FEDERAL RESERVE BANK OF NEW YORK

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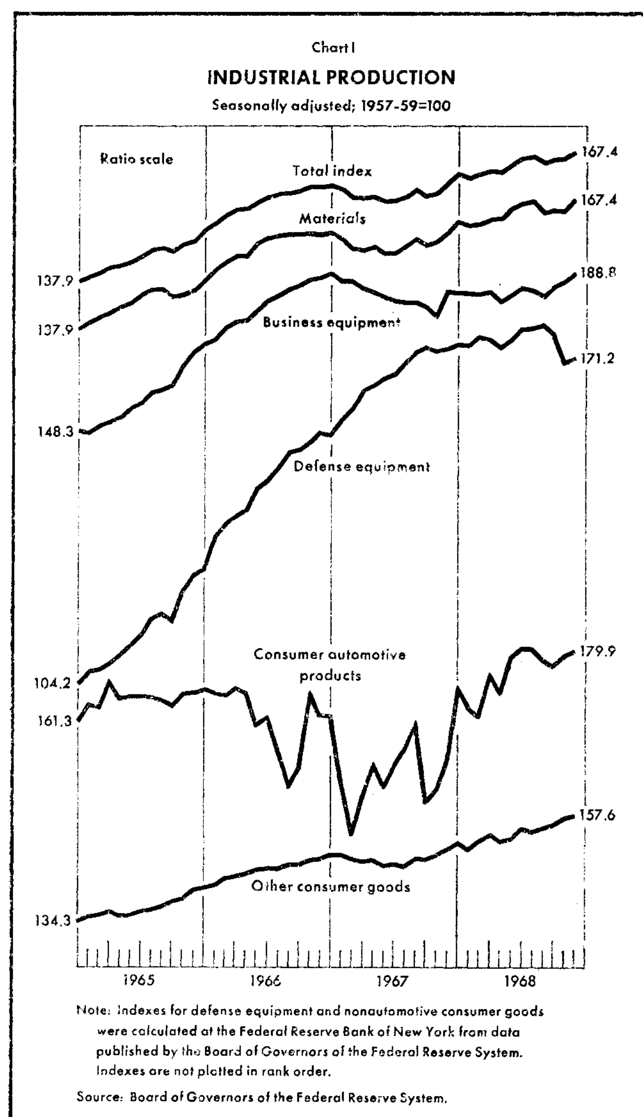
The Business Situation

As 1968 drew to a close, the economy continued to expand at an excessive rate. In November, almost every indicator of business activity was strong. Industrial production rose a full 1 percent to a new peak. The backlog of unfilled orders for durable goods increased again, as the volume of new orders remained at a high level. Employment registered a sharp advance, and the December increase was even more marked. The unemployment rate in these two months was down to 3.3 percent, the lowest since 1953. Retail sales advanced approximately ½ percent in November, following two months of slight easing. Price developments continued to be disturbing, with significant increases occurring at both wholesale and retail levels. When the Board of Governors of the Federal Reserve System announced its mid-December approval of an increase in the discount rate from 5¼ percent to 5½ percent, it cited "the resurgence in inflationary expectations that is impeding the restoration of economic stability" as one reason for its action.[1]

OUTPUT, INVENTORIES, AND CONSTRUCTION ACTIVITY

In November, industrial output registered its largest and most broadly based rise since last spring. The Federal Reserve Board's index of industrial production rose by 1.7 percentage points (seasonally adjusted) to 167.4 percent of the 1957-59 average (see Chart I). This advance brought the index to a new high, surpassing the peak set last July when the steel industry was working at a feverish pace to meet the demands of users who were building up inventory as a hedge against a possible steel strike. The sharp cutback in steel production that followed the August 1 contract settlement had caused the total production index to fall substantially that month. After a further moderate decline in September, steel production turned up in October. In November, the index of iron and steel output advanced again, account-



Note: Indexes for defense equipment and nonautomotive consumer goods were calculated at the Federal Reserve Bank of New York from data published by the Board of Governors of the Federal Reserve System. Indexes are not plotted in rank order.
Source: Board of Governors of the Federal Reserve System.

[1] For a fuller reference, see page 7.

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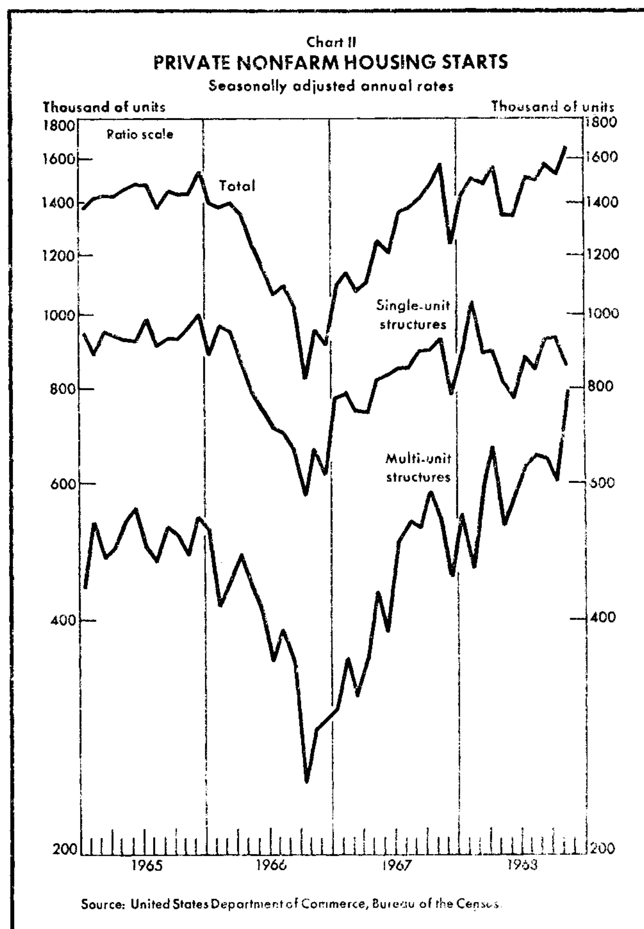
ing for about a quarter of the month's total production gain. In December, output of steel ingots rose by 12 percent, pushing the level of activity closer to normal.

The materials component of the total index recorded a sharp rise in November, due partly to the increase in steel. However, advances in the output of other industrial materials, as well as the settlement of a strike in the coal industry, contributed to the gain. Output of both business and defense equipment advanced substantially. Beginning with September, the production of business equipment has moved up sharply, suggesting that the considerable increase in outlays indicated by recent surveys of business capital spending plans is indeed taking place. Production of consumer goods also rose in November. The gain in the automotive index, however, was limited by the stability of auto assemblies, which held at a seasonally adjusted annual rate of 9.2 million units. In December, automobile output slipped about 3 percent.

The recent behavior of new orders for durable goods underscores the strong outlook for industrial production. Although the volume of new orders edged off in November by $0.6 billion, this easing followed two very large monthly increases. The decline in new orders was concentrated in the machinery and defense-oriented industries; these were the groups in which the October increases had been particularly large. New orders for construction materials rose for the fourth consecutive month, and orders received by blast furnaces and steel mills advanced for the third month in a row. Since the volume of new orders continued to outstrip the volume of shipments, the backlog of unfilled orders expanded further to reach $82.6 billion.

The relationship between total business inventories and total sales remained relatively stable in October, with strong increases occurring in both sales and inventories. For the trade sector, however, the inventory-sales ratio moved up from a very low level as stocks rose and sales declined. A substantial part of the increase was at automotive outlets, reflecting continued high motor vehicle production in a month when sales moved down. The rise in the trade ratio was offset by a decline in the manufacturing ratio, which stemmed from a sizable advance in durables shipments. In November, the inventory-sales ratio for manufacturing recovered a bit.

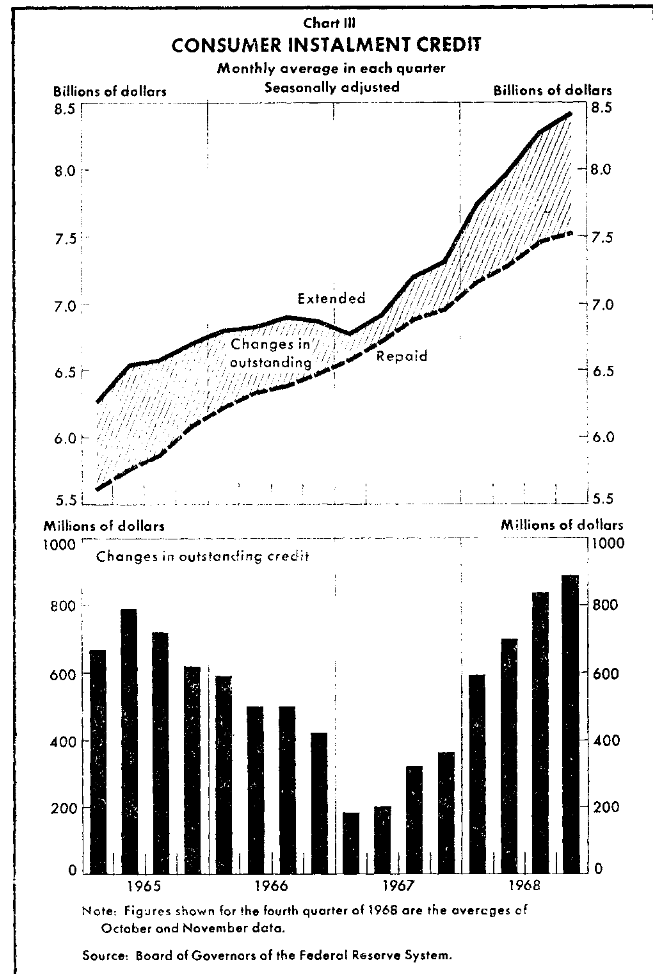
Residential construction activity was vigorous again in November. The volume of building permits issued by local authorities increased 1 percent from October, seasonally adjusted, while private nonfarm housing starts climbed 7½ percent to a seasonally adjusted annual rate of 1.65 million units. The starts figure was the highest since early 1964. This November surge was centered entirely in multi-unit structures, where there was a jump of over 30 percent in the number of units begun. In the first year following the sharp 1966 slump in residential construction, both single-home and multi-unit starts had increased rapidly (see Chart II). The rise in multi-unit home building was particularly strong, and similar strength was exhibited again in 1968. Consequently, in the first eleven months of 1968, the rate of multi-unit starts averaged a full 20 percent above the number of such starts in 1965, prior to the slump. In contrast, the slower recovery of nonfarm single-unit starts in 1967, and the leveling-out that occurred in 1968, produced a 1968 average that was just under the 1965 rate. This change in the composition of new housing construction is not surprising in view of population trends. The shift may, however, also reflect the reluctance of some institutional investors to add to holdings of single-family mortgages and their growing preference for apartment mortgages, particularly when financing arrangements provide equity participation for the mortgage lender.



EMPLOYMENT, INCOME, AND CONSUMER DEMAND

The labor market tightened appreciably in November. There was a relatively large increase in the labor force, but an even sharper rise in employment. On a seasonally adjusted basis, the number of unemployed persons declined and the unemployment rate dropped 0.3 percentage point to 3.3 percent, the lowest since 1953. Moreover, in contrast to developments in other months when there was a large change, the unemployment rate decreased in virtually all categories. The rates for adult women and adult men both fell to post-Korean war lows.

The number of persons on nonfarm payrolls increased by 219,000, seasonally adjusted, bringing the total to a record 68.9 million. Manufacturing employment moved up, chiefly reflecting the settlement of labor disputes in the ordnance and machinery industries. Similarly, the settlement of the strike in the coal industry boosted mining employment by 44,000, but this rise was offset by the effect of the New York City teachers' strike. A major part of the large increase in total employment occurred in the relatively low-paying service industries. In addition, a decline in the average workweek of manufacturing production workers partially offset the effect on incomes of the gains in manufacturing employment and hourly pay. Reflecting these developments, the wage and salary component of personal income rose in November by a relatively modest $2.5 billion. In the first two months of the fourth quarter, wage and salary growth averaged $2.3 billion, compared with an average of $3.2 billion in the first three quarters of the year.



In December, payroll employment made a further sharp gain of 266,000, seasonally adjusted. Both service and manufacturing employment again showed particular strength. Settlement of the New York City teachers' strike, which had lasted five weeks, contributed to a large rise in the number of persons on government payrolls. Construction employment also advanced strongly, following virtual stability in November, when unusually bad weather held down employment gains. The civilian labor force, seasonally adjusted, advanced markedly again in December, with the rise about matching the increase in total employment. The unemployment rate thus remained at 3.3 percent. The rate for adult men, however, dropped further, reaching the lowest level since the series began in 1948.

Retail sales rose 0.6 percent in November to $28.9 billion, seasonally adjusted. However, this rise, which followed two months of moderate decline, was entirely in sales at nondurables outlets. Durables sales were off 1 percent, mainly reflecting a decrease in the automotive group, which in addition to new cars includes used cars, auto parts, and repairs.

Sales of new domestic automobiles declined in November by almost 3 percent to a seasonally adjusted annual rate of just under 9 million units. In December, sales volume fell again to a pace of about 8¼ million units. For 1968 as a whole, sales of domestically produced automobiles will probably be about 8.6 million units. This compares very favorably with the 7.6 million units sold in 1967 and is only slightly below the 1965 high of 8.8 million units. However, sales of imported cars, which have claimed an increasingly large share of the American market, reached a record in 1968 of about 1 million units. Thus, total new car sales for the year may wind up at about 9.6 million units. This would be an all-time high.

Considering the increase in the income tax withholding

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rates that became effective in mid-July as a result of the tax surcharge, consumer demand over the July-November period has shown surprising strength. Consumers have financed this high level of spending in part by greater use of instalment credit (see Chart III). Indeed, the increase in outstanding credit reached a record $947 million (seasonally adjusted) in October. In November, the rise was somewhat smaller, largely reflecting a decline in extensions of automobile credit and personal loans. However, this recent sharp uptrend in consumer credit outstanding was in line with the rapid advance that started in mid-1967.

PRICE DEVELOPMENTS

Prices at the consumer level climbed steeply again in November, although the rise was not so great as the extraordinarily large gain in the previous month. At an annual rate, the November increase was 4.9 percent. This brought the advance for the first eleven months of 1968 to a yearly rate of 4.8 percent. The November rise would have been even larger but for some seasonal declines in retail food prices. All other components advanced, with particularly sharp increases occurring in housing and service costs. Wholesale prices also rose in November, with the wholesale price index showing an increase of 0.5 percentage point. Preliminary data for December indicate that the total wholesale price index advanced 0.2 percentage point to 109.8 percent of the 1957-59 average. Prices rose for farm products as well as for industrial commodities. The December increase in prices of industrial commodities brought that index to a level 2.6 percent above the year-ago figure. This advance was not only considerably larger than the 1967 rise of 1.8 percent, but was the steepest since 1956.

PERSPECTIVE '68

Each January this Bank publishes *Perspective,* a brief review of the performance of the economy during the preceding year. This booklet is a layman's guide to the economic highlights of the year. A more comprehensive treatment is presented in our *Annual Report,* available in March.

Perspective '68 is available without charge from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045. A Spanish version will be available soon.

The Money and Bond Markets in December

An atmosphere of deepening pessimism and caution pervaded the money and capital markets in December. Yields on a wide range of obligations—including Treasury, corporate, and tax-exempt securities—soared to levels unmatched in modern history.

The first of two successive ¼ percentage point increases in the prime lending rate of commercial banks was initiated on the first business day of the month. The new 6½ percent rate was largely unexpected by the market and triggered apprehension that upward adjustments in other key interest rates would soon follow. Steadily mounting indications that inflationary pressures were persisting, despite the imposition of fiscal restraint, led many market participants to predict that monetary policy would soon be tightened, possibly through an increase in the discount rate of the Federal Reserve Banks. In this setting, yields on Treasury obligations and most other debt instruments throughout the maturity range moved sharply higher on balance during the first half of the month.

After the close of business on December 17, the Board of Governors of the Federal Reserve System announced that it had approved an increase from 5¼ percent to 5½ percent in the discount rate of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, and

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Dallas, effective December 18.[1] The Board stated that:

> This discount rate increase was approved in recognition of the advances that have taken place in other market interest rates in recent months and also in light of the resurgence in inflationary expectations that is impeding the restoration of economic stability. The objective of Federal Reserve policy is to foster financial conditions conducive to the reduction of inflationary pressures, with a view toward encouraging a more sustainable rate of economic expansion and attaining reasonable equilibrium in the country's balance of payments. The present action is being taken in furtherance of a policy of restraint. . . . The increase restores the rate to the level prevailing between April 19 and August 15, 1968. This level is the highest in nearly four decades.

No changes were made in the ceiling rates which member banks may pay on time deposits under the provisions of Federal Reserve Regulation Q. This omission tended to confirm the belief that the central bank had decided to act more forcefully to limit credit expansion.

The money and bond markets responded to the Federal Reserve action in an orderly fashion on December 18. Initially yields even receded slightly, reflecting momentary relief in some quarters that the discount rate increase had not been larger. Later that same day, however, the market atmosphere weakened again after the major commercial banks throughout the nation swiftly announced a second round of increases in the prime rate, boosting this key interest rate to a record level of 6¾ percent. Subsequently, prices fell precipitously and market yields rose to unprecedented levels. With the firm intent of monetary policy clearly evident and with discussion in some quarters of the possibility of a new credit "crunch", market participants remained pessimistic during the remainder of the month, although there was some improvement in the tone of the Government securities market toward the year-end.

A rather sharp expansion of reserve availability due to seasonal factors contributed to relatively comfortable money market conditions during the first half of December. When reserve availability contracted thereafter, however, the money market tightened markedly. Federal funds traded predominantly at 5⅞ percent on most days through December 18, and thereafter mainly in a 6¼ to 6½ percent range. The high rates were particularly discouraging to money and bond market participants, while member bank borrowings at the Reserve Banks rose near the year-end statement date to levels that had not been exceeded for many years.

THE GOVERNMENT SECURITIES MARKET

A very cautious tone prevailed in the market for Treasury notes and bonds in December, and prices adjusted sharply lower during the period. (Associated yield increases are illustrated in the right-hand panel of the chart.) In initial reaction to the prime rate increase to 6½ percent, prices of intermediate-term coupon issues declined on December 2 by as much as 19/32 point. Longer term Treasury issues, which were also adversely affected by sharply rising yields for corporate and tax-exempt obligations, recorded price losses of as much as 1 5/16 points that day. As the month progressed, an atmosphere of nervousness predominated in the Government securities market. Indications of continued buoyancy in the domestic economy, accompanied by the persistence of inflationary pressures, gave rise to a feeling on the part of many in the market that monetary policy would soon be tightened. Against this background, prices of intermediate-term coupon issues declined fairly steadily during the first half of December, and yields on some issues climbed to historic highs (see chart). To be sure, demand sporadically improved when some market participants were attracted to the high prevailing yields. In the longer term maturity area, where very sharp price losses had boosted yields to record levels during the first few days of December, demand also improved modestly at times and scattered price gains partially offset the losses suffered at the very beginning of the month. However, trading in the coupon sector remained fairly light during the first half of December, chiefly involving year-end tax switching and professional activity. Despite the bearish undertone of the market and the persisting uncertainty over the near-term outlook for interest rates, excessive selling pressures did not develop.

The coupon sector initially took in stride the Federal Reserve discount rate rise which was announced shortly after midmonth. Market participants had considered the possibility of more severe action by the monetary authorities, and some modest price improvement actually occurred in early trading on December 18. Later that day, however, many of the nation's large commercial banks announced another ¼ percentage point increase in the prime rate, boosting it to a record 6¾ percent. This

[1] The Board later approved an increase in the discount rate of the other three Federal Reserve Banks—those of San Francisco, St. Louis, and Kansas City—effective December 20.

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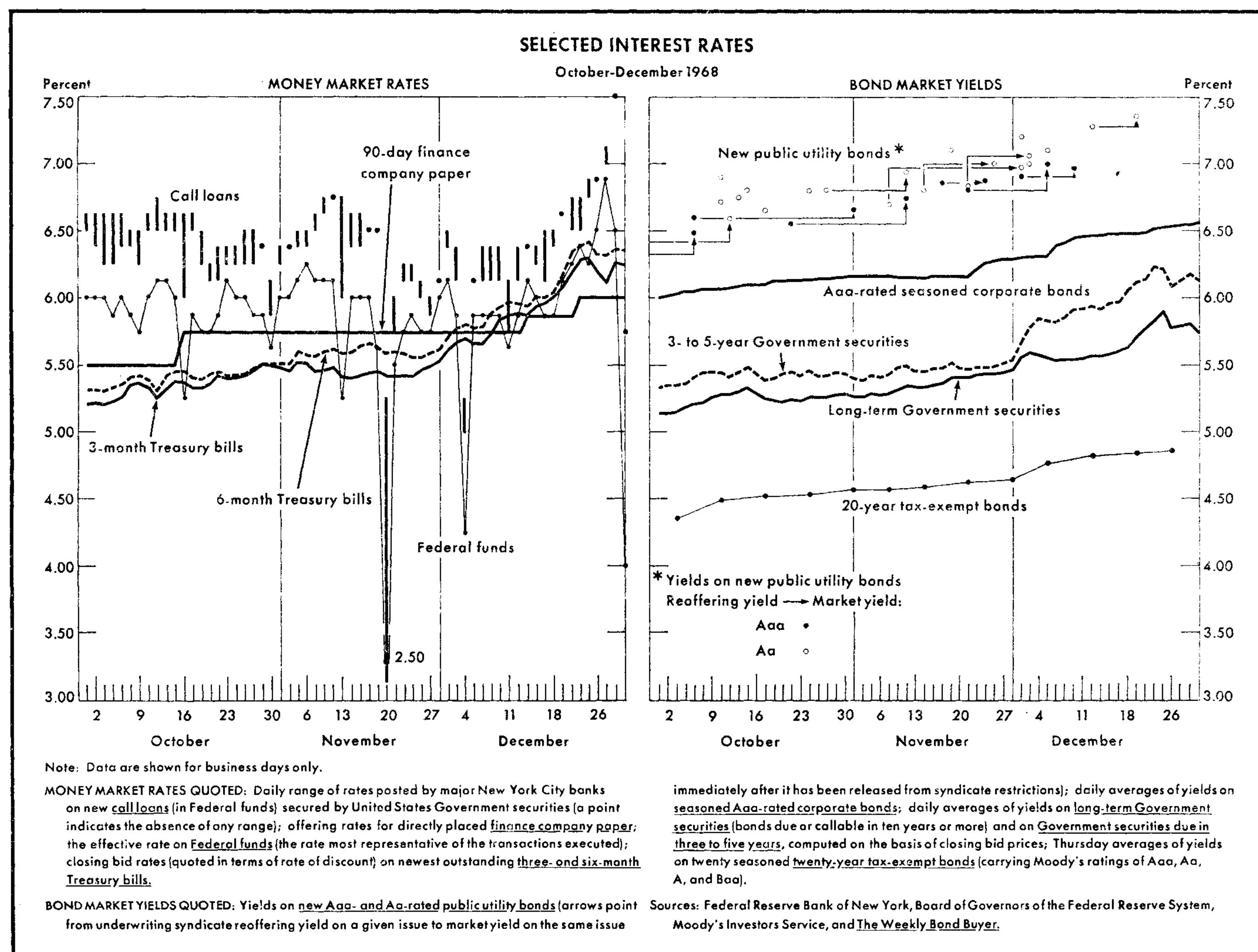

Note: Data are shown for business days only.

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 (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 seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on 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.

move triggered an immediate and fairly sharp decline in prices of Treasury notes and bonds amid predominantly professional activity. The tone of the coupon sector continued to deteriorate over the next week, and prices dropped sharply throughout the maturity spectrum in response to greatly expanded offerings from professional and investor sources. Market participants became increasingly convinced that, in view of the rapid pace of domestic economic expansion and the current posture of monetary restraint, interest rates would continue to rise in the short run. Nevertheless, despite the persistence of a cautious undertone, prices rallied at times toward the end of the year in response to some investor demand and professional short covering. Over the month as a whole, prices of most issues maturing within five years declined by from ¼ point to as much as 2⁵⁄₃₂ points, while prices of longer term issues were 1⅞ points to as much as 4⅜ points lower.

Treasury bill rates rose steeply during December in response to pressures emanating from several sources. The prime rate increase that was initiated on December 2 induced a rapid rise in bill rates in the early days of the month, as professional participants cautiously marked prices lower in an attempt to lighten their inventories. Moreover, offerings of June tax anticipation bills by commercial banks expanded. These bank offerings reflected both underlying concern that bill rates might rise still further and portfolio adjustments linked to large calls on Treasury Tax and Loan Accounts immediately following the December 2 payment date for the tax bills.

Basically, however, the primary factor responsible for

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the heavy undertone in the bill sector during the first half of December was the widespread conviction that current domestic economic conditions would necessitate some new action by the monetary authorities, probably involving a discount rate increase. The upward trend in bill rates during this period pushed bond-equivalent yields on many key issues, including six-month bill maturities, well above 6 percent. Nevertheless, a strong investment demand for bills occasionally emerged during the interval.

The Federal Reserve discount rate announcement removed an element of market uncertainty, and bill rates initially declined slightly on December 18. A weaker tone soon reappeared, however, when market participants reacted to the prompt increase in the commercial bank prime rate that followed the discount rate action. Over most of the remainder of the month, bill rates moved sharply higher, on balance, mainly in response to selling pressures from professional sources and commercial banks. In the closing days of the month, the unusually high yield levels stimulated improved demand, including bank buying for year-end statement purposes, and bill rates receded somewhat.

At the last monthly auction of the year, held on December 23, average issuing rates on the new nine- and twelve-month bills were set at record levels of 6.483 percent and 6.412 percent, respectively, 79 and 84 basis points higher than average rates at the comparable November auction (see Table III). The bond-equivalent yield in both cases was 6.84 percent. At the final regular weekly auction of the month, held on December 27, average issuing rates for the new three- and six-month bills were set at 6.199 percent and 6.332 percent, respectively, 75 and 76 basis points above average rates established a month earlier but 8 and 7 basis points, respectively, below the record rates set at the December 20 weekly auction.

OTHER SECURITIES MARKETS

A heavy tone persisted in the markets for corporate and tax-exempt bonds in December and, as in other market sectors, a steady price decline boosted yields to record levels. Market sentiment grew quite bearish following the rise early in the month in the commercial bank prime rate. The weakness of both sectors was reflected in the upward trend in yields on new offerings, the price adjustments on slow-moving recent issues following the removal of syndicate price restrictions, and the postponement of several scheduled flotations because of adverse market conditions. Investment interest improved somewhat around midmonth in response to the unusually high yield levels, and several new corporate and tax-exempt offerings were accorded fairly good receptions. Subsequently, however, prices of tax-exempt and corporate bonds declined further in the wake of the increase in the Federal Reserve discount rate that was announced on December 17 and the rise in the prime rate that followed soon after. The end-of-year lull in activity, however, limited the price reaction in these sectors to moderate proportions.

At the close of the year, *The Weekly Bond Buyer's* yield index of twenty seasoned tax-exempt issues was quoted at 4.85 percent, 21 basis points higher than a month earlier and 78 basis points higher than the year's low reached in August. Moody's index for seasoned Aaa-rated corporate bonds closed the year at 6.55 percent, 26 basis points higher than a month earlier. The Blue List of advertised dealer inventories of tax-exempt securities contracted steadily, as underwriting activity declined, and totaled $547 million at the end of the month as against its November 29 level of $858 million.

BANK RESERVES AND THE MONEY MARKET

A fairly firm tone prevailed in the money market at the beginning of the month, and Federal funds traded predominantly in a 5⅞ to 6⅛ percent range on December 2 and 3. The basic reserve position of the eight major New York City banks improved, as the rise in private deposits that had begun at these institutions in mid-November continued. This gain was offset elsewhere, however, for the average basic reserve deficit of thirty-eight large banks in money centers outside New York increased, partly reflecting a contraction in Government deposits. Nevertheless, excess reserves were accumulated by the major New York City banks, and reserve availability was enhanced by a rise in Federal Reserve float. Consequently, money market conditions eased as the week progressed, and the effective rate on Federal funds dropped to 4¼ percent on the final day of the December 4 statement period.

A relatively comfortable tone prevailed in the money market over the December 11 statement week. Member banks carried a substantial amount of excess reserves into the period. More significantly, however, "market" factors—notably Treasury deposits at the Reserve Banks which were depleted preceding the midmonth tax date and Federal Reserve float—released a considerable volume of reserves to member banks throughout the nation (see Table I). Reserve distribution generally favored smaller banks, while forty-six large banks in the major money centers experienced a $1.4 billion deterioration in their average basic reserve position, principally as a result of a contraction in demand deposits and an expansion in loans to Government securities dealers. However,

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Table I

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

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

Factors	Changes in daily averages—week ended on				Net changes
	Dec. 4	Dec. 11	Dec. 18	Dec. 25	
"Market" factors					
Member bank required reserves	+ 23	− 34	− 305	− 86	− 402
Operating transactions (subtotal)	+ 30	+ 510	+ 871	− 308	+1,103
Federal Reserve float	+ 30	+ 346	+ 747	+ 347	+1,470
Treasury operations*	+ 68	+ 415	+ 125	− 391	+ 217
Gold and foreign account	− 6	− 8	− 1	+ 17	+ 2
Currency outside banks	− 215	− 194	− 282	− 185	− 876
Other Federal Reserve accounts (net)†	+ 151	− 48	+ 281	− 95	+ 289
Total "market" factors	+ 53	+ 476	+ 566	− 394	+ 701
Direct Federal Reserve credit transactions					
Open market instruments					
Outright holdings:					
Government securities	+ 307	− 797	− 722	+ 435	− 777
Bankers' acceptances	− 2	—	− 1	− 2	− 5
Special certificates	—	+ 13	+ 326	− 339	—
Repurchase agreements:					
Government securities	+ 28	− 28	—	+ 60	+ 60
Bankers' acceptances	—	—	—	+ 7	+ 7
Federal agency obligations	+ 1	− 1	—	+ 4	+ 4
Member bank borrowings	− 50	− 97	+ 139	+ 285	+ 277
Other loans, discounts, and advances	—	—	—	—	—
Total	+ 285	− 909	− 258	+ 449	− 433
Excess reserves	+ 338	− 433	+ 308	+ 55	+ 268

	Daily average levels				
Member bank:					
Total reserves, including vault cash	**26,840**	26,441	27,054	27,195	26,883‡
Required reserves	26,383	**26,417**	26,722	26,808	**26,583‡**
Excess reserves	**457**	**24**	332	387	**300‡**
Borrowings	**532**	**435**	574	859	**600‡**
Free, or net borrowed (−), reserves	− 75	− 411	− 242	− 472	− 300‡
Nonborrowed reserves	26,308	26,006	26,480	**26,336**	26,283‡
Net carry-over, excess or deficit (−)§	**56**	200	25	**162**	**111‡**

	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	− 568	−1,233	− 55	+1,606	− 250
More than one year	—	—	− 358	—	− 358
Total	− 568	−1,233	− 413	+1,606	− 608

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Includes assets denominated in foreign currencies.
‡ Average for four weeks ended on December 25, 1968.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS DECEMBER 1968

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Averages of four weeks ended on Dec. 25
	Dec. 4	Dec. 11	Dec. 18	Dec. 25	
Eight banks in New York City					
Reserve excess or deficiency(−)*	165	− 107	100	91	62
Less borrowings from Reserve Banks	69	86	104	275	134
Less net interbank Federal funds purchases or sales(−)	395	938	1,154	1,389	969
Gross purchases	*1,524*	*1,918*	*1,997*	*1,966*	*1,851*
Gross sales	*1,129*	*981*	*843*	*578*	*883*
Equals net basic reserve surplus or deficit(−)	− 299	−1,131	−1,158	−1,572	−1,040
Net loans to Government securities dealers	641	776	1,151	848	854
Net carry-over, excess or deficit(−)†	− 25	77	− 31	57	20
Thirty-eight banks outside New York City					
Reserve excess or deficiency(−)*	43	− 24	20	− 5	9
Less borrowings from Reserve Banks	152	114	256	368	223
Less net interbank Federal funds purchases or sales(−)	1,896	2,417	2,003	1,831	2,037
Gross purchases	*3,149*	*3,495*	*3,324*	*3,088*	*3,264*
Gross sales	*1,253*	*1,078*	*1,322*	*1,257*	*1,228*
Equals net basic reserve surplus or deficit(−)	−2,004	−2,555	−2,239	−2,204	−2,251
Net loans to Government securities dealers	362	486	590	345	446
Net carry-over, excess or deficit(−)†	19	38	12	25	24

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

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In per cent

Maturities	Weekly auction dates—December 1968				
	Dec. 2	Dec. 9	Dec. 16	Dec. 20	Dec. 27
Three-month	5.633	5.788	5.966	6.278	6.199
Six-month	5.730	5.906	6.017	6.401	6.332

Maturities	Monthly auction dates—October-December 1968		
	Oct. 24	Nov. 22	Dec. 23
Nine-month	5.446	5.693	6.483
One-year	5.401	5.568	6.412

* 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.

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Federal funds were readily available during most of the period from banks outside the large money centers, and in this setting Federal funds traded predominantly at a fairly comfortable 5⅞ percent.

The tone of the money market grew slightly firmer as midmonth approached. The leading New York City banks transferred a reserve deficiency into the December 18 statement period, while major banks outside the central money market carried only a relatively small amount of eligible excess reserves into the period (see Table II). Although the basic reserve deficit of the eight major New York City banks was little changed during the week on a daily average basis, caution was engendered by a rise in loan demand over the December 16 corporate tax payment date and by the possibility of a rapid loss of tax payments credited to Government deposit accounts. Moreover, System open market operations during the week absorbed a portion of the continued high level of reserves released through changes in "market" factors. Against this background, a fairly good demand for Federal funds developed over the statement period and most trading took place in a 5⅞ to 6⅛ percent range.

The money market grew substantially firmer in the latter part of December. As time passed, float fell from the abnormally high levels of prior weeks, and reserves were absorbed in volume by the replenishment of the Treasury's low balances at the Reserve Banks. In addition, reserve requirements increased sharply, as the earlier deposit growth was reflected with a two-week lag under the new accounting method. Reserve management by the major money market banks became especially cautious in the face of the usual year-end pressures, apprehension over further loss of time deposits, and a tighter monetary policy. Federal funds traded predominantly in a 6⅛ to 6⅜ percent range during the statement week ended on December 25 and mainly in a 6½ to 6⅞ percent range from December 26 through December 30, with some trading at rates as high as 7⅛ percent on Friday, December 27. (The effective rate fell to 4 percent on December 31 under the weight of a massive accumulation of excess reserves.) In this atmosphere, the nation's banks resorted to borrowing at the "discount window" in dramatic volume. Member bank borrowings from the Federal Reserve averaged $859 million over the December 25 statement period. For the four statement weeks ended on December 25, borrowings averaged $600 million, and in the statement period ended on January 1, borrowings soared to a $1.3 billion average. Mainly reflecting cautious reserve management in the uncertain climate which prevailed during much of December, excess reserves of all member banks averaged $300 million during the four weeks ended on December 25, $58 million more than during the four statement weeks ended on November 27. In the January 1 statement period, excess reserves rose to an average level of $862 million.

In the wake of the two ¼ percent increases in the prime lending rate of commercial banks, which raised this key rate to 6¾ percent, and the upward adjustment in the Federal Reserve discount rate from 5¼ percent to 5½ percent, rates for a wide spectrum of money market instruments moved higher in December. Rates quoted by dealers in bankers' acceptances on ninety-day instruments rose by ½ percent to 6⅝ percent bid-6½ percent offered, rates on dealer-placed prime four- to six-month commercial paper rose generally by ¼ percent to 6¼ percent offered, while offering rates on directly placed commercial paper moved ⅜ percent higher to 6¼ percent. Offering rates posted in December by the major New York City banks on time certificates of deposit (C/D's) were predominantly at the Regulation Q ceiling levels throughout the maturity range. As rates on virtually all competing money market instruments, including Treasury bills, rose progressively during the month, C/D's were at a widening yield disadvantage and commercial banks were unable to replace all the heavy volume that matured over the quarterly corporate dividend and tax payment period. The volume of C/D's outstanding at the weekly reporting banks in New York City declined by $1 billion between November 27 and December 31 (including a $554 million loss during the December 18 statement week) as against a $523 million rise in November. Liabilities of United States banks to their foreign branches declined by $1.2 billion, compared with an increase of $193 million in November.

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Bank Credit Card and Check Credit Plans in the Second District*

Bank credit card and check credit plans have become an important feature of commercial banking over the past few years. These two new forms of consumer credit, which have been introduced all over the country, are beginning to have a significant impact in the consumer and personal finance areas. Second District banks have participated in the growth and development of these new programs, and currently more than ninety Second District banks with total deposits of $67 billion have some type of credit card or check credit plan in full operation. This article focuses on the growth and development of bank credit card and check credit programs, with particular emphasis on the Second District.

The material used in the article derives largely from information developed by a Task Group that was established by the Federal Reserve System in March 1967 to make a thorough examination of bank credit card and check credit plans and to provide for the collection of statistical data.[1] As part of the study, the Federal Reserve System conducted late in 1967 a survey of bank credit card and check credit plans. All commercial banks with any such plan were requested to provide information on the basic features. The survey contains the most comprehensive data available on bank credit card and check credit plans.

CHARACTERISTICS OF BANK CREDIT CARD AND CHECK CREDIT PLANS

In many respects, bank credit card plans are similar to the credit card plans developed by major nonbank corporations. The card-issuing bank establishes relationships with merchants who agree to honor its card for retail purchases. Participating merchants maintain an account with the bank and receive credit immediately for all deposited sales slips which originate via the credit card. The bank then bills its cardholders for all purchases made with the card. For its service the bank charges the merchant a fee in the form of a discount on each sales slip.

Affiliation with a bank credit card program helps a merchant reduce his accounting and record-keeping costs. It also reduces his credit losses and collection expenses. Furthermore, since affiliation lessens the amount of credit the merchant has to extend to customers, it tends to reduce his own need for bank credit. Finally, membership in a bank credit card program permits the merchant to offer credit facilities that are competitive with department stores and other large retail outlets, and may help to enlarge the merchant's sales volume.

For a credit card plan to be profitable, a large number of merchants in a given market area must be enrolled and many cardholders are needed. For this reason, most banks initiating a new credit card program resort to mass mailings to insure widespread initial ownership of their card. While banks often prepare their first mailing on an unsolicited basis, some customer screening is usually undertaken. Cards are ordinarily sent only to past customers or other individuals who meet specified credit standards.

Most bank credit card plans permit the cardholder to get cash advances at his bank as well as to charge purchases at all participating retail outlets. Cardholders are billed once a month, and if the bill is paid soon after receipt there is no charge. An interest charge, usually between 1 percent and 1.5 percent monthly, is typically made on any outstanding balances.

Banks that desire a credit card plan but do not wish to devote the requisite resources to the initiation and operation of such a program may become licensees of another bank offering a credit card. Under such a correspondent arrangement, the licensee bank agrees to offer the card to its customers and typically enlists local merchants in the plan. These licensing arrangements give the licensee banks the competitive advantages of a credit card program while reducing the costs and operational difficulties of such a program.

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* Patrick Page Kildoyle, Economist, Financial Statistics Division, had primary responsibility for the preparation of this article.

[1] The group's findings were published in July 1968 under the title "Bank Credit-Card and Check-Credit Plans". The report may be obtained for $1.00 a copy (85 cents each for ten or more) by writing Publications Services, Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington, D. C., 20551.

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Until very recently, bank credit cards for the most part have been of a local or regional nature, primarily because of the legal restrictions on branch banking and the comparatively limited market for consumer lending that this has implied for any given bank. In order to permit individual bank credit cards to be used over wider geographical areas, thereby making them more attractive, interchange systems have been developed. A cardholder of any bank in the interchange system may use his card for purchases at merchants signed up by other banks participating in the system. While these interchange systems are still evolving, some consolidation is becoming evident, and they appear to be laying the foundation for nationwide bank credit card systems.

Check credit programs were designed to meet some of the same needs as bank credit cards. While there are differences in the operation of the various plans in use throughout the country, the basic format of these programs, which usually are offered under trade names such as "Advance Credit" or "Instant Credit", is quite similar. In general, check credit programs resemble the credit lines granted to business borrowers, although there are no compensating balance requirements. Under these programs, applicants deemed sufficiently creditworthy are granted a stated line of credit, all or a portion of which may be borrowed simply by writing a check. The majority of banks issue special checks for their check credit accounts, although some attach the credit line to the customer's checking account and allow the customer to overdraw his checking account up to the credit line.

Commercial banks typically impose tighter credit requirements for check credit than they do for instalment loans of equivalent size. This is largely because check credit involves a continuous granting of credit. Check credit accounts are constantly scrutinized and examined for overuse or even "line riding" (i.e., continuous borrowing of the maximum permitted) as well as for late payments. In addition, each account is usually given a reasonably thorough periodic credit examination, in which changes in income, employment, and other borrower characteristics considered indicative of the borrower's ability to handle debt are evaluated to determine whether the borrower continues to merit his line of credit. Some banks also require a financial statement from those customers requesting large credit lines.

Many banks, according to the 1967 survey, have established relationships with American Express and Carte Blanche, two major transportation and entertainment (T & E) credit card companies that enable the banks to offer T & E cardholders a hybrid form of check credit. For the most part, T & E companies do not provide financing for charges made on their cards, and they require full payment for purchases, with certain exceptions, soon after receipt of the billing statement. However, T & E cardholders who have established check credit accounts with banks that have set up special relationships with T & E companies may have their T & E card charges financed by these banks.

HISTORY OF THE PLANS

The development of bank credit card plans has been erratic. The first bank credit card plan was launched in 1951 by the Franklin National Bank, Mineola, New York. Other banks soon followed, and by 1953 it was estimated that almost 100 commercial banks throughout the country had announced plans to enter the field. Many of the bankers initiating programs during those years overestimated the potential rewards to be gained from the operation of a credit card plan. When the vast requirements of a fully comprehensive credit card operation became apparent, many of the early participants decided to cut their losses and discontinue these operations.

Very little new activity took place on the bank credit card front until 1958-59, when the Bank of America in California initiated its Bank Americard and the Chase Manhattan Bank in New York City launched its Chase Manhattan Charge Plan. Again there was a brief burst of renewed enthusiasm, with many new entrants, but activity soon tapered off a second time. It was not until two or three years ago that the latest—but certainly not the last—phase of the history of bank credit cards began. Since about 1965, the development of bank credit cards has once more been gaining momentum, with many banks initiating credit card programs. As of June 1968, 416 banks throughout the country had credit card plans in full operation, with outstanding consumer credit under these plans totaling $953 million.

Check credit plans have had an even briefer history than bank credit cards, having originated only in the mid-1950's. There have been two spurts of activity: in the late 1950's and in the second half of the present decade. The plans have proved quite popular with both bankers and the general public. The public has reacted favorably to the one-time credit review aspect of the plans and to the convenience of a line of credit. At the same time, many bankers tend to prefer them to credit cards because of their comparatively lower start-up and operating costs, and because many consumer credit officers feel they are better equipped to handle the problems of check credit plans than of credit cards. As of June 1968, 844 banks in the nation had check credit

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plans, with $646 million of outstanding check credit balances.

DEVELOPMENT OF THE PLANS AT SECOND DISTRICT BANKS

The development of credit card and check credit plans in the Second District appears to have followed the national pattern fairly closely, but there have been some significant differences. While no data are available either nationally or for this District on the number of banks that have begun and subsequently terminated credit card or check credit plans, an indication of the pattern of development in this District may be derived from information on existing plans. The figures in Table I show the number of credit card and check credit plans in operation at the end of September 1967 at Second District banks, instituted each year between 1951 and September 1967. Some banks offer both credit card and check credit plans, and a number have more than one type of check credit plan.

Most commercial banks in this District, mindful of the costly experiences of some banks in past years in operating credit card programs, have chosen the check credit route instead. The latest year for which data are available, 1967, was by far the most active period of development of check credit plans, with forty-seven new check credit plans coming into existence in this District during the first nine months. (Thirty-three of these were affiliated with American Express or Carte Blanche.) As of June 1968, the Second District ranked third, behind the San Francisco and Chicago Federal Reserve Districts, in terms of credit outstanding under bank credit card plans, but in terms of credit outstanding under check credit plans they were tied for first place with the San Francisco District (see Table II).[2]

A credit card program is an expensive undertaking, requiring sophisticated electronic data-processing equipment and specialized personnel. Not many banks have been willing or able to undertake the expense of a credit card program. As Table III indicates, in June 1968 there were only twenty-seven banks with credit card programs in the Second District, but eighty-one with check credit plans. These

Table II

CREDIT OUTSTANDING ON BANK CREDIT CARD AND CHECK CREDIT PLANS

As of June 30, 1968, by Federal Reserve District
In millions of dollars

Federal Reserve District	Credit card plans	Check credit plans	Total
Boston	37	64	101
New York	120	142	262
Philadelphia	14	83	97
Cleveland	36	44	80
Richmond	47	27	74
Atlanta	49	35	84
Chicago	153	62	215
St. Louis	26	16	42
Minneapolis	1	9	10
Kansas City	12	16	28
Dallas	21	6	27
San Francisco	435	142	577
Grand total	953	646	1,599

Note: Because of rounding, figures may not add to totals.
Source: Board of Governors of the Federal Reserve System.

Table I

NUMBER OF CREDIT CARD AND CHECK CREDIT PLANS INITIATED EACH YEAR AT SECOND DISTRICT BANKS

In operation September 30, 1967*

Year	Credit card plans	Check credit plans
1951	1	0
1952	1	0
1953	2	0
1954	2	0
1955	0	1
1956	0	1
1957	0	0
1958	0	3
1959	7	26
1960	0	2
1961	0	1
1962	0	0
1963	0	1
1964	0	4
1965	0	3
1966	2	13
1967 (through September)	3	47

Note: These figures represent the number of *plans* initiated each year by Second District banks, not the number of banks with plans.
* Plans initiated and terminated prior to September 1967 are excluded.

[2] These Second District rankings suggest a comparatively favorable degree of penetration of the potential consumer credit market, when the latter is measured by the total amount of consumer credit outstanding at commercial banks. The Second District was third in the volume of such outstandings, behind the San Francisco and Chicago Districts.

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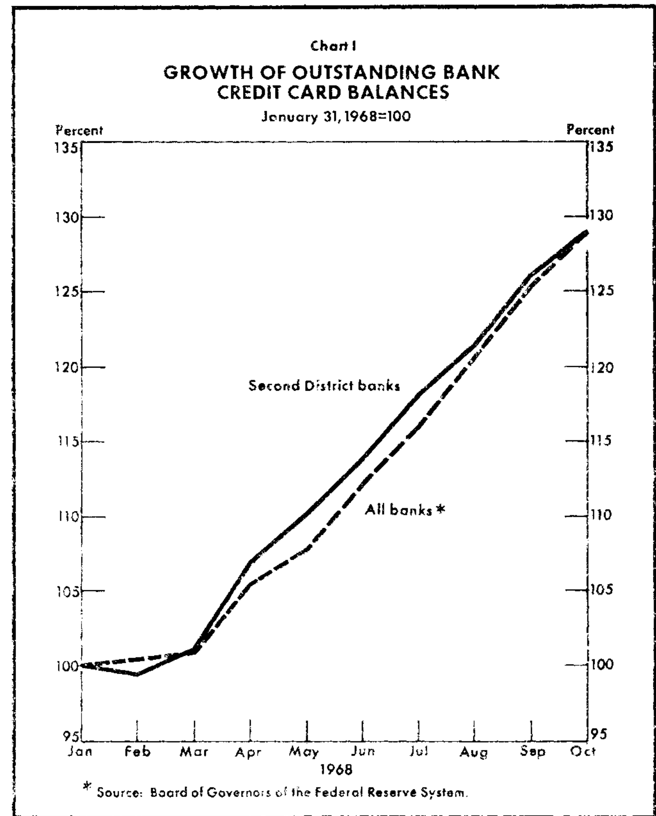
latter plans were offered by all size-groups of banks, while credit cards were offered by only the five largest size-groups. No Second District bank with total deposits of less than $25 million reported having outstandings under credit card programs, while five banks of this size reported check credit outstandings. A total of fourteen banks offered both credit cards and check credit; the smallest of these banks had deposits of $100 million or more. Banks with deposits in the $100 million to $499.9 million range had the largest number of plans of each type. Seventeen banks, or approximately two thirds of the District banks with credit card programs, were in this size-class, as were thirty-three of the eighty-one District banks with check credit plans.

In October 1968, Second District banks held only about 13 percent of the total credit outstanding nationally under bank credit card plans, but they held about 23 percent of the national total of check credit outstandings. This difference is due, for the most part, to the fact that only a few of the major banks in the New York metropolitan area have introduced credit cards, while almost all have some type of check credit plan in operation. A number of the large New York City banks, however, have recently indicated that they plan to enter into credit card operations in the near future.

Between January and October 1968, check credit outstandings in the Second District grew considerably faster than the national average, while credit card outstandings at Second District banks rose at the same rate as the national average. The growth in outstandings under both types of plans was rapid, however, at both Second District banks and nationwide. Second District credit outstanding under bank credit card and check credit plans expanded by 29 percent and 40 percent, respectively (see Charts I and II). Nationally, both series grew 29 percent. The figures for both the Second District and the nation reflect the entry of new banks into the field as well as the growth of outstandings under existing plans.



The 1967 survey of bank credit card and check credit plans indicated that about 35,500 merchants were honoring a total of 1.4 million credit cards issued by banks in the Second District. About 40 percent of these card accounts (or 550,000) were considered active accounts. Check credit accounts numbered 210,000, of which 70 percent was active. The average active credit card account in the Second District had an outstanding balance due of $117, while the average active check credit account had a balance due of $662.

Commercial bank income from credit card programs is derived from two major sources: merchant discounts and cardholder charges. Merchant discounts, which are calculated as a percentage charge on each sales slip, vary according to industry, with airlines typically charged the lowest discount. The discounts charged the merchants are

Table III

NUMBER OF SECOND DISTRICT BANKS WITH CREDIT CARD AND/OR CHECK CREDIT PLANS, BY SIZE OF BANK

June 30, 1968

Size of bank (total deposits in millions of dollars)	Number of Second District banks	Banks with credit card plans	Banks with check credit plans
Under 10	144	0	2
10-24.9	121	0	3
25-49.9	74	2	14
50-99.9	44	3	14
100-499.9	64	17	33
500-999.9	9	2	5
1,000 and over	12	3	10
All size-groups	468	27	81

Source: Call Report for June 30, 1968.

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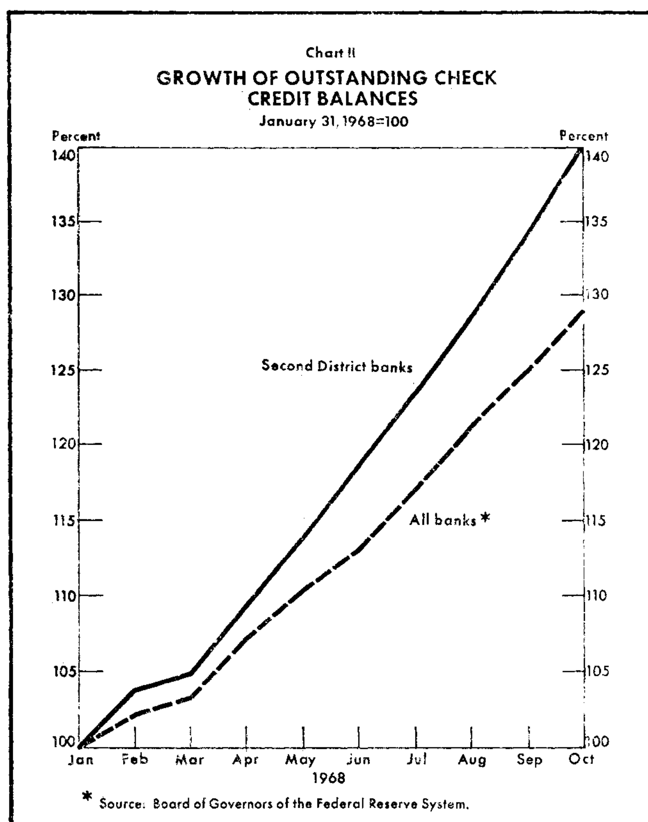
sometimes, in effect, reduced through rebates, the amount of rebate depending on the volume of sales generated by the credit cards. At least one bank has established a schedule that gears the rebate also to the average size of sale, with merchants having higher dollar charges per sale being given higher rebates.

Banks in this District charge merchants (excluding airlines) discounts ranging from as low as 1 percent to as high as 8 percent, with 5 percent the most typical discount rate. Airlines generally are charged 2 percent. Insofar as the service charge to the cardholder is concerned, almost all banks in this District make a uniform monthly charge of 1 percent of the unpaid balance for cash advances to credit cardholders and 1½ percent of the unpaid balance on retail purchases. The rates are in some cases held at these levels because they are at state legal maximums. There is some evidence that increased competition between credit card programs has resulted in lower merchant discounts, and that over the long run the cardholder charges have become the more important revenue source for the credit card banks.

Lines of credit under check credit plans offered by Second District banks typically range from about $1,000 to $2,000, but some are as small as $100 and some as large as $5,000. The use of special checks for these plans remains more common than allowing overdrafts on regular checking accounts, although this latter arrangement is now offered by about 40 percent of all plans. Monthly service charges on check credit accounts usually run about 1 percent per month on the unpaid balance, including insurance charges.



DELINQUENCIES AND CHARGE-OFFS

Ever since the launching of the first bank credit card plan and the first check credit plan, there has been considerable concern regarding the quality of the credit extended under these programs. Credit of this sort appears to have a higher potential for default or fraud than standard consumer credit, and greater vigilance is required. It is, therefore, encouraging to note that estimates of delinquency rates for both credit card and check credit plans in this District seem to be fairly well in line with delinquencies on other kinds of consumer credit. For September 1967, the New York State Bankers Association indicated that 2.0 percent of all standard consumer credit loans was delinquent thirty days or more. Figures from the September 1967 System survey of bank credit card and check credit plans indicate that delinquencies for Second District bank credit cards at that time were 2.2 percent of active accounts and delinquencies on check credit were 2.0 percent.[3]

Actual dollar losses, or charge-offs, at Second District banks for both credit card and check credit plans also do not seem excessive when compared with banks in other Districts. In the first six months of 1967, Second District banks wrote off a total of $332,000 of credit card outstandings, amounting to 0.51 percent of the total credit card outstandings in September 1967. Nationally, however, the charge-off rate amounted to a much larger 1.97 percent. This latter, comparatively high, charge-off rate reflects to some extent the recent proliferation of new bank credit card programs. When banks initiate a credit card program, they anticipate that charge-offs will be fairly high for the first year or two, until the program gets off the ground. Once the program has become fully operational, there is usually a sharp decline in charge-offs.

[3] These delinquency rates on credit card and check credit plans may not be fully comparable to the delinquency rates published by the New York State Bankers Association, due to slight differences in the method of computation.

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When, for example, charge-off rates are calculated only for the commercial banks that began their credit card programs prior to 1966, the national rate declines from 1.97 percent to 1.18 percent.

Charge-offs under check credit plans at Second District banks were also below the national average. During the six months ended June 1967, Second District banks wrote off $135,000 of check credit outstandings. This amounted to 0.14 percent of the September 1967 outstandings. Nationally, the comparable check credit charge-off rate was 0.23 percent.

RELATIVE IMPORTANCE OF BANK CREDIT CARD AND CHECK CREDIT PLANS

While bank credit card and check credit plans are rapidly growing segments of the banking industry, it must nevertheless be kept in mind that at present they still are relatively insignificant when compared with other types of consumer credit. For example, bank credit card and check credit outstandings on October 31, 1968 amounted to only 3.0 percent and 3.4 percent, respectively, of the total $4.6 billion of consumer instalment credit outstandings at Second District banks. Nevertheless, should these forms of credit extension continue to grow at anywhere near their recent rates, they will become in a relatively short time a far more significant factor in Second District banking —as well as in the entire banking industry—than they are now.

While it is true that these new credit techniques have not as yet garnered a large share of the consumer credit market, their impact on the individual banks operating the programs has been more consequential. When the consumer loan portfolios of only those banks with credit card and check credit plans are examined, it is found that credit card banks in the Second District currently have about 9 percent of their consumer credit in the form of credit card outstandings, and check credit banks have about 5 percent of their consumer credit in the form of check credit outstandings. Some banks rely far more heavily than others on these instruments for consumer loans. A few, for example, have more than 15 percent of their consumer instalment credit in the form of credit card outstandings, and at least one bank has more than 20 percent in the form of check credit outstandings.

CONCLUDING COMMENT

Bank credit card and check credit programs, although only fairly recent banking innovations, are becoming of greater importance both to Second District banks and the entire banking industry. While the programs have caused some problems, commercial banks on the whole have come to grips with these problems and are solving them. Although the future of these new credit techniques cannot be foreseen in detail, there is ample evidence that the programs will continue to expand and thus have a greater impact on the banking system in the future.

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Publications of the Federal Reserve Bank of New York

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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*)

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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 1969) 9 pages. A layman's guide to the economic and financial highlights of the previous year. ($6 per 100 for copies in excess of 100*)

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