part of that year. With the ratio of inventories to sales reaching undesirably high levels (see Chart I), businesses sharply reduced the rate of accumulation in the first half of 1967, gradually bringing stocks into a more normal relation to sales. As measured in the gross national product (GNP), spending on inventories fell from a seasonally adjusted annual rate of $18.5 billion in the fourth quarter of 1966 to $7.1 billion in the first quarter of 1967 and then to only $0.5 billion in the second quarter. This very sharp cutback in inventory accumulation was in good part responsible for the sluggishness which characterized the economy in the first half of last year. By the second half of 1967, a substantial part of the adjustment had been completed, and at the same time the demand situation improved markedly. Inventory spending then began to rise, reaching a seasonally adjusted annual rate of $9.2 billion in the final quarter of the year.

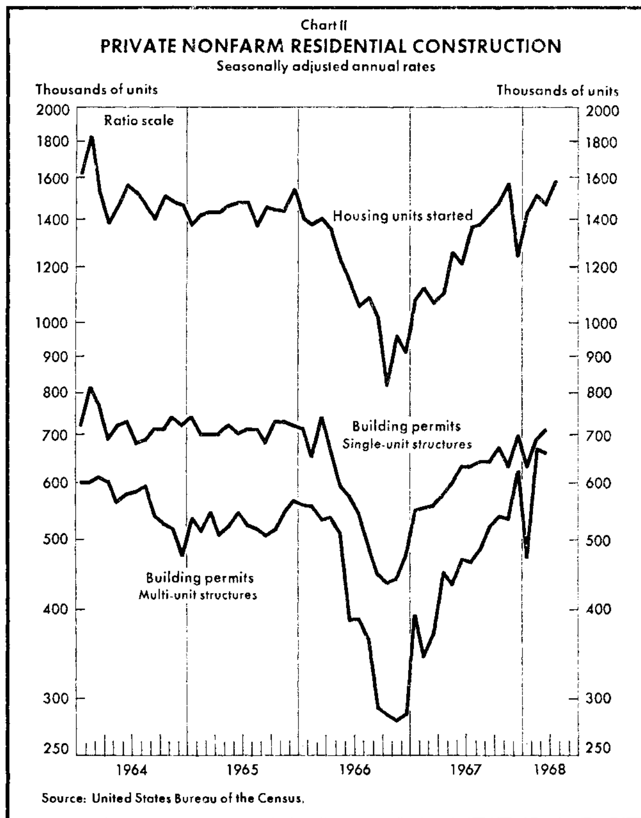


The first three months of 1968, however, saw a sharp reversal in the upward trend of accumulation. In contrast to the early 1967 situation, this drop in the rate of inventory investment appears to have resulted in part from a surge in consumer demand which exceeded business expectations. The consumer demand component of GNP, measured at a seasonally adjusted annual rate, rose in the first quarter by an unprecedented $16.9 billion.[1] This upsurge was due not only to the rapid expansion of incomes—stimulated by the increases in the minimum wage and social security benefits—but also to consumers' willingness to spend a substantially greater portion of their incomes. The Commerce Department now estimates that the savings rate, which has been running at very high levels since 1966, dropped to 6.6 per cent of disposable income in the first quarter, compared with 7.5 per cent in the final quarter of last year. Taken by itself, this decline in the savings rate accounted for about one fourth of the first-quarter advance in consumer spending. The strong rise in consumer spending cut heavily into business stocks—notably at the trade level—and the rate of inventory accumulation fell from the fourth quarter's $9.2 billion to only $2.7 billion. At the same time, the inventory-sales ratio for total business dropped to the lowest level since mid-1966. Because the first-quarter decline resulted primarily from a larger than expected rise in demand, inventory accumulation may well increase in the coming months. Indeed, in April, manufacturers' inventories rose by $¾ billion, the largest monthly advance since December 1966 and sharply above the $¼ billion average monthly increase of the first quarter.

The residential construction picture was mixed in April (see Chart II). The erratic series on nonfarm housing starts rose 8 per cent to a seasonally adjusted annual rate of 1.6 million units, the highest since early 1964. The number of units authorized by permits issued by local authorities, however, fell in April, perhaps reflecting the recent tightening in the home mortgage market. A considerable part of the strength in residential construction in recent months has come from the apartment-building

[1] The Department of Commerce has revised its preliminary estimate of first-quarter GNP, which was discussed in the May issue of this *Review*. Although final demand was revised up by $0.6 billion, inventory spending was revised down by $1.2 billion. Thus, at a seasonally adjusted $19.4 billion, the first-quarter increase in total GNP is $0.6 billion less than the preliminary estimate.

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



sector. The relative stability of single-unit permits contrasts with the upward movement in permits issued for multi-unit construction. While this divergence may reflect a shift in demand, many institutional investors have been reluctant to add to their holdings of single-family mortgages while continuing to acquire mortgages on multi-unit dwellings. In part, this policy is due to the fact that in some states there are usury ceilings on single-family mortgage rates which are below current market rates. In general, usury ceilings do not apply to mortgages on multi-unit dwellings.

EMPLOYMENT, INCOME, AND CONSUMER DEMAND

The employment situation remained tight in April. The unemployment rate dropped by 0.1 percentage point to 3.5 per cent of the labor force, matching the lowest rate since 1953. At the same time, the rate for married men —a key sector of the labor force—fell to a record low of 1.5 per cent. As to employment itself, the picture in April was clouded by the civil disorders which affected employment during the survey week. The payroll survey of nonfarm employment, conducted by the Bureau of Labor Statistics, registered a mild advance of about 100,000—chiefly due to the settlement of several labor disputes, notably those involving the glassblowers and copper workers. While the number of workers in mining and manufacturing thus moved up, declines were registered in the construction and trade sectors. Although construction employment has eased slightly for two months, following a very large gain in February, it continues to run at near-record levels.

Employment in the retail sector was particularly affected by the civil disorders. According to the household survey taken by the Bureau of the Census, the number of persons in the civilian labor force and the number employed both declined in April. (Unlike the payroll survey of employment, the household survey treats workers on strike as employed. Thus, the April household survey did not reflect the strike settlements which had a marked influence on payroll employment.) In this survey, the April decline in employment was centered in the number of women holding part-time jobs in the retail sector where curfews and disorders closed stores during the survey week.

The expansion of personal income in April, though about in line with the average monthly increase in 1967, appeared relatively small when compared with the unusually large gains in February and March. In those months, incomes were swelled by the hike in the minimum wage and the increase in social security benefits. In addition to the fact that personal income growth slowed to a more normal rate in April, the month's advance was also dampened by the effects of the nationwide strike by telephone workers.

The moderate April gain in income, set against a background of civil disorders, was accompanied by a decline in retail sales, according to the preliminary report of the Department of Commerce. Among the retail outlets, auto dealers were particularly affected by the disturbances following Dr. King's death, and April auto sales were down by about 10 per cent from March to a seasonally adjusted annual rate of 7.9 million units. Preliminary data for May, however, indicate that sales recovered sharply, rising to a rate of 8.5 million units.

PRICE AND COST DEVELOPMENTS

Prices continue to advance at both the retail and wholesale levels. The consumer price index moved up in April at an annual rate of 4.0 per cent, as prices of food, housing, apparel, and services all rose. The rate of increase in consumer prices accelerated sharply in the spring of last

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

year, and the index has continued to advance rapidly since that time. On a year-to-year basis, consumer prices rose 4.0 per cent over April of 1967—the highest rate of inflation in seventeen years. At the wholesale level, preliminary data for May indicate that a further jump in food prices outweighed a decline in industrial prices, pushing the wholesale price index up by 0.1 percentage point. Following nine months of large increases, industrial wholesale prices eased 0.2 percentage point in May, as copper prices fell from the inflated levels reached during the long strike in that industry.

Recent wage settlements continue to add pressure to the price situation. According to data tabulated by the Bureau of Labor Statistics, major collective bargaining agreements reached during the first quarter resulted in a median wage and benefit increase of 6.2 per cent a year, compared with a median of 5.2 per cent under agreements concluded during 1967. Moreover, the first quarter was marked by an exceptionally large rise in hourly labor compensation averaged for the entire private economy (though a substantial part of the advance was due to the nonrecurring effects of the increases in employer contributions for social insurance and in the minimum wage). Thus, despite a substantial improvement in output per man-hour, unit labor costs in the private economy increased significantly between the fourth and the first quarters.

The Money and Bond Markets in May

The financial community grew deeply apprehensive in May, as it weighed the potential economic consequences of the fiscal deadlock between the Congress and the Administration. Market uneasiness intensified after leaders in the House of Representatives decided at midmonth to delay a vote on the tax surcharge proposal at least until June. Many observers expected that further monetary restraint would be inevitable if no fiscal compromise materialized. Moreover, the sudden turmoil in France and renewed uncertainty in the international financial sphere contributed to the deepening tone of pessimism in the domestic financial markets. A somewhat more confident tone emerged in the money and bond markets toward the end of the month and rates eased somewhat, when hopes were rekindled that the Congress might at long last take positive action on the tax surcharge proposal. An undertone of uncertainty persisted, however, until the end of the month when the President stated that he would accept a $6 billion spending cut to insure a tax increase.

Despite the high interest rates that beset the money and bond markets, the demands for borrowed funds were substantial in May, adding to market pressures. There was a rapid flow of new and scheduled debt offerings from corporations and local governing authorities, as well as an expansion in the volume of short-term Treasury obligations because of the Treasury's May financing operations. At the same time, however, the volume of loanable funds available in these markets was generally quite limited since investment sources became reluctant to commit their funds to debt instruments, even at sharply lower prices.

In this setting, money market rates and yields on intermediate- and longer term obligations rose on a broad scale during the first two thirds of the month—frequently to record levels for modern times. As market rates increased sharply, observers grew fearful that a significant flow of funds out of savings institutions and commercial bank depository accounts into higher yielding obligations would result. The rates offered by the leading commercial banks on new negotiable time certificates of deposit (C/D's) were increased to the ceiling levels allowed under the provisions of Regulation Q (as revised in April) but, with yields on competing money market instruments rising more sharply, the net outstanding volume of C/D's contracted. In order to cover reserve deficits, the money market banks borrowed large sums in the Federal funds market, from their branches abroad and, to some extent, at the Federal Reserve "discount window". In addition, banks in the central money market reduced their holdings

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

of short-term tax-exempt securities. As the month progressed, commercial bankers became increasingly apprehensive over their ability to raise funds with which to accommodate loan demands in the coming months. Several major commercial banks announced increases of from ¼ per cent to ½ per cent (applied to the face amount) in the interest rates that they charge on many types of consumer instalment loans, the first broad rise in these rates since mid-1966.

THE GOVERNMENT SECURITIES MARKET

During the first half of May, much of the activity in the market for Treasury notes and bonds arose in response to the Treasury's May financing, the terms of which were announced on May 1.[1] The Treasury extended to owners of two outstanding issues maturing on May 15 the right to exchange their holdings for new 6 per cent seven-year notes, and—in a separate phase of the operation—also offered 6 per cent fifteen-month notes for cash subscription, pricing both issues at par. Subscription books were open from May 6 through May 8 for the seven-year notes and on May 8 only for the fifteen-month notes (for which commercial banks were permitted to make full payment through credits to Treasury Tax and Loan Accounts). The market responded favorably to the financing announcement, and initial price adjustments in outstanding issues were fairly modest. In early "when-issued" trading, the new 6's of 1975 moved to a premium bid of 100$^{6}/_{32}$ at a time when market sentiment was buoyed by reports that Paris had been selected as the site for preliminary Vietnam peace negotiations. However, the financing operation took place against a background of renewed uncertainty over the outlook for Congressional action on the proposed tax increase.

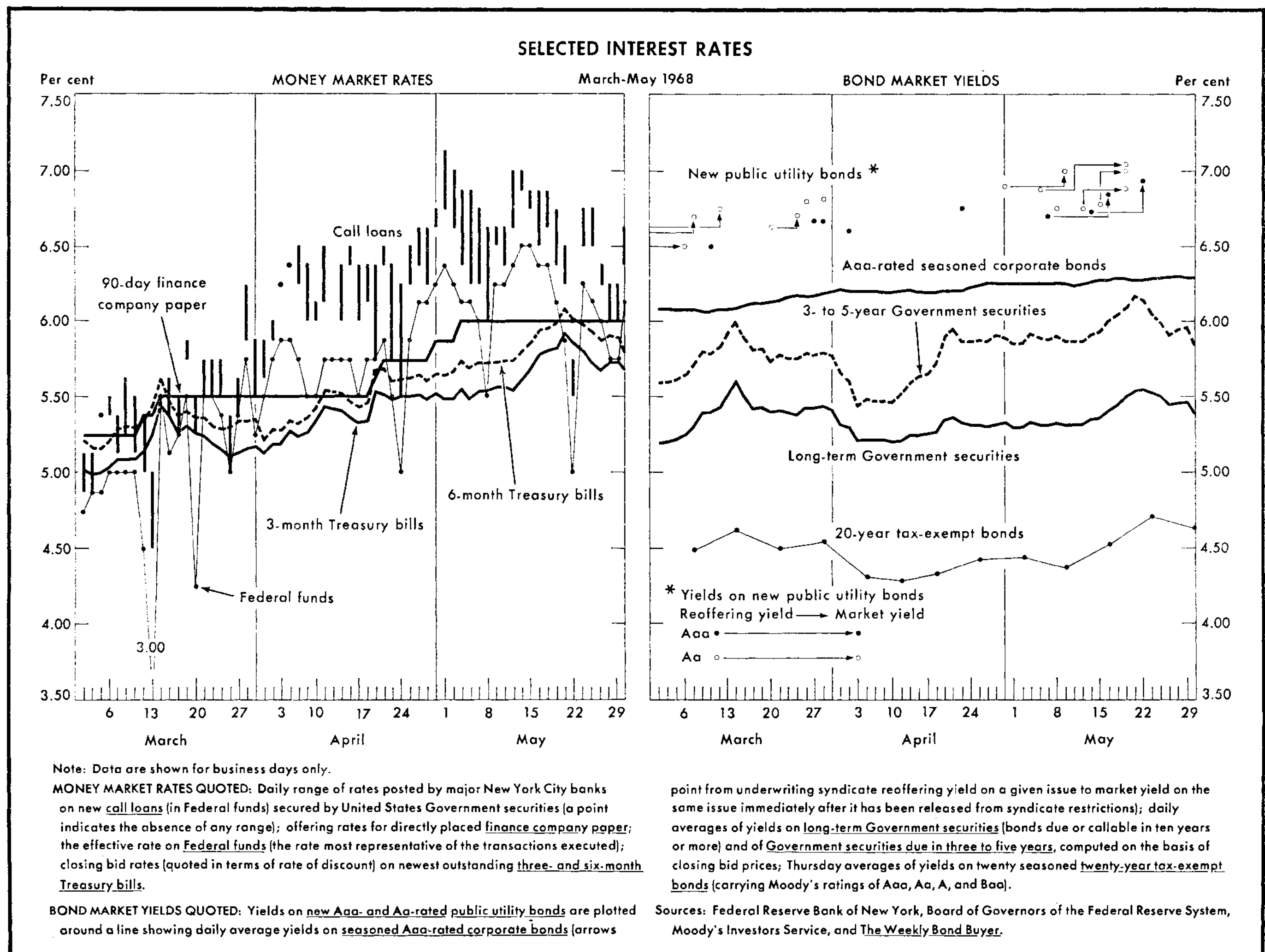
At the beginning of the month, some market observers had been inclined to think that prospects for an agreement between the Congress and the executive branch on a new tax and expenditures plan appeared to be improving. However, at a May 3 press conference, President Johnson, while strongly urging the Congress to take prompt action on a tax surcharge, indicated reservations about accepting a cut in expenditures greater than $4 billion. (The Senate had passed a bill combining a tax surcharge with a $6 billion spending cut. The larger spending cut was also favored by some key members of the House Ways and Means Committee.) Then, on May 6, the House Ways and Means Committee approved expenditure reductions of at least $4 billion and a tax increase closely in line with the Administration formula, and forwarded the bill to a Congressional conference group. Subsequently, the joint House-Senate Committee recommended a tax increase in combination with a $6 billion cut in expenditures. While the financial markets welcomed this news of positive action to achieve fiscal restraint, there was much uncertainty as to whether the tax-spending package could be passed by the full House and whether such a package would be acceptable to the Administration. Prospects for passage improved near the month end, however, when President Johnson agreed to accept the $6 billion spending cut.

Prices of Treasury notes and bonds fluctuated during the early part of the month in response to the barrage of international news and domestic fiscal developments. (See the right-hand panel of the chart for corresponding yield movements.) Some demand for the newly offered 6 per cent notes of 1975 (trading on a when-issued basis) arose largely in connection with swaps out of outstanding notes and bonds, but the availability in the market of rights was sizable and prices of the refunding issues moved narrowly during the subscription period. The results of the financing revealed that the Treasury had raised approximately $2 billion in new cash through its combined exchange and cash offering operation. About $6.7 billion of the $8 billion in Treasury notes and bonds maturing on May 15 was converted into the 6 per cent notes of 1975. The exchanges included $2.7 billion of the $3.9 billion of eligible maturing securities held outside the Federal Reserve Banks and Government accounts. The Treasury's cash offering of 6 per cent fifteen-month notes was oversubscribed. Total tenders exceeded $10 billion, including approximately $8.4 billion from commercial banks for their own account and $1.8 billion from all other sources. The Treasury accepted about $3.4 billion of these subscriptions, and set a 28 per cent allotment on subscriptions in excess of $100,000. (Subscriptions for $100,000 or less were allotted in full, while those exceeding $100,000—and thus subject to a partial allotment—were assured of at least $100,000.) The financing results surpassed the expectations of most market participants; however, there was little subsequent price reaction to the news.

As midmonth approached, commercial banks began to dispose of some coupon issues prior to the May 15 settlement date for the new fifteen-month Treasury notes (which, as noted, carried full Tax and Loan Account privileges and were, therefore, quite attractive to the banks). At the same time, investment buying of Treasury

[1] For details of the announcement, see this *Review* (May 1968), page 98.

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



Note: Data are shown for business days only.

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

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

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

notes and bonds contracted while dealers grew restive over the very firm tone of the money market and the persistently high cost of financing their securities positions. Against this background, prices of intermediate- and long-term Treasury notes and bonds drifted lower. The downward price movement gathered momentum after the mid-month decision by leaders in the House of Representatives to delay a vote on the tax surcharge until early June or later. This news generated renewed uncertainty over the fiscal outlook and the future course of interest rates throughout the securities markets. In the Treasury coupon sector, dealers became increasingly anxious to reduce their positions while investors grew more reluctant to commit their funds to debt obligations.

Subsequently, the bond market atmosphere became deeply pessimistic. The slow pace of the Paris peace talks made market participants feel that no near-term reduction in defense expenditures could be expected. Furthermore, many observers reasoned that the posture of monetary policy would continue to be restrictive for some time and might, in fact, become more so in the absence of fiscal restraint. The turbulent situation in France, the rising demands for gold in the European markets, and renewed pressures on the pound sterling cast new shadows over the international financial scene and reinforced the uneasiness of domestic bond markets. In this setting, the improvement reported in the first-quarter United States balance-of-payments position failed to elicit any significant optimism in the coupon sector. Thus, prices of Treasury notes and bonds moved steadily lower during the May 16 to May 21

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

period, primarily in response to selling pressure from professional sources, while investment activity subsided further.

An improved tone emerged in the coupon sector on May 23 when participants grew more optimistic about the fiscal restraint package, following comments by the Chairman of the House Ways and Means Committee to the effect that he expected the legislation to be passed. Subsequently, prices of Treasury notes and bonds moved irregularly higher. The market also reacted favorably when the President stated late in the month that he would reluctantly agree to a $6 billion cut in expenditures in order to gain Congressional approval of a tax increase.

In the market for Treasury bills, a fairly good atmosphere was evident in the opening days of May, when dealers anticipated that considerable reinvestment demand for bills might develop from sellers of rights to the Treasury's May refunding operations. However, a more cautious tone quickly appeared, as such demand fell short of expectations and high dealer financing costs (call loan rates posted by the major New York banks ranged from 6 to 7⅛ per cent in early May) generated selling pressure from professional sources. The perplexing, shifting status of the tax legislation in the Congress also exerted a continuous influence—sometimes bullish, at other times bearish—upon the bill sector. Although there was some net investment demand for the shortest bill maturities at times, investor interest in longer term bills was generally quite limited, while dealers became increasingly aggressive in their bill offerings. Against this background, rates for bills maturing beyond July generally moved higher through May 13 while rates on shorter bills declined slightly during this period. Subsequently, the bill market was adversely affected by the news that House action on the tax surcharge had been postponed and by renewed uncertainty over the future posture of monetary policy. From May 14 through May 21, bill rates rose sharply throughout the maturity spectrum in largely professional trading. (See the left-hand panel of the chart.) Investors did not contribute significantly to the selling pressure, but dealers termed investment demand disappointing. As bill yields moved higher, some market participants expressed concern that a further increase might be made in the Federal Reserve discount rate and in Regulation Q ceilings governing commercial bank time deposit rates.

A better tone developed in the bill market on May 22, and rates eased irregularly over the remainder of the month when demand expanded and participants became more hopeful that some fiscal restraint would materialize. Toward the close of the period, bill rates declined sharply in response to President Johnson's remarks on a spending reduction.

At the regular monthly auction of longer bill maturities on May 23, the new nine-month and one-year Treasury bills were awarded at average issuing rates of 6.086 per cent and 6.079 per cent, respectively (see Table III), in each case 42 basis points above the comparable average auction rates established a month earlier and the highest interest rates that the Treasury has paid on its direct obligations since the Civil War. However, at the final regular weekly bill auction of the month (held on May 27), average issuing rates on the new three- and six-month issues were set at 5.696 per cent and 5.869 per cent, respectively, 20 and 26 basis points above average auction rates on the comparable issues sold by the Treasury in late April but 15 and 13 basis points below rates set at the May 20 auction.

In the market for Government agency securities, prices of most outstanding issues declined steadily until late in the month in response to the same factors affecting prices in other markets for debt obligations. In addition, the announcement around midmonth that the Export-Import Bank would offer $500 million of participation certificates on June 4 also contributed to the nervousness of the agency sector. Several new agency issues reached the market in May, and at their generally attractive price levels drew fairly good receptions. On May 8, the Federal land banks offered at par $344 million of 6.30 per cent bonds (to replace $242 million of maturing securities and to raise $102 million in new cash); this issue was very well received at first. A week later, investors also accorded an excellent initial reception to a $326 million offering by the Federal Home Loan Banks of 6¼ per cent eleven-month notes (priced at par), which was used to roll over a maturing $300 million issue and to provide some new cash. On May 16, the Banks for Cooperatives floated $264 million of 6.20 per cent six-month debentures at par. The offering, which partially replaced a $352 million maturing issue, was well received at first but declined in price subsequently amid the generally cautious atmosphere prevailing in the market. On May 21, the Federal intermediate credit banks offered at par (for refunding purposes and to raise new cash) approximately $428 million of 6.45 per cent nine-month debentures which were well received. On May 29, the Federal National Mortgage Association offered $400 million of two-year 6.60 per cent debentures at par. The debentures, which replaced maturing securities, were generally well received.

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, prices fluctuated widely during the early part of the month

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

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MAY 1968

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

Factors	Changes in daily averages—week ended on					Net changes
	May 1	May 8	May 15	May 22	May 29	
"Market" factors						
Member bank required reserves*	+ 130	— 58	+ 330	— 88	+ 114	+ 428
Operating transactions (subtotal)	— 337	— 363	— 107	+ 29	— 230	—1,008
Federal Reserve float	— 380	+ 6	+ 26	+ 368	— 368	— 348
Treasury operations†	— 32	+ 149	— 120	— 123	+ 156	+ 30
Gold and foreign account	— 34	+ 46	+ 16	— 27	— 106	— 105
Currency outside banks*	+ 108	— 656	— 27	+ 36	+ 84	— 455
Other Federal Reserve accounts (net)‡	+ 4	+ 91	— 3	— 223	+ 3	— 128
Total "market" factors	— 207	— 421	+ 223	— 59	— 116	— 580
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 176	+ 97	— 131	+ 333	+ 187	+ 662
Bankers' acceptances	—	—	— 1	+ 1	—	—
Repurchase agreements:						
Government securities	+ 130	+ 272	+ 42	— 300	— 144	—
Bankers' acceptances	+ 13	+ 40	— 30	— 9	— 14	—
Federal agency obligations	+ 5	+ 10	— 7	— 5	— 3	—
Member bank borrowings	+ 23	+ 149	— 111	— 43	+ 95	+ 113
Other loans, discounts, and advances	—	— 1	— 1	—	—	— 2
Total	+ 348	+ 566	— 237	— 25	+ 121	+ 773
Excess reserves*	+ 141	+ 145	— 14	— 84	+ 5	+ 193
	Daily average levels					
Member bank:						
Total reserves, including vault cash*	25,514	25,717	25,373	25,377	25,268	25,450§
Required reserves*	25,247	25,305	24,975	25,063	24,949	25,108§
Excess reserves*	267	412	398	314	319	342§
Borrowings	674	823	712	669	764	728§
Free (+) or net borrowed (—) reserves*	— 407	— 411	— 314	— 355	— 445	— 386§
Nonborrowed reserves*	24,840	24,894	24,661	24,708	24,504	24,721§
	Changes in Wednesday levels					
System Account holdings of Government securities maturing in:						
Less than one year	+1,600	— 600	—3,189	— 284	+ 62	—2,411
More than one year	—	—	+3,565	—	+ 61	+3,626
Total	+1,600	— 600	+ 376	— 284	+ 123	+1,215

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 five weeks ended on May 29.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MAY 1968

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Averages of five weeks ended on May 29*
	May 1	May 8	May 15	May 22	May 29*	
Eight banks in New York City						
Reserve excess or deficiency(—)†	22	53	10	39	11	27
Less borrowings from Reserve Banks	60	64	123	—	77	65
Less net interbank Federal funds purchases or sales(—)	582	696	781	431	65	511
Gross purchases	*1,093*	*1,405*	*1,438*	*1,215*	*1,152*	*1,261*
Gross sales	*510*	*709*	*657*	*784*	*1,087*	*749*
Equals net basic reserve surplus or deficit(—)	— 621	— 707	— 894	— 392	— 131	— 549
Net loans to Government securities dealers	623	575	511	497	385	518
Thirty-eight banks outside New York City						
Reserve excess or deficiency(—)†	18	38	40	45	21	32
Less borrowings from Reserve Banks	107	298	99	139	134	155
Less net interbank Federal funds purchases or sales(—)	186	666	688	878	345	553
Gross purchases	*1,688*	*2,011*	*2,157*	*2,202*	*1,895*	*1,991*
Gross sales	*1,503*	*1,345*	*1,470*	*1,323*	*1,550*	*1,438*
Equals net basic reserve surplus or deficit(—)	— 274	— 926	— 747	— 972	— 458	— 675
Net loans to Government securities dealers	484	366	116	163	2	226

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—May 1968			
	May 6	May 13	May 20	May 27
Three-month	5.507	5.558	5.847	5.696
Six-month	5.697	5.750	5.995	5.869

Maturities	Monthly auction dates—March-May 1968		
	March 26	April 23	May 23
Nine-month	5.424	5.665	6.086
One-year	5.475	5.663	6.079

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

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

in a rapidly changing atmosphere. The status of the tax surcharge legislation and the Vietnam peace talks were the major influences on the corporate and tax-exempt markets during this period.

In the corporate sector, where yields on newly issued bonds had climbed to near-record levels in late April and where an increasingly heavy calendar of scheduled flotations was on tap for May, a very cautious tone persisted at the beginning of the month. A $50 million A-rated 1993 utility issue carrying no special call protection was reoffered to yield a record 7¼ per cent and initially encountered some investor resistance. However, the tone of the corporate bond market briefly improved in the wake of the House Ways and Means Committee vote favoring a tax increase. Two new high-grade utility issues (one rated Aaa and the other Aa), both with five-year call protection, were reoffered on May 7 and 8 to yield 6.70 per cent and 6.75 per cent, respectively, about 5 basis points below the yields offered on recent comparable issues, and were accorded fairly good investor receptions. Although a slightly better undertone also emerged in the market for tax-exempt bonds during this period, the Blue List of dealers' advertised inventories remained quite high, the calendar of scheduled flotations continued to swell, and the adverse technical position of the sector exerted considerable restraint upon market sentiment.

As midmonth approached, the markets for corporate and tax-exempt bonds focused with increasing concern upon the uncertain outlook for final passage of the tax surcharge (and other pending fiscal measures), the related future course of monetary policy, and the unsettled international financial situation. The persisting firm tone of the money market and the unabated growth in the calendar of scheduled corporate and tax-exempt bond issues also contributed significantly to a weakening tone in these sectors. On May 14, an issue of $70 million of Aaa-rated telephone company debentures (due in 2008) with five years of call protection was offered to yield about 6.73 per cent and—in reflection of the rapidly worsening tone of the corporate sector—was poorly received by investors. During the same period, diminishing investor demand prompted the lifting of underwriter pricing restrictions on two corporate issues with unsold balances, and subsequent price concessions boosted yields by about 10 basis points in each case. In the tax-exempt sector, the Blue List climbed around midmonth to its highest level of the year and, despite the absence of much investor demand, a steady stream of new offerings was announced by state and local governmental authorities. Yields on seasoned tax-exempt issues rose sharply, while underwriters vainly attempted to stimulate investor interest in slow-moving recent issues by reducing prices to raise yields as much as 15 to 20 basis points.

The tone of the corporate and tax-exempt markets deteriorated further after midmonth. In the tax-exempt sector, as market yields continued to rise sharply, New York City on May 21 rejected bids for $71 million of its notes because of its dissatisfaction with the level of interest costs. At the same time, another large municipality canceled a scheduled bond sale as a result of the unsettled market conditions. In the corporate sector, syndicate price restrictions on several recent flotations were lifted, and yields were adjusted sharply higher.

In the closing days of May, a better tone emerged in the corporate and tax-exempt sectors and prices rallied, when participants became more optimistic about the Federal fiscal outlook.

Over the month as a whole, the Blue List of dealers' advertised inventories of tax-exempt bonds fell by $72 million to $513 million, while *The Weekly Bond Buyer's* average yield for twenty seasoned tax-exempt issues (carrying ratings ranging from Aaa to Baa) rose sharply to 4.64 per cent, 21 basis points above its level at the end of April. In the corporate sector, Moody's index of yields on Aaa-rated seasoned corporate bonds rose to 6.29 per cent by May 31, as against 6.25 per cent at the end of April. (See the right-hand panel of the chart.)

BANK RESERVES AND THE MONEY MARKET

The tone of the money market was generally firm in May. Although nationwide reserve availability was fairly stable over the month as a whole (see Table I), market expectations deteriorated, credit demands increased, and rates on a wide spectrum of money market instruments moved higher. The bulk of Federal funds transactions occurred in a 5¾ to 6½ per cent range, significantly above the 5½ per cent discount rate, and the rates posted by the major New York City banks on new loans to Government securities dealers frequently ranged from 6 per cent to 7 per cent. Before the end of May, rates on Treasury bills had climbed to record highs, bankers' acceptance rates had risen by ¼ per cent, and rates on directly placed and dealer-placed commercial paper were ⅛ per cent and ¼ per cent, respectively, higher than at the end of April. In the last few days of May, the money market was somewhat less taut and key market rates receded from their highs. Over much of the month, the leading commercial banks offered new time C/D's close to or at the ceiling rates permitted by Federal Reserve regulation, and encountered increasing difficulty in attracting such deposits.

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

During the first half of May, the reserve positions of banks in the major money market centers remained under substantial pressure (see Table II). In the two weeks ended on May 15, the basic reserve deficits of the major banks in New York City deepened somewhat, largely in reflection of increased bank lending to Government securities dealers during the Treasury's May financing operations coupled with declines in demand deposits. Nationwide reserve availability (as measured by net borrowed reserves) remained fairly steady during the early part of May and increased moderately around midmonth, when required reserves contracted. During much of this period, however, reserve distribution favored banks outside the money centers, and the reserve city banks turned to several sources in their search for funds to cover their mounting reserve deficiencies. Thus, they bid strongly for Federal funds at effective rates of from 6⅛ per cent to 6½ per cent and occasionally as high as a record 6⅝ per cent. At the same time, the pace of bank borrowing from their affiliates abroad accelerated during this period and balances due to the foreign branches of the leading New York City banks expanded steadily to record levels. Banks also continued to borrow a considerable volume of funds from the Federal Reserve Banks to fill their residual reserve needs, and member bank borrowings at the discount window averaged over $750 million in the two weeks ended on May 15. In addition, the New York City banks substantially reduced their holdings of short-term tax-exempt obligations during this period. During the second half of the month, the tone of the money market was generally firm but less taut than earlier. Nationwide reserve availability contracted approximately to its early May range, but banks in the central money market managed to accumulate a greater volume of excess reserves and moved into a somewhat more comfortable basic reserve position. Banks located outside the central money market remained under considerable reserve pressure, however.

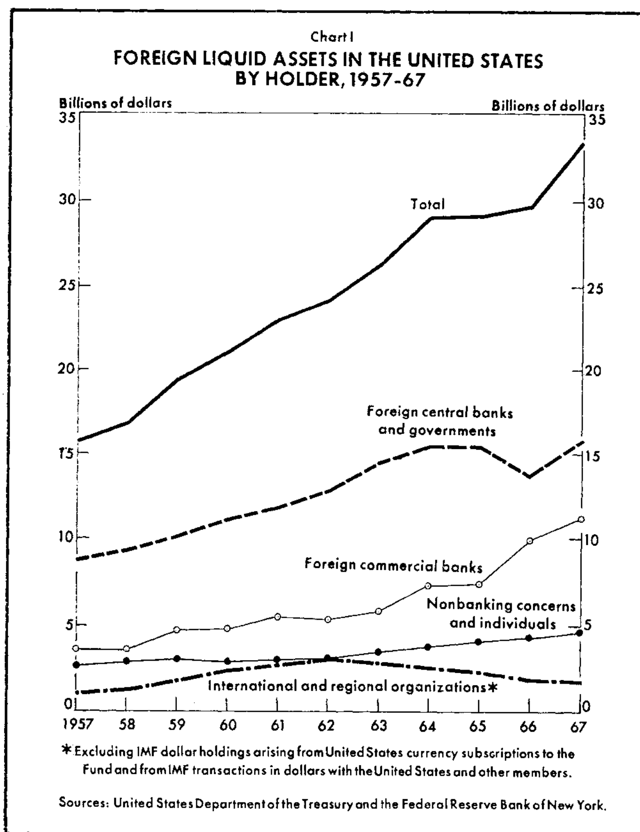
Rates posted by the New York City banks on new negotiable time C/D's of under six-month maturity were generally quoted at the highest rates permitted by Federal Reserve regulation throughout the month. On C/D's maturing in 180 days or more, the 6¼ per cent ceiling rate was posted by several major money market banks early in the period and by virtually all banks at the close of the month. As the month progressed, and rates on other money market instruments rose above Regulation Q ceilings, the banks experienced some difficulty in replacing maturing C/D's. The major New York City banks reported a $260 million net decline in their outstanding C/D's over the five weeks ended on May 29.

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

Foreign Liquid Assets in the United States, 1957-67*

Foreign liquid assets held in the United States have more than doubled over the last decade. At the end of 1967 they stood at almost $33½ billion (see Chart I), with the bulk of these holdings accounted for by foreign monetary authorities and foreign commercial banks.[1] The reasons for maintaining liquid assets in the United States, of course, vary with the foreign holder. However, almost all these foreign holdings reflect the dollar's predominant role as a store of value and means of international payment and rest on foreign confidence in its stability. Foreign monetary authorities have been willing to build up large liquid dollar balances, because the dollar has proved to be an attractive international reserve asset and the principal medium for official foreign exchange operations. At the end of last year these liquid asset holdings stood at just over $15½ billion. As shown in Chart II, they accounted for nearly half the total of all foreign liquid assets in the United States.

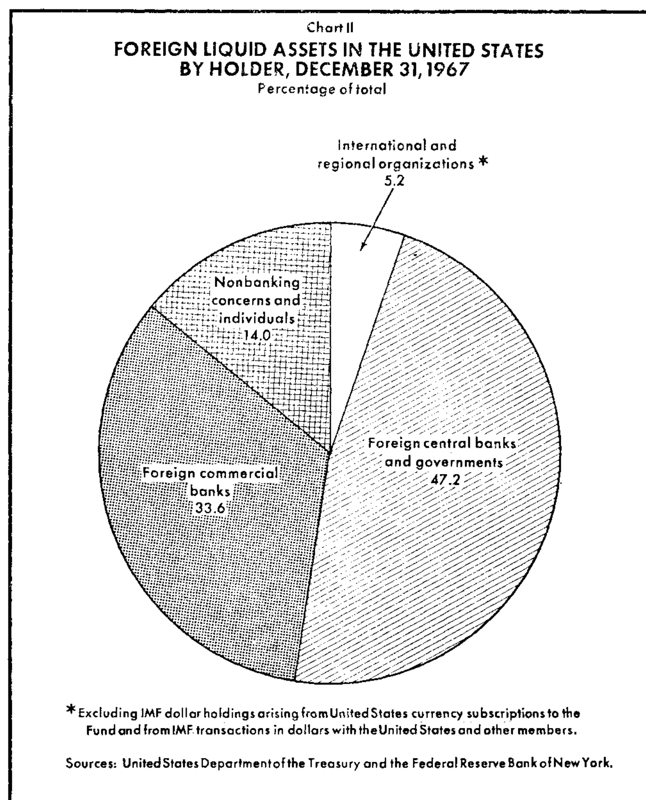
At the same time, private foreigners have acquired substantial liquid assets here for use in a growing volume of international commercial and financial transactions and because of the wide range of investment opportunities in the United States. The growth of the Euro-dollar market —particularly the participation in this market of United States banks as borrowers through their foreign branches —has been a major factor in the growth of privately held liquid assets in the United States. Furthermore, the operations of foreign banks through branches and agencies in the United States has contributed substantially to the growth of such holdings. Thus, foreign commercial banks accounted for the bulk of the increase in the aggregate of foreign private liquid assets held in the United States to nearly $16 billion at the end of 1967, an amount more than two and one-half times the level outstanding ten years earlier. Dur-



* Leon Korobow, Special Assistant, Foreign Department, had primary responsibility for the preparation of this article.

[1] Foreign liquid assets in the United States, as defined for balance-of-payments purposes, consist of demand deposits, time deposits of not more than one year's original maturity, United States Treasury securities that are marketable or convertible (without regard to maturity), and other assets—such as negotiable certificates of deposit, bankers' acceptances, and commercial paper—held by foreigners in United States banking institutions and having an original maturity of not more than one year. The bulk of these holdings is denominated in United States dollars; at the end of 1967 only $915 million was denominated in foreign currencies. In addition, a small amount represented United States liabilities to the International Monetary Fund which arose in connection with the IMF's general gold deposits in the United States. Foreign liquid assets held in the United States do not, however, include gold held for foreign governments at the Federal Reserve Bank of New York.

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



ing the same period, international and regional organizations acquired almost $1 billion of liquid assets in the United States, bringing their holdings to over $1½ billion at the end of 1967.

In addition to their liquid assets, foreigners—mainly national monetary authorities and international and regional organizations—have increased their holdings in the United States of near-liquid assets to a total of $2½ billion by the end of 1967. These assets consist principally of time deposits in United States banks, including certificates of deposit (C/D's), having an original maturity of more than one year. Although these holdings are considered long-term investments in the United States balance of payments, they have many attributes of liquidity.[2]

Although foreign monetary authorities have added very substantially to their dollar reserves over the period as a whole, they have increased their gold reserves by an even larger amount. Since the United States Treasury was a major supplier of this gold, United States gold reserves fell by about $10¾ billion during the period 1957-67. This decline, by and large, was the result of gold sales to a small number of Western European countries. However, in 1967 nearly all the drain of just under $1¼ billion represented the United States share of the losses sustained by the active members of the Gold Pool in stabilizing the market price of gold in London.

OWNERSHIP OF FOREIGN LIQUID ASSETS IN THE UNITED STATES

In analyzing the distribution of foreign liquid assets in the United States—by both type and location of owner—it must be kept in mind that the reported data can be difficult to interpret. For example, increased deposits by official institutions in the Euro-dollar market may be accompanied by a rise in private foreigners' liquid holdings in the United States, as the banks receiving the deposits hold them in their own name or relend them to other foreign banks or firms. In addition, official forward exchange operations by both the United States and foreign monetary authorities can give rise to temporary shifts in liquid dollars held in the United States from official to private hands. Another complication for the analysis of ownership results from dollar deposits placed by residents in one country with banks in another foreign country and lent onward, finally to appear in United States statistics as liabilities to still another country.

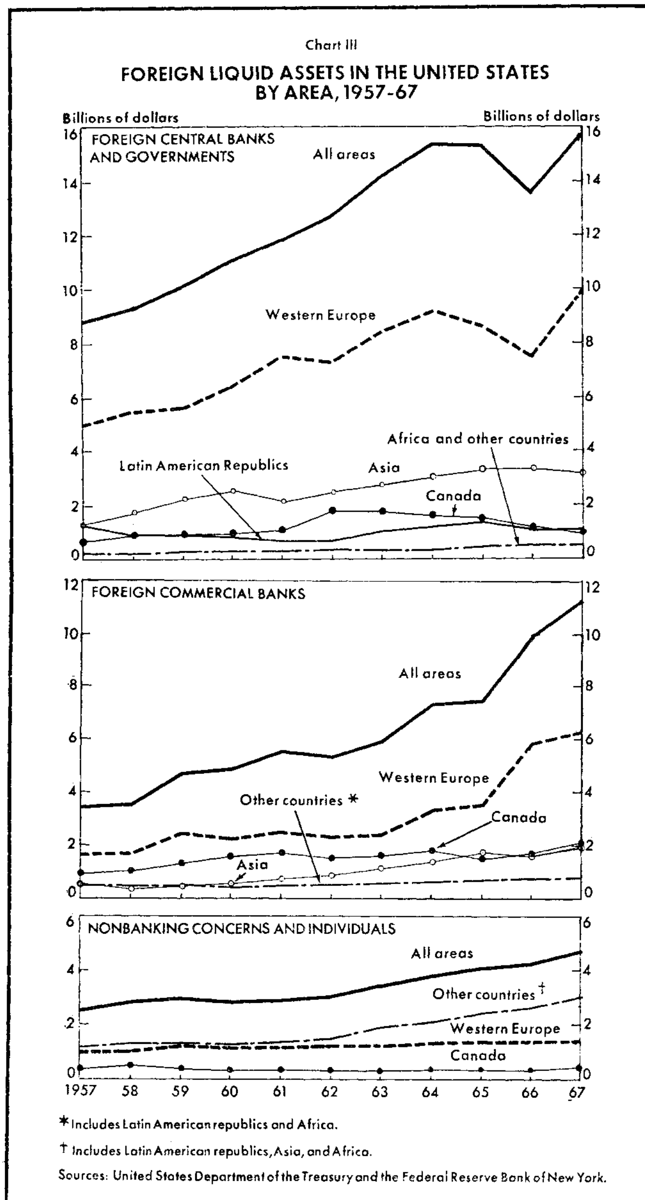
Moreover, foreign-held liquid dollars in the United States are subject to influences which can produce rather sharp movements between owners as reported by type and country. Thus, rapid shifts of funds can take place across international currency exchanges, reflecting actual or anticipated changes in conditions in major financial markets in response to altered domestic or international economic and political developments. Nevertheless, during the period under review, significant patterns have emerged not only in the ownership but also in the composition of these foreign-owned assets in the United States, and these patterns are discussed in the sections to follow.

FOREIGN CENTRAL BANKS AND GOVERNMENTS. Foreign central banks and governments increased their liquid assets here by nearly $7 billion in the decade after the end of 1957. Western European monetary authorities, whose liquid holdings in the United States totaled almost $10 billion at the end of 1967, accounted for about $4¾ billion of this increase in official holdings to a new peak (see Chart III). However, official Western European holdings declined sharply in 1966, before recovering the next year. In 1966,

[2] For a historical series giving United States banks' long-term liabilities to foreigners, see the *Federal Reserve Bulletin.*

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

tight monetary conditions in the United States led United States banks to make heavy use of foreign-owned dollar balances acquired through their foreign branches, particularly those in Western Europe. The branches (which are regarded as foreign banks in the United States balance-of-payments statistics) actively sought foreign-owned dollars for placement in accounts with their respective parent organizations. As private foreigners in turn acquired dollar balances for placement with the branches, central bank holdings were reduced in the aggregate. In addition, the branches, notably those located in the United Kingdom, received substantial offerings of liquid dollars as funds flowed from official United Kingdom reserves to private foreign holders during the market uncertainties in the spring and summer of 1966, when foreign investors sharply reduced their sterling balances.



* Includes Latin American republics and Africa.
† Includes Latin American republics, Asia, and Africa.
Sources: United States Department of the Treasury and the Federal Reserve Bank of New York.

The easing of monetary conditions in the United States late in 1966, however, set the stage for a sharp reflow of funds to foreign monetary authorities. By the year-end, United States banks had started to reduce borrowings from their foreign branches. These branches in turn began to pour back into the Euro-dollar market the funds obtained earlier when pressures were acute. Moreover, as the new year began, returning confidence in sterling sparked a strong demand for pounds, and a sizable covered interest incentive emerged in favor of short-term investments in the United Kingdom. These developments combined through the first quarter of 1967 to produce large movements of funds through the Euro-dollar market into official hands, with the Bank of England the principal beneficiary of this influx. Such flows continued at a much reduced pace in the spring and, as midyear approached, were interrupted by the increasing tensions in the Middle East, culminating in the outbreak of war in June. In those circumstances, heavy flows of funds between official and private holders of dollars as well as among foreign central banks swept through the foreign exchanges before more normal conditions were restored with the cessation of fighting.

But new doubts about currency parities—particularly sterling—soon reasserted themselves and gathered momentum during the summer and fall. The events surrounding the devaluation of the pound in November 1967 and the ensuing uncertainties in December triggered unprecedented flows of funds between central banks and between official and private holders. In the aggregate, official liquid holdings here rose by about $1½ billion in the latter part of 1967, thus accounting for most of the year's rise. This increase was entirely concentrated among official holders in Western Europe, where currency uncertainties distorted normal international commercial and financial flows and generated massive repatriations of funds from sterling and Euro-dollars into local currencies. During 1967, official operations conducted to ease the impact of these flows of funds added to the aggregate of outstanding foreign liquid assets in the United States, both official and private.[3]

[3] For a description of these official operations, see Charles A. Coombs, "Treasury and Federal Reserve Foreign Exchange Operations", this *Review* (March 1968), pages 38-52.

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

In contrast to the recent sharp movements in the liquid assets in the United States owned by monetary authorities in Western Europe, Asian central bank holdings here have grown rather steadily during the past decade. Asian holdings increased by nearly $2 billion during the entire period under review, reaching just over $3 billion by the end of 1967. A substantial portion of this gain was accounted for by Japan as a consequence of that country's growing strength in international trade and finance. The modest dip in official Asian assets last year largely resulted from shifts of liquid dollars into long-term time deposits in the United States.

Canadian official assets in the United States reached a peak in 1962 in the wake of Canada's recovery from an exchange market crisis in the early part of that year. At that time Canada's official holdings in the United States were significantly bolstered by substantial gold sales to the United States and a large drawing from the International Monetary Fund (IMF). The subsequent gradual decline in Canada's liquid holdings here reflected a number of factors, including repayment of the IMF drawing, conversions into United States dollars of Canadian dollars drawn from the IMF by other Fund members, and short-term capital outflows in response to the pull of the high United States money market rates in 1966. In addition, in 1966 and 1967, the Canadian government purchased outstanding securities from United States residents.[4]

The liquid assets in the United States of the Latin American republics at the end of 1967 (about $1 billion) were somewhat below the level of ten years earlier. Moreover, few of the newly formed African central banks added significantly to their holdings in the United States during this period.

PRIVATE FOREIGNERS. As noted above, the activities of United States banks in obtaining funds through their foreign branches and the operations of foreign commercial banks through their branches and agencies in the United States have made a very substantial contribution to the growth of foreign commercial banks' aggregate holdings of liquid assets in the United States; these foreign-owned assets rose to about $11 billion by the end of 1967, more than triple the amount outstanding ten years earlier (see Chart III). In collecting and placing liquid dollars with their head offices, the United States banks' foreign branches, which are foreign banks for balance-of-payments purposes, obtain liquid claims on the United States institutions. It should be noted that these placements are not subject to legal reserve requirements and Federal Deposit Insurance Corporation charges because they are not deposits as defined by the applicable regulations. Moreover, the interest rates that foreign branches pay on time deposits placed with them are not subject to Regulation Q ceilings. As monetary conditions tightened in the United States in 1966, United States banks intensified their search for foreign-owned dollars through more aggressive bidding for Euro-dollars by their overseas branches. These efforts were very successful, and over the course of that year the branches increased the funds held with their head offices in the United States by an extraordinarily large amount—about $2 billion. To some extent, of course, the United States branches were the recipients of money flowing out of sterling during the spring and summer of that year.

Total outstanding placements by foreign branches with their head offices in the United States reached a peak for the year in excess of $4 billion in mid-December 1966. The subsequent easing of money market conditions in the United States was an important factor in a reduction of more than $1 billion from that peak in the first half of 1967. During the last six months of 1967, however, United States banks' liabilities to their foreign branches surged ahead, reaching new peaks briefly late in the year. The renewed advance in branch placements with head offices was partly in response to favorable interest cost differentials between rates on C/D's and Euro-dollars through the late summer of 1967 and, to some extent, probably also reflected anticipations of tighter monetary conditions in the United States. In addition, during November and December of 1967, United States banks' foreign branches had received substantial funds in the wake of the severe disturbances that had dominated the exchange markets in these months.

The operations of United States-owned foreign branches not only have affected the growth of total foreign commercial banks' liquid assets in the United States, but have also strongly influenced their regional distribution. Western European banks, which are at the center of the Euro-dollar market, accounted for more than one half of the $11 billion total of foreign commercial banks' liquid assets here as of the end of 1967 and for about 60 per cent

[4] During the period, Canada implemented its agreement of July 1963 with the United States (subsequently amended) to keep its international reserves within an agreed limit in return for exemption on new securities issues from the United States interest equalization tax and the guidelines applicable to long-term investments by nonbank financial institutions cooperating with the President's voluntary foreign credit restraint program. Discussion and details of this agreement can be found in the Bank of Canada's *Annual Report of the Governor to the Minister of Finance,* 1965 and 1966.

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

of their growth since 1957 (see Chart III). At the end of 1967, more than half of the Western European total consisted of the holdings of commercial banks in the United Kingdom, where the operations of United States-owned branches have been especially important. It should be noted that commercial banks and official institutions in other Western European countries as well as in other parts of the world hold substantial liquid dollar balances in the form of claims on United Kingdom banks, and United Kingdom banks in turn hold portions of these funds as liquid balances in the United States.[5] Commercial banks in other major Western European countries—notably Swiss banks, traditionally havens for foreign-owned funds—also hold significant amounts of liquid dollars in the United States.

The activities of Canadian banks, operating through their United States agencies and affiliates, have contributed significantly to the relatively rapid growth of foreign commercial banks' liquid assets in the United States. The Canadian agencies, which are not deposit-taking institutions, have acted as intermediaries on behalf of their head offices in Canada, which have offered United States corporations attractive rates and maturities for United States dollar deposits. If the Canadian head offices place such funds in liquid form with their New York agencies, these institutions acquire dollar liabilities to their Canadian head offices. The agencies in turn use these balances to finance loans to brokers and securities dealers and in other operations in the New York money and loan markets.[6] Canadian banks not only function as intermediaries in the United States market, but the home offices also accept and place Euro-dollars in other countries and accept dollar deposits from and extend dollar loans to Canadian residents. These operations contributed significantly to movements in Canadian commercial banks' liquid holdings in the United States, which have remained in excess of $1½ billion in recent years and in 1967 rose to a new peak for the period of about $2 billion.

The holdings of Asian commercial banks constituted about 17 per cent of the December 1967 total of all foreign commercial banks' liquid assets in the United States. Both their substantial size and relatively sharp growth have been heavily influenced by the increase of the liabilities of Japanese agencies in the United States to their head offices in Japan. The Japanese agencies in the United States, like the Canadian agencies, are regarded as domestic institutions in the United States balance of payments, and therefore the funds deposited with them by their head offices in Japan are regarded as foreign liquid assets. The agencies in turn employ the dollars to finance Japan's international trade. In addition, part of the Japanese agencies' liabilities to their head offices represents trade bills drawn on United States importers and then forwarded by the head offices in Japan to the United States agencies. The latter normally accept the instruments, credit the head offices with liquid claims, and then hold the instruments to maturity.

In addition to the factors just described, foreign commercial banks' liquid asset holdings in the United States have grown moderately in response to working-balance needs associated with the expansion of international trade and finance.

Private nonbanking concerns' and individuals' liquid assets here have shown a fairly steady uptrend since 1957, and by the end of 1967 stood at just over $4½ billion. Most of the growth since 1957 in this category of foreign liquid assets is attributable to an increase in Latin American holdings, which accounted for half of the total at the end of 1967. Apart from the liquidity requirements of Latin American-based businesses, particularly in the petroleum industry, individuals and corporations in many Latin American countries have found dollar balances, notably short-term time and savings deposits, increasingly attractive investments in the face of continuing domestic inflation and currency uncertainties. Western Europeans held about 30 per cent of the aggregate of these privately held liquid assets at the end of 1967; such holdings are importantly influenced by the growth of contingency reserves of foreign-owned life insurance companies operating in the United States.

INTERNATIONAL AND REGIONAL ORGANIZATIONS. At the end of 1967, international and regional organizations held somewhat more than $1½ billion of liquid assets in the

[5] The extent to which banks in the United Kingdom have served as a center for the mobilization of foreign-owned dollars is indicated by Bank of England data on United Kingdom banks' external liabilities in dollars. These data show that, at the end of 1967, United Kingdom banks' total deposit liabilities denominated in dollars to nonresidents stood at about $9½ billion. See Bank of England, *Quarterly Bulletin* (March 1968), page 83.

[6] New York State banking statutes prior to 1960 prohibited foreign commercial banks from opening branches—i.e., offices that accept deposits for their own account—although foreign banks could and still can operate agencies in New York. But no outright restrictions prevented foreign banks from organizing a banking subsidiary under a New York State charter, an option which several foreign banks have chosen. In 1960, new legislation permitted foreign commercial banks to open branches in New York State, provided that United States banking institutions were accorded reciprocal privileges in the country in which the foreign bank is domiciled. A number of foreign commercial banks have elected to take advantage of the opportunity to open a branch in New York State.

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

United States.[7] Changes in these holdings mainly reflect a number of special transactions of the IMF, the operations of the International Bank for Reconstruction and Development (IBRD), and the activities of the Inter-American Development Bank (IADB).

During the period under review, the IMF increased its liquid assets in the United States, by more than $775 million, to $1 billion at the end of last year. This gain resulted largely from reversible Fund gold sales to the United States to obtain earning assets and from IMF gold deposits placed with the United States to mitigate other Fund members' gold purchases made in connection with subscriptions under the 1965 IMF quota increase. The liquid dollar balances of the IBRD and the IADB reached a peak of just over $2 billion in 1962, as resources for lending accumulated faster than loan disbursements. Subsequently, these holdings fell to about $675 million by the end of 1967 as a result of more rapid use of resources and sizable shifts of liquid dollars into long-term time deposits.

COMPOSITION OF FOREIGN LIQUID ASSETS IN THE UNITED STATES

FOREIGN CENTRAL BANKS AND GOVERNMENTS. There are marked differences in the type of liquid assets held in the United States by foreign official institutions, compared with those held by private foreigners. Foreign central banks have held the bulk of their liquid assets in the United States in those short-term instruments providing a maximum of security and liquidity. These requirements have been met largely by United States Treasury securities, because the broad and active markets for these instruments have assured easy liquidation of sizable amounts. At the end of 1967 more than 60 per cent of these liquid holdings of foreign monetary authorities took the form of United States Government securities (see Chart IV). While these assets are concentrated in short-term United States Treasury obligations (bills and certificates of indebtedness), foreign central banks and governments also hold a sizable amount of United States Government bonds and notes (see Chart V).

Foreign central bank holdings of short-term United States Treasury securities largely reflect routine investments in Treasury bills. However, from time to time these banks have temporarily acquired liquid dollars in the form of special United States Treasury certificates of indebtedness as a result of inter-central-bank reciprocal currency operations.[8] For example, when the United States initiates a swap drawing on a foreign central bank, the United States obtains a specific amount of foreign currency and the foreign central bank obtains an equivalent amount of dollars. These dollars are generally invested in special United States Treasury certificates, although some foreign monetary authorities have chosen to place the dollars in Treasury bills. Normally, the United States uses the foreign exchange so acquired to purchase dollars held by the foreign central bank pending reversal of the short-term swap contract. Thus no net increase in aggregate central bank liquid holdings in the United States takes place, although United States swap drawings usually result in an increase in the special Treasury certificates outstanding during the term of the swap. In contrast, a swap drawing on the United States by a foreign central bank increases the total of foreign liquid assets held here (matched by an equivalent amount of United States foreign currency assets). These assets arise in the form of special Treasury certificates (or in the form of Treasury bills) unless the foreign central bank immediately disburses the dollars in foreign exchange market operations or subsequently turns the Treasury instrument into cash. Outstanding Treasury certificates of indebtedness arising from swap drawings totaled nearly $1½ billion at the end of 1967; this amount by and large reflected drawings by the United States.

In addition to the short-term United States Treasury securities denominated in dollars described above, there was outstanding at the end of 1967 about $150 million equivalent of special Treasury certificates of indebtedness denominated in foreign currencies. These certificates were sold by the United States Treasury to foreign monetary

[7] These holdings exclude about $4¾ billion of IMF-owned dollars which arose mainly in connection with the United States currency subscription to the Fund but also as a result of United States drawings on the IMF. United States transactions with the IMF, as well as other members' transactions in dollars with the Fund, are accorded special treatment in the United States balance of payments; the net of changes in these transactions represents the change in the United States reserve position with the IMF. With outstanding United States drawings on the IMF still within the "gold tranche" (i.e., the amount equal to 25 per cent of a country's quota that can be drawn virtually at will), the change in the United States reserve position with the Fund is treated as part of United States monetary reserves in the balance of payments. See the *Treasury Bulletin* or the *Federal Reserve Bulletin* for a historical series on IMF liquid dollar holdings and dollar transactions with the United States and other Fund members.

[8] United States Treasury certificates of indebtedness are short-term instruments issued with a given coupon rate. Such instruments have been issued in marketable form or in the form of special Treasury certificates which are nonmarketable but are convertible into cash at short notice. At the end of 1967, only the special Treasury certificates of indebtedness were outstanding.

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

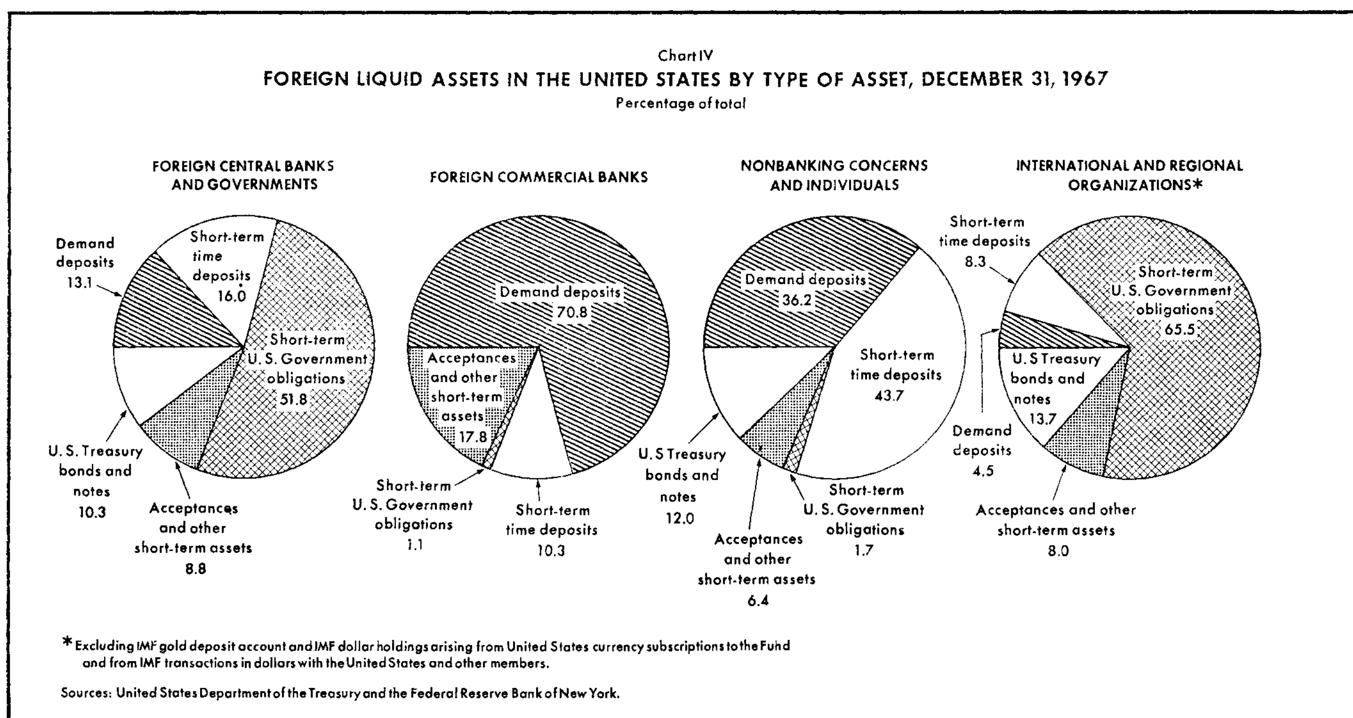


Chart IV
FOREIGN LIQUID ASSETS IN THE UNITED STATES BY TYPE OF ASSET, DECEMBER 31, 1967
Percentage of total

* Excluding IMF gold deposit account and IMF dollar holdings arising from United States currency subscriptions to the Fund and from IMF transactions in dollars with the United States and other members.

Sources: United States Department of the Treasury and the Federal Reserve Bank of New York.

authorities in order to obtain needed foreign exchange while meeting the special liquidity requirements of those authorities.[9] It should be noted that, just as United States swap drawings usually result in a change in form but not in the aggregate amount of outstanding liquid holdings here of foreign monetary authorities, the proceeds of Treasury sales of foreign-currency-denominated securities are used to absorb dollars from foreign authorities, leaving unchanged the aggregate of foreign liquid assets in the United States.

Foreign central banks and governments also held about $1½ billion of liquid United States Treasury bonds and notes at the end of 1967 (see Chart V). These holdings consisted of about $900 million of marketable Treasury securities and about $700 million of special Treasury bonds or notes which, although not marketable, are readily convertible into cash or short-term United States Treasury securities.

With respect to foreign monetary authorities' holdings of nonmarketable Treasury bonds or notes which are readily convertible into cash or short-term Treasury instruments, virtually all these securities have been denominated in foreign currencies. These foreign-currency-denominated securities, first introduced in 1963, were offered to foreign monetary authorities in order to help meet United States official foreign exchange needs. The outstanding amount of such instruments in the hands of foreign central banks and governments rose to a peak just over $1 billion in late summer of 1965 and then declined when the United States subsequently repaid part of these obligations. In addition, some of these instruments were replaced at maturity with special short-term Treasury securities when market yields on United States Government bonds had moved above the 4¼ per cent statutory maximum payable on such newly issued securities. Although Treasury notes (and short-term Treasury securities) did not come under an interest rate ceiling, the Treasury lacked authority to issue Treasury notes denominated in foreign currency. In order to continue its policy of offering foreign central banks market yields on special United States Treasury securities, the Treasury therefore issued foreign-currency-denominated certificates of indebtedness (mentioned above). In late 1966, authority was obtained to issue foreign-currency-denominated Trea-

[9] The circumstances under which foreign-currency-denominated obligations have arisen, or have been liquidated, are described in the reports of "Treasury and Federal Reserve Foreign Exchange Operations", by Charles A. Coombs, regularly appearing in this *Review* in March and September.

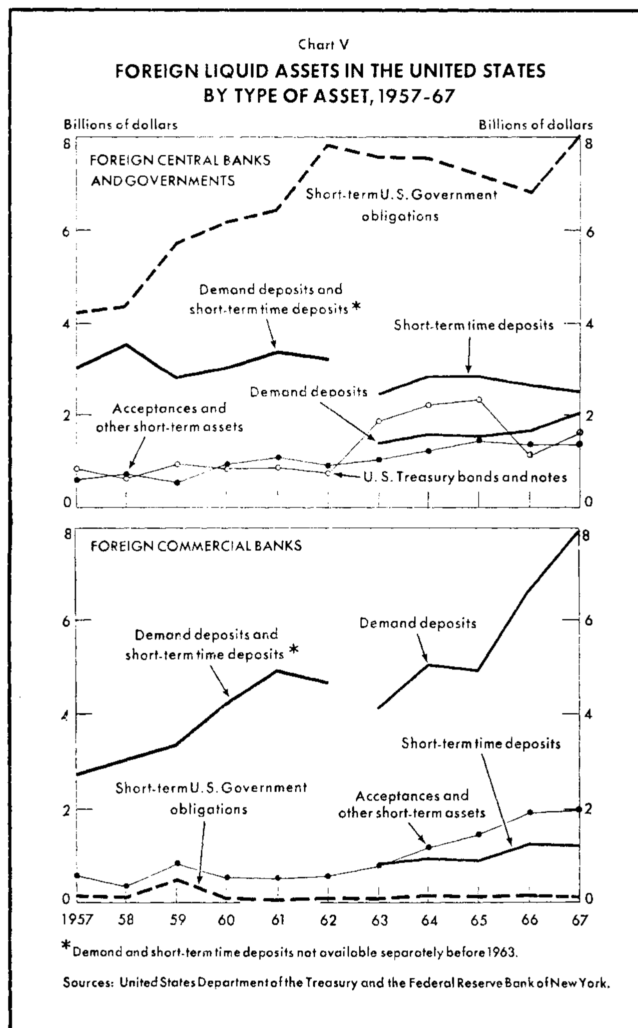
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

sury notes, and most of the certificates have been refunded into notes. Moreover, to meet subsequent United States foreign exchange needs, the Treasury issued further notes in the foreign-currency series; at the end of 1967, such convertible Treasury securities outstanding totaled just over $675 million.[10]

Foreign monetary authorities have placed somewhat increased emphasis in recent years on holdings of bankers' acceptances and other prime short-term money market assets, notably negotiable time C/D's (which are included in the United States balance of payments and the charts under "acceptances and other short-term assets" rather than under "short-term time deposits"). This change perhaps is the result of the attractive yields available, the substantial growth of the commercial paper market, and the development of the secondary market for negotiable C/D's. After rising in 1964, short-term time deposit holdings (excluding C/D's) have fallen back, probably reflecting central banks' and governments' preference for C/D's. In addition, these institutions' holdings of long-term time deposits (not shown) have risen sharply.

Foreign central banks have held demand deposits to the minimum necessary to meet the routine flow of payments through their dollar accounts. Central banks' major payments can be scheduled to some extent and their short-term investments—e.g., United States Treasury bills—are highly liquid. Therefore their demand accounts in general have been kept to relatively small proportions.

FOREIGN COMMERCIAL BANKS. In contrast to the asset composition of foreign central banks' and governments' liquid holdings in the United States, a high proportion of foreign commercial banks' liquid assets is held in the form of demand deposits, rather than in the form of earning assets (see Chart IV). Actually, however, a very substantial part of the nearly $8 billion in so-called "demand deposits" represents deposits held by the foreign branches of United States banks with their head offices. In addition, the head offices of foreign commercial banks have held substantial demand deposits with their agencies or branches in the United States. The holdings of the head offices of Canadian and Japanese agencies in the United States have been quite large. Just as any bank employs its deposits to acquire earning assets, the United States institutions involved—i.e., the United States head offices of their foreign branches and the Japanese and Canadian agencies in the United States—use their resources to acquire such assets. But the relationship between head office and branch or agency is a far closer one than just bank and depositor, so that the foreign branch or head office does in effect, through its intercorporate accounts,



* Demand and short-term time deposits not available separately before 1963.

Sources: United States Department of the Treasury and the Federal Reserve Bank of New York.

---

[10] In addition to the types of securities just described, the Treasury has issued nonconvertible foreign-currency-denominated securities from time to time since 1962. Such nonconvertible United States Treasury obligations are not considered liquid in the balance of payments. At the end of 1967, about $360 million equivalent of these instruments was outstanding, of which $250 million represented special nonliquid securities issued to the German Federal Bank in conjunction with the agreement between the United States and German governments regarding the offsetting of $500 million of United States military expenditures in Germany, in four quarterly installments of $125 million each. In addition, the Treasury has issued to foreign monetary authorities nonconvertible nonmarketable securities denominated in dollars. These obligations arose in United States Government transactions with the governments of Canada and Italy; at the end of 1967, they stood at $490 million. Such securities are not considered liquid in the United States balance of payments.

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

share in the return on the United States entity's assets earned with the resources placed in the United States by the related foreign branch or head office.

United States Treasury bills have played a minor role in the portfolios of foreign commercial banks, because the applicable Federal income tax exemptions on discount earnings on bankers' acceptances and on earnings on time deposits and negotiable C/D's have given these instruments a clear yield advantage.[11] Foreign commercial banks have acquired substantially larger holdings of bankers' acceptances than of negotiable C/D's, however. These holdings in the United States of bankers' acceptances and negotiable C/D's are included under the category "acceptances and other short-term assets" as shown in Charts IV and V. In addition, this category includes a sizable amount of Japanese trade bills mentioned above in connection with the operations of the Japanese agencies.

FOREIGN NONBANKING CONCERNS AND INDIVIDUALS. Foreign nonbanking concerns and individuals have more than doubled their holdings of short-term time deposits from the end of 1963 through the end of 1967 to about $2 billion, as higher yields on these instruments became possible with the increase of interest rate ceilings under Regulation Q. This growth occurred partly at the expense of Treasury bills and acceptances and other short-term money market instruments. At the same time, holdings of United States Treasury bonds and notes have risen moderately since 1963 but by the end of last year had barely exceeded levels reached by 1960; these assets probably reflect holdings of institutions, such as insurance companies, which have longer term investment requirements but which are alert to changing yield opportunities.[12] A moderate growth in demand balances has taken place, as would be expected with rising world commerce.

INTERNATIONAL AND REGIONAL ORGANIZATIONS. IMF dollars held for investment purposes represent the proceeds of reversible gold sales to the United States to obtain earning assets. These assets are held entirely in the form of United States Government securities.[13] United States Treasury securities have accounted for more than half of the liquid assets in the United States owned by nonmonetary international and regional organizations. However, the latter's holdings of bankers' acceptances and negotiable C/D's have shown a tendency to rise in recent years in response to the availability of more attractive interest rates. The recent substantial shifts into long-term deposits were accompanied by a decline in holdings of United States Government securities, although short-term time deposit holdings were also reduced. These institutions' holdings of United States Government securities and the predictable nature of their lending operations have produced only minimal need for dollars in the form of demand deposits (see Chart IV).

[11] The exemptions are available to foreign corporations not engaged in trade or business in the United States and, in some situations, to foreign corporations which are so engaged.

[12] Although foreign commercial banks may hold United States Treasury bonds and notes, available evidence indicates that virtually all foreign private holdings of such instruments were in the hands of foreign corporations and individuals, and Charts IV and V were constructed on this assumption.

[13] In addition to these dollars held as investments, which totaled just over $775 million at the end of 1967, the Fund held slightly more than $225 million in liquid claims on the United States. These claims arose as the IMF placed gold deposits with the United States in order to offset the decline in the United States gold stock resulting from other members' purchases of gold with dollars to meet their gold subscription under the 1965 general increase in IMF quotas.

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

Publications of the Federal Reserve Bank of New York

The following is a selected list of publications available from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N. Y. 10045. Copies of charge publications are available at half price to educational institutions, unless otherwise noted.

1. CENTRAL BANK COOPERATION: 1924-31 (1967) by Stephen V. O. Clarke. 234 pages. Discusses the efforts of American, British, French, and German central bankers to reestablish and maintain international financial stability between 1924 and 1931. ($2 per copy.)

2. ESSAYS IN MONEY AND CREDIT (1964) 76 pages. Contains articles on select subjects in banking and the money market. (40 cents per copy.)

3. KEEPING OUR MONEY HEALTHY (1966) 16 pages. An illustrated primer on how the Federal Reserve works to promote price stability, full employment, and economic growth. Designed mainly for secondary schools, but useful as an elementary introduction to the Federal Reserve. ($6 per 100 for copies in excess of 100.*)

4. MONEY AND ECONOMIC BALANCE (1967) 27 pages. A teacher's supplement to *Keeping Our Money Healthy*. Written for secondary school teachers and students of economics and banking. ($8 per 100 for copies in excess of 100.*)

5. MONEY, BANKING, AND CREDIT IN EASTERN EUROPE (1966) by George Garvy. 167 pages. Reviews recent changes in the monetary systems of the seven communist countries in Eastern Europe and the steps taken toward greater reliance on financial incentives. ($1.25 per copy; 65 cents per copy to educational institutions.)

6. MONEY: MASTER OR SERVANT? (1966) by Thomas O. Waage. 48 pages. Explains the role of money and the Federal Reserve in the economy. Intended for students of economics and banking. ($13 per 100 for copies in excess of 100.*)

7. PERSPECTIVE (January 1968) 9 pages. A layman's guide to the economic and financial highlights of the previous year. ($7 per 100 for copies in excess of 100.*)

8. THE NEW YORK FOREIGN EXCHANGE MARKET (1965) by Alan R. Holmes and Francis H. Schott. 64 pages. Describes the organization and instruments of the foreign exchange market, the techniques of exchange trading, and the relationship between spot and forward rates. (50 cents per copy.)

9. THE STORY OF CHECKS (1966) 20 pages. An illustrated description of the origin and development of checks and the growth and automation of check collection. Primarily for secondary schools but useful as a primer on check collection. ($4 per 100 for copies in excess of 100.*)

* Unlimited number of copies available to educational institutions without charge.

Subscriptions to the MONTHLY REVIEW are available to the public without charge. Additional copies of any issue may be obtained from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045.

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