FEDERAL RESERVE BANK
OF NEW YORK

MONTHLY REVIEW

FEBRUARY 1969

Contents

Volume 51 **No. 2**

Central Banking in a Time of Stress*

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The past year has been a difficult one for monetary policy, both at home and abroad. It began with the Federal Reserve seeking to restrain a boom, while hoping that the Congress would soon extend a helping hand by enacting a tax increase. The Federal Government had been running a huge budget deficit, and its financing severely limited the room for maneuver for monetary policy. Internationally, we had to deal with the aftermath of the sterling devaluation, a rush for gold that verged on panic, then a heavy blow at the French franc two months later. Meanwhile, our own trade balance was deteriorating badly, chiefly as a direct result of the inflation at home.

A major development of the past year was, of course, the enactment of the tax surcharge and expenditure control bill. The initial fears of "overkill", as well as the hopes of a prompt moderation of excessive demand, did not survive for long. The subsequent inflationary developments and expectations have served to emphasize the need for fiscal restraint. Without the shift from a budget deficit of more than $25 billion in the last fiscal year to approximate balance this year, a shift aided substantially by the tax surcharge and expenditure restraints, it is difficult to imagine what would have developed. For that reason, I would like to commend all those bankers who worked tirelessly for this fiscal policy measure, and who —as much as any group—succeeded in persuading a Congress facing election to increase the tax burden. Bankers, in that effort, were carrying on in their best tradition of civic responsibility.

Monetary policy also had to grapple with the inflationary surge of 1968. During the first half of the year, the rate of growth of bank credit was brought down from the high level of the preceding six months. The demands of the Treasury and other borrowers pushed interest rates up, while the Federal Reserve maintained restraint as the tax bill worked its way through the Congress. After the midyear enactment of fiscal restraint, and the quick response of financial markets to the promise of a lower level of credit demands, the System shifted to accommodate the market's move to lower interest rates. With the benefit of hindsight, we can now regret that too-hasty reaction, for it is clear that the growth of money and credit was excessive in an economy marked by undiminished momentum and powerful inflationary forces. Toward the end of the year, there was an appropriate tightening of policy.

I have merely touched on some of the difficult problems of the past year; it is already clear that there will be more of them to face before 1969 is ended. What I prefer to speak about today, however, is the structure of the Federal Reserve System and its position in our Government, and how these features lend themselves to an effective way of developing answers to these difficult problems. I certainly do not intend to argue that the present structure of the System or its formulation of policy is perfect. But I do wish to examine critically some suggestions for radical change, and to call your attention to some elements of strength in our present arrangements.

All of you, I am sure, know in your own organizations occasions when equally intelligent and concerned men facing the same facts come to different policy conclusions. This happens, of course, as votes are counted at meetings of the Federal Open Market Committee and the Federal Reserve Board, whether the policy problem be one of open market operations, discount rates, or bank mergers. No one has a monopoly of wisdom, and the more able

*An address before the forty-first annual midwinter meeting of the New York State Bankers Association, New York City, January 20, 1969.

minds that can be effectively brought to bear on these difficult questions, the better. A special strength of the System is its regional structure that brings it close to the day-to-day life of the whole country. In the Federal Reserve System we especially recognize the great value of the views of the Reserve Bank directors, developed as they are all around the country and in experience with business conditions and financial markets. In a somewhat narrower context, we in the Reserve Banks are aware how much we owe our directors in their decisions and advice on developing and managing an efficient organization and on introducing new methods and techniques.

The idea is sometimes advanced that it would be desirable to concentrate monetary authority in Washington still further. I would like to point out, however, that such a move would not only reduce the part played by the Reserve Banks in the policy formation process, but might also risk the loss of the valuable participation by the Reserve Bank directors. The member banks have a fine record of electing as directors outstanding businessmen and bankers who contribute both sound judgment and intimate knowledge of the current state of the economy to the formulation of monetary policy. The Federal Reserve Act, of course, requires these elected directors—together with other leaders of the community appointed as directors by the Board of Governors—to establish, or reestablish, the discount rate every two weeks. Their action, as you know, is subject to the approval of the Board of Governors, but it seems to me clear that there is an advantage in having discount rate action reflect these combined judgments. Although I probably do not have to tell you so, I must note at this point that the directors deliberate and vote in the broad public interest, whatever their positions in private life.

At every meeting the directors express views on business and credit conditions that are useful to each Reserve Bank president at meetings of the Federal Open Market Committee. I cannot exaggerate the value of the collective judgment of the Reserve Bank directors, expressed as they carry out the responsibilities imposed on them by the Congress. And it seems to me most unlikely that we could continue to attract men of the same high quality if they were to be deprived of a meaningful role in formulating monetary policy.

Another suggestion advanced in recent years is that discretionary judgment with respect to monetary policy is undesirable. Instead, it is argued, there ought to be a fixed rule that would guide the monetary authorities. Under this approach the stock of money would be increased by a uniform percentage each quarter or month. I certainly believe that monetary policy can and should be improved and that its record during the past year has been something less than perfect. But I am not persuaded that we should aim at a fixed percentage growth in the money supply month in and month out regardless of what else is going on in the economy: whether Federal spending is rising rapidly or slowly, whether business capital spending is lively or sluggish, whether labor is in short supply or abundantly available, and whether price increases are negligible or staggeringly large. Moreover, in some circumstances steady growth in the money stock would, in my judgment, entail wild gyrations in interest rates and financial values that could threaten economic stability. I cannot refrain from noting also that advocates of a fixed rule with respect to money have reached no agreement either as to the definition of money or as to the appropriate growth rate of money, however defined.

Turning now to the coordination of System policies with other Government measures, we in the Federal Reserve like to emphasize that the System is not independent *of* the Government, but independent *within* the Government. Naturally, the System is responsible to, and must be responsive to, the Congress, from which all its powers derive. But there is, and there should continue to be, close and frequent consultation with the Administration, especially such bodies as the Treasury Department and the Council of Economic Advisers. The public interest requires the frankest exchange of information and views. In the final analysis, the Federal Reserve must be able to determine monetary policy free from the day-to-day pressure of partisan politics, and the structure of the System helps to attain this end.

I should like to turn now to the area of the System's relations with its member banks. The fact is, of course, that any monetary policy to be effective must work on and through banks. The Federal Reserve can do a great deal just by its control of the cash reserves of the banking system. But it can do a great deal more, and do it more effectively, if banks understand and support its policy. It is not easy, on the face of it, for bankers to approve a policy that restrains their ability to extend credit when interest rates are high. Nonetheless, bankers generally do support such a policy if they are persuaded that it is in the country's best long-run interest, because they then see that it is in their interest as well. Indeed, I was impressed last year with the large number of bankers who criticized the Federal Reserve because it was not still tougher on credit expansion.

It is not easy, to take another example, to support a voluntary program that requests an actual reduction in profitable loans to creditworthy foreign borrowers, risking a loss not only of today's earnings but a handicap in developing future attractive business. Yet bankers have supported this policy, and I hope will continue to do so as long as the need is so urgent, for a strong dollar is in their best long-run interest, as it is in every American's. I believe that one reason for wide support among bankers for policies such as these is the structural relationship between member banks and the Federal Reserve, and the channel of communication which that relationship provides.

I am aware that from time to time some matters come to the fore on which there may be honest differences of opinion. Bankers rightfully feel free to criticize Federal Reserve actions, in both the regulatory and monetary policy fields. Generally, the criticism is constructive, reflecting an active banker participation in the discussion of what is good for the economy and the nation. Not infrequently the criticism is deserved as well and has helped to bring about improvements. For example, there has been a growing feeling that inequitable treatment has developed as between national banks and state-chartered members; one such inequality related to the establishment of operating subsidiaries. Recently the Federal Reserve Board withdrew its objection to the establishment of bank subsidiaries to conduct activities that may be handled more effectively in this way than as a department of the bank itself. This, of course, applies only where state law permits the use of such subsidiaries, as it does in New York State. Progress in eliminating such inequalities and in coping with other problems may not have been as swift or on as broad a front as some of us may wish, but progress is being made and, I hope, will continue to be made. The best way to foster such progress is for you, as bankers, to maintain your interest and participation in System affairs and to let us have your suggestions for improvement.

The Federal Reserve, as I have indicated, is aware of these problems and is seeking ways to eliminate many of the causes of dissatisfaction. We have, as you know, completed a comprehenive study of the discount mechanism on which your views were solicited. A primary purpose of the proposed changes in discount administration is to make the privilege of membership more useful to banks. The System has recently organized a vigorous effort to focus upon some of the supervisory matters which may give rise to dissatisfaction by bankers. Perhaps I should mention, too, that we are at the moment studying closely the implications of the blossoming of one-bank holding companies. With these efforts as evidence, I can assure you that the System is concerned about these supervisory matters and is moving steadily toward improvement.

I have devoted some time to questions about the structure and the policy-making methods of the Federal Reserve System because I think these matters are of substantial and lasting importance. But they take on added significance at this time when our economy and our banking system are being subjected to serious inflationary pressures that distort their effective working. Credit demands are high because of inflation, but the System is trying to limit the growth of bank credit for the same reason. Banks are being pinched by the Regulation Q ceiling, which causes funds they might otherwise attract to be diverted to marketable instruments yielding more than CD's can. Yet, the stubborn fact is that inflation must be resisted and that monetary policy must be in the front line. One can also admit, in this connection, that even the temporary period of "accommodation" during last summer has made our present problems more difficult.

As we look ahead, I still believe we can count on last year's fiscal measures, now supplemented by the increase in the social security tax, to cool down our overheated economy somewhat. We can also look forward to a reduction of Treasury debt between mid-March and June of some $8 billion, in marked contrast to the experience of last spring. Nevertheless, there will surely be a long and arduous way to go before we return to a satisfactory degree of price stability. Yet such a return is essential, not only for the health of our economy at home but for the preservation of confidence in the dollar abroad. It is impossible to repeat too often the warning that continued inflation distorts business judgments on policies involving investment in plant and equipment or in inventories, on wage and price policies, and that decisions that turn out to be unsound and unsustainable will make the necessary correction so much the more painful. I am deeply disturbed, therefore, by the prevalence of inflationary psychology as evidenced by excessive speculation in commodity, security, and real estate markets.

While it is illusory to suppose that we can somehow squeeze all the inflation out of the economy in a few short months, or that the necessary adjustments will be painless for everybody, it is nonetheless true that a continued and successful effort is essential. The alternative, demonstrated again and again in other countries that have had to adopt harsh measures of austerity, is surely less attractive; the problem does not get easier to grapple with if it is pushed away into the future.

It may also be worth reminding ourselves what it is we are trying to achieve. At home, we ought to aim at a gradual reduction in the rate of price inflation, and to do so with a minimum rise in overall unemployment. To reduce the rate of price inflation to 2 percent a year might be a practicable interim goal. To those who fear that this might mean an excessive rise in unemployment, I would point out that at present we face a situation of extreme labor scarcity in most parts of the country, combined with a serious unemployment problem in certain fields, and especially with respect to the nonwhite population. I would hope that we could make continued progress in cutting unemployment in these special areas, while at the same time moderating the more general situation of extreme labor shortage. What we should seek now is a better balance between production and aggregate demand; monetary and fiscal policies can help greatly to achieve that balance. If we do so, we will be mounting a successful attack on the discouraging outlook that now confronts those savers who provide the capital for economic growth by putting their funds in thrift accounts or bonds. We will also be restoring our international trade surplus, largely by reducing the recent unsustainable surge in imports; that improvement, in turn, will strengthen the international monetary structure in which the dollar is the keystone.

This formidable task cannot be accomplished by Government fiscal policy and Federal Reserve monetary measures alone. It needs the cooperation of management and labor, and indeed of all elements in the economy. I have tried to suggest that in banking we have developed a framework in which such cooperation has worked effectively. You, as bankers, advising your corporate and individual customers, can do much to extend that cooperation by fostering understanding during the difficult months ahead as we try to slow down the economy's unsustainable pace to a growth rate that will produce greater real gains for all of us over the long run.

The Business Situation

Concrete signs of a needed moderation in the rate of economic expansion have remained meager thus far in 1969. Recently received information indicates that demand continued to be excessive and inflationary as the old year ended, although pressures in the consumer sector tended to ease somewhat. The gross national product advanced vigorously in the October-December quarter, the labor market tightened further, and prices continued to soar. The relatively small increase in personal consumption expenditures was apparently responsible to some degree for a substantial accumulation of inventories at the retail trade level. The 10 percent tax surcharge was very likely an influence on consumer behavior, but the fundamental trend of consumer demand was obscured by the dampening effects of the widespread outbreak of flu. The magnitude of the fourth-quarter advances in industrial production, business fixed investment, residential construction, employment, and prices left little doubt regarding the exuberance of the economy as 1968 drew to a close. It is clear that the task of restoring a satisfactory degree of price stability will be long and difficult.

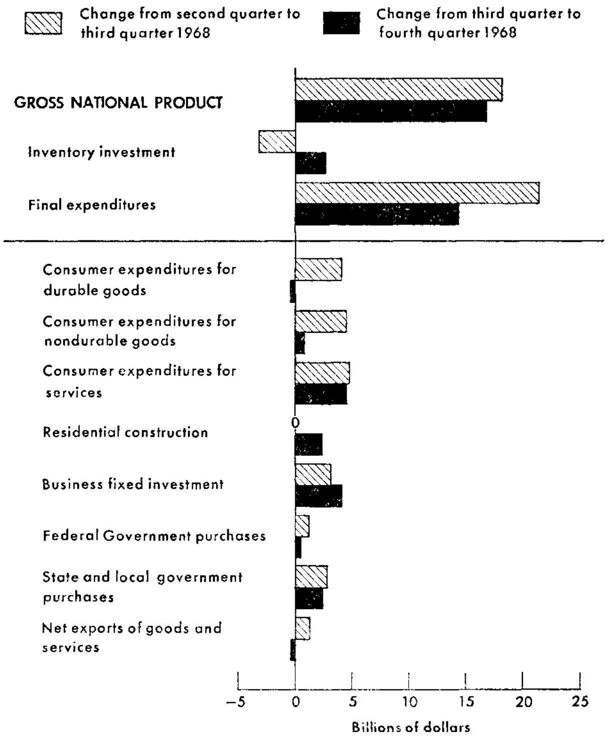
GROSS NATIONAL PRODUCT IN THE FOURTH QUARTER

The nation's total output of goods and services (GNP) increased by $16.8 billion in the final quarter of 1968 (see Chart I) to a seasonally adjusted annual rate of $887.8 billion, according to preliminary estimates by the Department of Commerce. This represented only a very modest slowing from the previous quarter's $18.1 billion advance. Of the total fourth-quarter expansion in demand, a bit more than half reflected simply higher prices. The implicit GNP price deflator—a broad, summary measure of price developments in all the components of national output—increased at an annual rate of just under 4 percent, exceeding the third-quarter pace of 3½ percent and equaling that recorded during the first half of 1968. The proportion of GNP growth consisting of real expansion—that is, the rise in output excluding the effect of price changes—diminished quarter by quarter through the year, giving clear evidence of the disturbing grip of inflationary forces. In the final quarter, real GNP increased at an annual rate of 3.8 percent.

Chart I

RECENT CHANGES IN GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted annual rates



Source: United States Department of Commerce.

The composition of the fourth-quarter gain in GNP differed markedly from that of the third-quarter increase. Generally speaking, private investment displaced consumer spending as the primary source of growth. Personal consumption expenditures rose by only $5.2 billion, considerably less than the third-quarter advance of $13.2 billion and the smallest since a like increase in the third quarter of 1967. Meanwhile, business increased its investment outlays for both fixed capital and inventories by $6.6 billion. Inventories were accumulated at a rate $2.5 billion above the pace of the third quarter, when there had occurred a decline of $3.3 billion in the rate of accumulation due to the working-off of strike-hedge steel inventories. The growth of final expenditures in all sectors—i.e., total expenditures less inventory accumulation—amounted to $14.3 billion, substantially below the $21.4 billion increase recorded in the previous quarter.

Consumers spent in the fourth quarter only a little over half of the $9.8 billion increase in disposable personal income. This cautious behavior marked a sharp shift from the third quarter, when income growth had been severely curtailed by the imposition of the tax surcharge and yet consumer spending had advanced by more than double the increase in disposable income. The savings rate rose in the fourth quarter to 6.9 percent from the preceding quarter's 6.3 percent, although it remained below the unusually high rates of late 1967 and early 1968. It seems quite possible that consumers were finally reacting to the effects on spendable income of the tax surcharge, and they may also have been anticipating the higher social security payments that started this January. The impact of these tax increases on recent expenditures is difficult to assess, however, especially since the widespread outbreak of flu toward the end of the year probably cut into retail buying. Whatever the causes, consumer demand for goods, as distinct from services, was on a plateau in the fourth quarter. Expenditures for durable goods declined slightly and expenditures on nondurable goods rose modestly, leaving a net gain of only $0.5 billion. The reduction in demand for durables was the first in five quarters, with a dampening in the pace of auto sales contributing significantly to the decline. Moreover, the increase in demand for nondurables was the smallest since an actual decline occurred in the final months of 1963. Most of the $5.2 billion rise in consumption during the quarter was in services. Such expenditures rose by $4.6 billion, an increase in line with the trend over the past few years.

Sales at retail outlets dropped about 2 percent in December, according to the preliminary report; this brought sales down to the lowest level since May. The weakness in sales was widespread, as it was for the quarter as a whole. It was particularly marked in the auto sector. In terms of the number of units sold, auto sales slid from a seasonally adjusted annual rate of just over 9 million in October, which was close to the average for the third quarter, to a bit under 9 million in November, and then to a rate of 8½ million units in December. Despite this slackening in the sales pace, over 8.6 million new domestic-model cars were sold in the United States market during the year, the highest annual total since 1965. In the early weeks of 1969, however, sales were running below the December pace.

The record increase in investment spending was the major factor propelling the economy in the fourth quarter. In addition to the $2.5 billion rise in the rate of inventory accumulation, fixed investment advanced by $6.4 billion, in dollar volume a record and in percentage terms the largest gain since early 1959. Of this increase, almost two thirds

($4.1 billion) comprised business capital investment; this latter gain resulted primarily from a record $3.1 billion surge in spending for equipment. According to a recent McGraw-Hill survey, the strength of demand for capital goods has rested partly on a desire to beat price rises, partly on anticipation of growing demand, and also —in significant degree—on a need to cut labor costs.

Expenditures for residential construction in the fourth quarter grew by $2.3 billion, the largest quarterly advance of the year. At a seasonally adjusted annual rate of $31.8 billion, such outlays were some $3½ billion above the year-earlier pace and more than $10 billion above the low reached in early 1967 at the depth of the slump in home building. Although outlays for residential construction in December registered another large gain, private housing starts plummeted that month to an annual rate of 1.45 million units, more than offsetting the sharp rise in November to the extraordinary rate of 1.72 million units. This is a highly volatile series, however, and both the November and December movements may have largely reflected statistical aberrations. Data on building permits showed a milder jump in November and but little softening in December, with the permit rate in the latter month exceeding the pace in all but two other months of the year. Some observers are concerned regarding the prospects for residential construction activity in 1969, as heavy business demands for funds threaten to put increasing pressure on the supply of mortgage funds. Housing industry spokesmen, however, remain guardedly optimistic. Last month, in order to improve the flow of funds into the mortgage market, the interest rate ceilings on home loans insured by the Federal Housing Administration as well as on loans guaranteed by the Veterans Administration were raised to 7½ percent from 6¾ percent.

Government purchases of goods and services increased by $2.9 billion in the September-December period, the smallest rise since the third quarter of 1967. State and local government expenditures accounted for most of the increase. The Federal Government was responsible for only $0.4 billion of the gain, largely representing defense spending. Thus, Federal Government expenditures contributed very little to the increase in inflationary pressures in recent months.

The remaining component of GNP, net exports of goods and services, declined $0.3 billion during the quarter, compared with a $1.3 billion advance in the third quarter. During the year as a whole, net exports of goods and services dropped precipitously, from $4.8 billion in 1967 to $2.4 billion. This was the smallest surplus since 1959, a consequence of the disturbing deterioration in our merchandise trade position.

RECENT DEVELOPMENTS IN PRODUCTION AND EMPLOYMENT

Industrial output registered another substantial gain in December. The Federal Reserve Board's index of industrial production climbed 0.9 percent to a seasonally adjusted 168.9 percent of the 1957-59 average. Reflecting the strength of capital goods demand, production of business equipment again increased more rapidly than total output. Indeed, output of business equipment rose by 5 percent between August and December while total industrial production gained 2½ percent. This surge in business equipment followed several quarters of virtual stability. It contrasted with the output of defense-oriented equipment, which fell 5 percent during those months after about three years of steady growth. Consumer goods output rose in December by only 0.3 percent. The modest size of the increase was largely attributable to cutbacks in auto and television production. The seasonally adjusted annual rate of auto assemblies had run for several months at a high plateau of about 9¼ million units, but in December slid off to below 9 million units. In January, as the sales pace declined and inventories swelled, production was cut back further and schedules for February call for additional reductions.

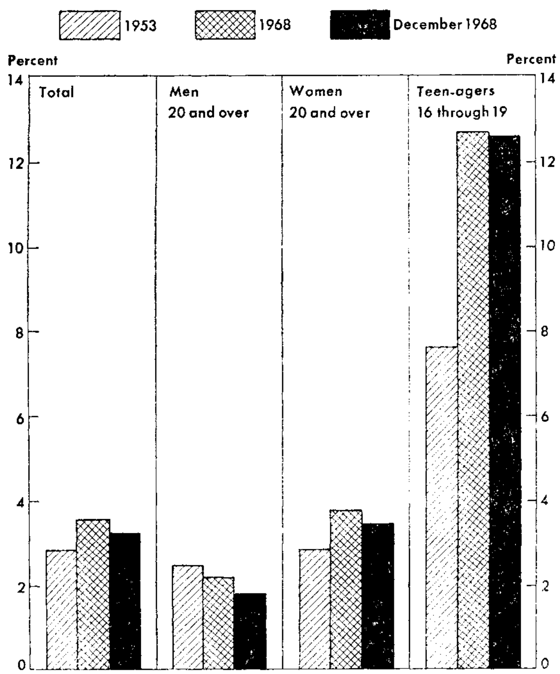
The production of materials recorded a sizable advance in December. The steel industry continued its swift recovery following the depletion of strike-hedge stockpiles, and it appears that steel production is now at a rate close to that which prevailed before the strike-anticipating inventory buildup. In January, steel production continued to move up, perhaps partly as a result of the strike by East and Gulf Coast longshoremen which has curbed imports. An increase in coal production, reflecting further recovery from the October strike, also contributed significantly to the December gain in materials output.

The volume of new orders received by manufacturers in December increased very slightly. A small drop in orders for nondurable goods was more than offset by a rise in orders for durables, principally a result of an increase in electrical machinery orders. At the same time, the backlog of unfilled orders registered its sixth successive gain, partly due to a sizable drop in shipments. Manufacturers' inventories also increased again, but the magnitude of the accumulation was by no means inordinate. While the inventory-sales ratio of manufacturers rose substantially, the ratio was close to the average for the year.

At the year-end, the manpower required for continued expansion of production was placing a heavy strain on the nation's labor resources. The seasonally adjusted unemployment rate held in December at the fifteen-year low of

3.3 percent that was reached in November. At that level, it is true, the rate was almost one percentage point above the low of 2.5 percent attained in May and June 1953 during the Korean war; the average for the entire year of 1968 (3.6 percent) was 0.7 percentage point higher than the 1953 average (see Chart II). Nonetheless, a breakdown of the total into various groups suggests that in some respects the economy may currently be experiencing the greatest excess demand for labor since World War II. The unemployed in today's labor market do not form a reservoir that serves to dampen in any effective way the upward surge in wages. Especially significant in December was the further tightening of the labor market for men 20 years of age and older, as their unemployment rate sank to a post-World War II low of 1.8 percent. For the full twelve months of 1968 their unemployment rate averaged only 2.2 percent, compared with 2.5 percent in 1953. While the 1968 unemployment rate for adult women, 3.8 percent, was considerably above the 2.9 percent prevailing in 1953, the December rate was down to 3.5 percent. Most striking was the unemployment rate for teen-agers, which was very much higher than in the Korean war period. This three-way breakdown, as well as other evidence, indicates that at the present time the unemployed consist largely of those seeking part-time or temporary work or who lack the skills required for the types of jobs that are open.

Chart II
UNEMPLOYMENT RATES IN 1953, 1968, AND DECEMBER 1968



Source: United States Department of Labor, Bureau of Labor Statistics.

PRICE DEVELOPMENTS

Wholesale prices advanced steeply in January, according to preliminary data, with the wholesale price index increasing by 0.8 percent, the largest rise since July 1953. Prices of industrial commodities continued to soar, climbing 0.5 percent; this was the biggest monthly jump since August 1956. A sharp boost in nonferrous metals prices coupled with another sizable increase in lumber and plywood prices accounted for most of the gain. Final December data indicate that the wholesale price index was 2.8 percent higher than in December 1967. The rise in the index of industrial commodities was nearly as large.

The consumer price index in December was 4.7 percent above the year-ago figure, the biggest December-to-December increase since early in the Korean war. The month's gain in the index was the smallest since September 1967 but nonetheless was at an annual rate of 3 percent. A partly seasonal drop in the prices of nonfood commodities, led by a decline in new and used car prices, was responsible for the deceleration. According to the Bureau of Labor Statistics, the January rate of increase was probably up again.

The Money and Bond Markets in January

In the first month of the new year, following the sharp upward adjustments in interest rates that had occurred in December, market psychology improved considerably for a time and the money and bond markets showed increased rate stability. Late in the month, however, a cautious atmosphere reappeared as the cumulative effects of increased monetary restraint became more visible.

After a brief reaction to the rise in the prime lending rate of commercial banks on January 7, prices of Government coupon issues were steady to higher over a large portion of the month. Contributing to the better tone were forecasts of Federal budget surpluses for fiscal 1969 and 1970, progress in procedural matters at the Vietnam meetings in Paris, and the absence of large-scale liquidation of securities by commercial banks.

Late in the month, caution revived as monetary indicators pointed to sustained monetary restraint. In addition, nervousness grew in the corporate and tax-exempt bond markets when investors exhibited lackluster interest in new offerings. At the same time, market activity contracted in the Government coupon sector and prices moved irregularly as participants awaited an announcement from the Treasury concerning its February refunding. The market reacted with some restraint when the Treasury offered either a fifteen-month note (priced to yield about 6.42 percent) or a seven-year note (priced to yield about 6.29 percent) as alternative replacements for the $14.5 billion of outstanding coupon issues maturing in mid-February. As the month drew to a close, prices of Treasury notes and bonds declined in quiet trading.

The money market displayed a firm tone through the major part of January, and most trading in Federal funds occurred in a 6¼ to 6⅝ percent range. Large commercial banks continued to experience sizable runoffs of certificates of deposit (CD's) during the month, as rates on Treasury bills and other competing short-term money market instruments remained more attractive. The major banks adjusted, in part, to the CD drain by increasing their borrowings in the Euro-dollar market.

THE GOVERNMENT SECURITIES MARKET

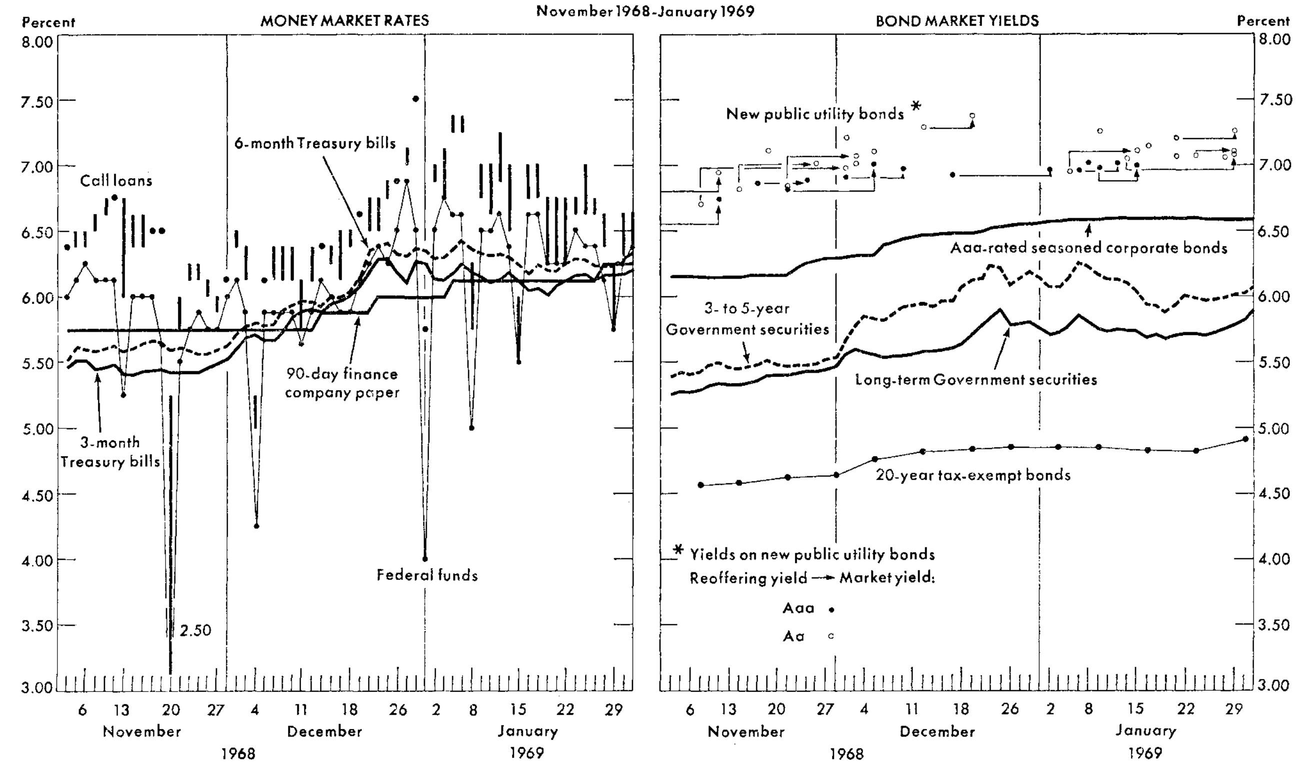
An atmosphere of caution persisted in the market for Treasury notes and bonds in early January. There was concern on the part of market participants over the possible severity and duration of monetary restraint. The January 7 increase in the prime rate briefly generated some nervousness over the interest rate outlook. Prices of Treasury notes and bonds consequently fluctuated in the first few days of January and then declined sharply in initial response to the prime rate action.

Subsequently, a continuing strong demand for short-term securities contributed to the view that near-term interest rate pressures might prove less severe than some observers had forecast. In addition, market sentiment was encouraged by an improvement in the technical position of the coupon sector, by the absence of any alarming amount of investment selling, particularly by banks, and by a steady demand—especially for intermediate-term issues—from a variety of investor sources. The market was also buoyed by the predictions of a Federal budget surplus and by the announcement that there had been a surplus in this nation's balance of payments in 1968. As a result, prices throughout the maturity range generally moved higher from January 8 through midmonth. (Associated yield declines are illustrated in the right-hand panel of the chart.)

On January 16 it was announced that negotiators in Paris had reached an agreement on certain procedural matters that had delayed the start of expanded Vietnam peace discussions. This news strengthened market hopes that interest rates might already have reached their peaks, and triggered a fairly sharp rise in prices of coupon issues. Subsequently, the market tone became less buoyant when commercial bank selling of intermediate-term issues developed, accompanied by some investor switching out of long-term Treasury securities into corporate and Federal agency issues. Moreover, overall activity contracted as attention began to focus on the Treasury's approaching

SELECTED INTEREST RATES

November 1968-January 1969



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.

refunding. Thus, from January 21 onward, prices of intermediate- and long-term coupon issues generally edged irregularly lower.

On January 29, the Treasury announced that holders of the 5⅝ percent notes and 4 percent bonds maturing on February 15 could, if they wished, convert their holdings into new 6⅜ percent notes of May 1970 which were priced to yield about 6.42 percent and/or into new 6¼ percent notes of February 1976 which were priced to yield about 6.29 percent. The public holds approximately $5.4 billion of the maturing securities, while an additional $9.1 billion is held by the Federal Reserve and Government accounts. (Subscription books for the exchange offerings were open from February 3 through February 5.) In the closing days of the month, activity was fairly light in the coupon sector. Prices of outstanding issues of short- and intermediate-term maturity receded slightly in adjustment to the refunding offerings. At the same time, longer term issues, which were affected by the heavier tone of the corporate and tax-exempt bond sectors, declined fairly sharply.

A good tone prevailed in the Treasury bill sector as the new year commenced. A broadly based demand for bills was evident from both professional and investor sources, while offerings were moderate and readily absorbed. News of the prime rate increase triggered a sharp but brief upward adjustment in bill rates on January 7. Subsequently, however, a steady investment demand for bills and some professional short covering spurred a rapid market recovery, and bill rates generally declined (as illustrated in the left-hand panel of the chart). Good commercial bank interest emerged at the January 14 auction of \$1¾ billion of additional June tax anticipation bills for which commercial banks were permitted to pay through credits to Treasury Tax and Loan Accounts. The tax bills were sold at an average issuing rate of 5.940 percent.

More optimistic reports concerning the Paris peace talks generated lively professional demand and produced a relatively sharp drop in bill rates on January 16. Over the next few days, rates continued to move lower in response to persisting investment and professional demand. From January 22 through the end of the month, however, a more cautious tone emerged in the bill sector. Investment activity in outstanding bills contracted somewhat, and concern over monetary restraint began to revive. Market participants appeared hopeful, however, that the Treasury's approaching refunding would generate demand for bills from holders of the maturing coupon issues who chose not to take on the Treasury's exchange offerings. Nevertheless, in the closing days of January, the refunding operation appeared to be producing little demand for bills. Moreover, bank offerings of the June tax anticipation bills expanded.

At the final regular weekly auction of the month, held on January 27, average issuing rates for the new three- and six-month bills were set at 6.167 percent and 6.255 percent, respectively, 3 and 8 basis points below the average rates established a month earlier. At the first monthly auction of the new year, on January 28, average issuing rates on the new nine- and twelve-month bills were set at 6.195 percent and 6.144 percent, respectively, 29 and 27 basis points lower than the record average rates at the comparable December auction (see Table III).

OTHER SECURITIES MARKETS

In the markets for corporate and tax-exempt bonds, yields continued to rise during the first few days of January, in some cases to record highs. Nonetheless, some new flotations encountered investor resistance. The undertone of caution was reinforced by the prime rate increase announced early in the month. Subsequently, however, a steadier tone emerged in both sectors. A fairly good investor interest in new and recently issued tax-exempt securities developed before midmonth. At the same time, underwriters in the corporate sector probed for new trading levels. While some corporate offerings were marketed at slightly lower yields, they often drew mixed receptions from investors.

In the final third of the month, prices of corporate and tax-exempt bonds moved lower on balance in relatively light trading. A more cautious undertone again emerged in both sectors during this period, reflecting some concern about the lack of investment interest in these securities as well as uncertainty over the outcome of the Treasury's refunding operation.

At the end of January, *The Weekly Bond Buyer's* yield index of twenty seasoned tax-exempt issues was quoted at 4.91 percent, 6 basis points higher than a month earlier. Moody's index for seasoned Aaa-rated corporate bonds closed the month at 6.59 percent, 4 basis points higher than a month earlier. The Blue List of advertised dealer inventories of tax-exempt securities totaled \$601 million at the end of the month as against the December 31 level of \$547 million.

BANK RESERVES AND THE MONEY MARKET

The tone of the money market was generally quite firm during January. In the January 8 statement period, reserve distribution favored banks outside the major money centers. As banks in the central money market came under heightened reserve pressures, largely because of a sizable contraction in demand and time deposits, the average basic reserve deficit of the eight major New York City banks deepened to \$1.4 billion (see Table II). Most Federal funds transactions during the week were effected in a 6½ percent to 6¾ percent rate range.

A firm tone persisted in the January 15 statement period. The average basic reserve deficit at the eight major New York City banks grew by \$130 million to almost \$1.6 billion, while the deficit of the thirty-eight major banks in the money centers outside New York City rose by \$206 million to almost \$2.1 billion. This deterioration resulted primarily from a further contraction in deposits coupled with an increase in required reserves—an increase which, because of the two-week lag under the new reserve-accounting method, reflected earlier deposit growth. On a nationwide basis, average member bank borrowings from the Federal Reserve Banks rose during the January 15 week by \$189 million and net borrowed reserves increased fairly sharply (Table I). The large money market banks also continued to purchase a substantial volume of Federal funds (see Table II), at rates which were predominantly in a 6⅜ to 6⅝ percent range during the statement period.

A steadily firm tone was evident in the money market during the January 22 statement week. A pronounced shift in reserve distribution in favor of the major money market banks occurred, as evidenced by a sharp improvement in the basic reserve positions of the eight major New York City banks and a slight improvement in the reserve positions of the thirty-eight money market banks

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1969

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

Factors	Changes in daily averages—week ended on					Net changes
	Jan. 1	Jan. 8	Jan. 15	Jan. 22	Jan. 29	
"Market" factors						
Member bank required reserves	− 625	− 328	− 573	+ 257	+ 668	− 601
Operating transactions (subtotal)	− 128	+ 135	+ 782	+ 169	− 358	+ 600
Federal Reserve float	+ 24	− 331	− 332	+ 43	− 558	−1,154
Treasury operations*	− 119	− 19	+ 16	+ 18	− 166	− 270
Gold and foreign account	+ 2	− 2	+ 1	+ 15	+ 69	+ 85
Currency outside banks	+ 84	+ 365	+1,138	+ 15	+ 393	+1,995
Other Federal Reserve accounts (net)†	− 120	+ 123	− 42	+ 78	− 95	− 56
Total "market" factors	− 753	− 193	+ 209	+ 426	+ 310	− 1
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 576	+ 398	− 175	− 480	− 503	− 184
Bankers' acceptances	− 1	+ 2	− 2	− 4	− 2	− 7
Repurchase agreements:						
Government securities	+ 166	− 54	− 172	—	—	− 60
Bankers' acceptances	+ 21	+ 1	− 29	—	—	− 7
Federal agency obligations	+ 7	+ 5	− 16	—	—	− 4
Member bank borrowings	+ 459	− 819	+ 189	+ 92	+ 112	+ 33
Other loans, discounts, and advances	—	—	—	—	—	—
Total	+1,228	− 467	− 205	− 392	− 393	− 229
Excess reserves	+ 475	− 660	+ 4	+ 34	− 83	− 230

	Daily average levels					
Member bank:						
Total reserves, including vault cash	28,295	27,963	28,540	28,317	27,566	28,136‡
Required reserves	27,433	27,761	28,334	28,077	27,409	27,803‡
Excess reserves	862	202	206	240	157	333‡
Borrowings	1,318	499	688	780	892	835‡
Free, or net borrowed (−) reserves	− 456	− 297	− 482	− 540	− 735	− 502‡
Nonborrowed reserves	26,977	27,464	27,852	27,537	26,674	27,301‡
Net carry-over, excess or deficit (−)§	191	298	117	69	115	158‡

	Changes in Wednesday levels					
System account holdings of Government securities maturing in:						
Less than one year	+ 331	− 215	− 535	+ 297	− 159	− 281
More than one year	—	—	—	—	—	—
Total	+ 331	− 215	− 535	+ 297	− 159	− 281

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 five weeks ended January 29, 1969.
§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS JANUARY 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended					Averages of five weeks ended on Jan. 29
	Jan. 1	Jan. 8	Jan. 15	Jan. 22	Jan. 29	
Eight banks in New York City						
Reserve excess or deficiency(−)*	291	− 29	− 16	36	18	60
Less borrowings from Reserve Banks	434	—	136	86	—	131
Less net interbank Federal funds purchases or sales(−)	1,090	1,403	1,410	635	− 128	882
Gross purchases	*1,634*	*2,166*	*2,333*	*1,735*	*1,353*	*1,844*
Gross sales	*544*	*764*	*923*	*1,100*	*1,481*	*962*
Equals net basic reserve surplus or deficit(−)	−1,232	−1,432	−1,562	− 685	146	− 953
Net loans to Government securities dealers	837	828	732	706	838	788
Net carry-over, excess or deficit(−)†	67	94	12	− 8	29	39
Thirty-eight banks outside New York City						
Reserve excess or deficiency(−)*	205	− 48	− 21	− 8	− 41	17
Less borrowings from Reserve Banks	483	186	237	346	260	302
Less net interbank Federal funds purchases or sales(−)	1,518	1,626	1,807	1,625	1,083	1,532
Gross purchases	*2,792*	*3,141*	*3,235*	*2,872*	*2,554*	*2,919*
Gross sales	*1,274*	*1,515*	*1,428*	*1,247*	*1,471*	*1,387*
Equals net basic reserve surplus or deficit(−)	−1,796	−1,859	−2,065	−1,979	−1,384	−1,817
Net loans to Government securities dealers	360	383	172	280	396	318
Net carry-over, excess or deficit(−)†	21	97	22	3	22	33

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 percent

Maturities	Weekly auction dates—January 1969			
	Jan. 6	Jan. 13	Jan. 20	Jan. 27
Three-month	6.227	6.215	6.076	6.167
Six-month	6.365	6.375	6.233	6.255

	Monthly auction dates—November 1968-January 1969		
	Nov. 22	Dec. 23	Jan. 28
Nine-month	5.693	6.483	6.195
One-year	5.568	6.412	6.144

* 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.

outside New York City (see Table II). At the same time, however, nationwide reserve availability contracted somewhat, largely as a result of System open market operations which more than absorbed the reserves released by market factors. Against this background, Federal funds traded predominantly in a 6¼ to 6⅝ percent range, while average member bank borrowings from the Federal Reserve Banks rose by an additional $92 million to $780 million.

In the final statement period of the month, the reserve positions of the forty-six major reserve city banks improved dramatically, partly as a result of a sharp contraction in required reserves and expanded borrowings from foreign branches. The large New York City banks actually accumulated an average basic reserve surplus (see Table II) for the first time in almost a year, and their net sales of Federal funds averaged $128 million. Accordingly, most Federal funds transactions took place in a 6⅛ to 6½ percent rate range. At the same time, nationwide reserve availability contracted by $195 million as average net borrowed reserves rose to $735 million. With reserve distribution sharply favoring money market banks, pressures on the reserve positions of banks outside the money centers intensified. As a consequence of heightened reserve pressures at the relatively smaller banks, member bank borrowings from the Federal Reserve Banks rose by $112 million to $892 million.

Offering rates posted by the major New York City banks on the various maturities of CD's generally remained at the Regulation Q ceiling levels in January, while the outstanding volume of CD's continued to fall. CD's outstanding at the weekly reporting banks in New York City declined by $810 million between December 31 and January 29, compared with a $1 billion contraction in December. At the same time, however, liabilities of United States banks to their foreign branches rose by $2.6 billion, more than offsetting the $1.2 billion contraction in December.

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Banking and Monetary Developments in the Fourth Quarter

Bank credit continued to expand in the fourth quarter although more moderately than in the third, the money supply grew at an accelerated pace, and member banks experienced increased pressure on their reserve positions. With economic activity extremely strong and an inflationary psychology prevalent, it became increasingly clear that the growth of money and credit was excessive. On December 17 the Board of Governors of the Federal Reserve System approved actions by the directors of nine of the Federal Reserve Banks raising the discount rate by ¼ percentage point to 5½ percent. Similar increases voted by the directors of the other three Reserve Banks were approved two days later. This restored the rate to the level prevailing from mid-April to mid-August, the highest in nearly forty years.

INTEREST RATES AND RESERVE POSITIONS

Money market rates rose substantially during the fourth quarter, with very sharp increases being registered in the closing weeks of the year. The rate for three-month Treasury bills, a key short-term rate that had fluctuated around 5.20 percent in September, peaked at a record high of 6.26 percent on December 24 and thereafter declined only slightly. As a result of the rise in rates, banks found it increasingly difficult to compete for funds through the issuance of large certificates of deposit (CD's). By early December, most banks were paying the CD ceiling rates established in mid-April under Regulation Q. These range from 5½ to 6¼ percent, depending on maturity. In December, CD liabilities at large weekly reporting banks declined substantially, and the net gain for the quarter was quite small.

Reserve positions of member banks came under growing pressure as the quarter progressed, and net borrowed reserves rose to an average of $354 million in December from a September average of $132 million. Member bank borrowings at the discount window increased slightly over the quarter as a whole. The effective rate on Federal funds fluctuated irregularly during most of the period but tended sharply upward during the last two weeks of December; in September it had averaged 5.78 percent, in December the average was 6.02 percent, but in the last two weeks of December the rate rose to an average of 6.10 percent. Rates on Euro-dollar funds increased throughout the quarter and were unusually high toward the end of December when a large number of United States corporations repatriated funds they had previously held on deposit in foreign banks. Thus, the New York City banks, who had made extensive use of this market as a source of funds during the third quarter, found it more costly to do so at a time when reserve pressures were intensifying.

With banks facing sustained strong loan demand and funds becoming more difficult to raise, the prime rate was moved up in December in two successive ¼ percentage point steps to 6¾ percent. The initial round of increases was started on the first business day of December and the second on December 18, the day the increase in the discount rate took effect. On January 7, 1969, the prime rate was raised again, to 7 percent. This is the highest rate in more than four decades.

BANK CREDIT

The growth of total commercial bank credit slowed to a seasonally adjusted annual rate of 10½ percent during the fourth quarter, after having accelerated sharply to a 19 percent rate during the third. However, this decline in the rate of expansion, which became evident during November and was even more pronounced in December, was largely the result of a sizable reduction in bank holdings of United States Government securities together with a sharp decline in securities loans. The composition of the quarter's seasonally adjusted $9.7 billion credit growth reflected the strong loan demand that was associated with the continued rapid rate of economic expansion. Although the overall growth in loans moderated somewhat, there was a record rise in loans other than securities loans. Bank investments, meanwhile, expanded by only \$1.2 billion, seasonally adjusted. The modest size of this increase seems to have reflected the hesitancy of the banks to advance their holdings of securities at a time when loan demand was strong and the banks were anticipating a sizable attrition of maturing CD's.

Commercial banks reduced their Government securities portfolios during the quarter by 14½ percent, seasonally adjusted annual rate. In the preceding quarter, seeking to rebuild liquidity, they had acquired substantial amounts of Government securities as well as of other investments. All of the fourth-quarter liquidation occurred in November, when banks were anticipating participation in a \$2 billion Treasury tax anticipation bill (TAB) issue for which they could make full payment by credits to Treasury Tax and Loan Accounts. The issue was paid for on December 2. During December, banks sold intermediate- and long-term Governments as well as many of the newly acquired bills, but largely as a result of the TAB issue they were left with a net increase in holdings of Government securities that partly offset the November liquidation. Despite the fourth-quarter reduction, banks increased their holdings of Government securities during the last half of 1968 by a substantial amount.

The fourth-quarter decline in holdings of Government securities was more than offset by purchases of "other securities"—principally tax-exempt obligations issued by states and municipalities—which were added to bank portfolios at a 21 percent seasonally adjusted annual rate. The rise constituted the largest quarterly increase in "other securities" in 1968. In December, however, the rate of increase, seasonally adjusted, moderated substantially.

Loans to securities dealers declined in the fourth quarter from the record level reached in the third. The large third-quarter increase had reflected financing of the record level of inventories built up by United States Government securities dealers over the summer, and the fourth-quarter decline in such loans largely reflected the reductions during the quarter in the average level of dealers' holdings. Loans to Government securities dealers were nonetheless high during the final quarter. Loans to stock market brokers and dealers also remained strong, probably owing to the heavy volume of stock market activity.

The growth rate of business loans—by far the largest single loan category—accelerated quarter by quarter in 1968 and reached a seasonally adjusted annual rate of just over 12 percent in the final quarter, though the pace of expansion moderated somewhat in December. The strong fourth-quarter increase can be related to increases in the rates of business inventory accumulation and fixed investment. Inventories rose in that quarter at an estimated \$10 billion seasonally adjusted annual rate, up from the \$7.5 billion rate of accumulation in the third quarter, and business fixed investment increased at a record rate of \$4.1 billion, considerably more than the third-quarter rise.[1] Perhaps there was also some stimulus to business loans as a result of a slight easing in loan rates for part of the quarter. This temporary easing was exemplified by the changes in the prime rate, which was lowered in late September but raised again in December.

Real estate loans posted a strong 14 percent gain, continuing the marked strengthening that began in September. Contributing to this expansion were the large increases during the quarter in construction outlays and private housing starts; the latter reached a seasonally adjusted annual rate of nearly 1.6 million units in the fourth quarter, the highest in almost five years. Moreover, real estate loans became more attractive after the liberalization of usury law ceilings in a number of states during the summer of 1968.

Consumer loans rose during the fourth quarter by 11 percent, seasonally adjusted annual rate. Although this was a large increase, it was considerably below the third quarter's 14 percent advance. That was the period, however, when the income tax surcharge went into effect, cutting heavily into the growth of disposable income. Consumption expenditures had nonetheless increased sharply that quarter, financed heavily by credit. In the fourth quarter, the growth of disposable income was stronger, but the rise in consumption expenditures slowed dramatically. This was reflected in an increase in the savings rate. However, consumer indebtedness to all types of lenders (bank and nonbank) continued to grow rapidly. Although the rate of increase in loans extended to consumers by banks slowed a bit, at the same time the overall credit demands in the consumer sector affected banks indirectly by giving rise to a record increase in bank lending to nonbank financial institutions. The major borrowers in this category are sales and personal finance companies. The increased volume of such lending may indicate that these borrowers were finding banks a relatively more attractive source of funds as the money markets firmed. Along with rates on other market instruments, those on paper directly issued by finance companies increased throughout the quarter.

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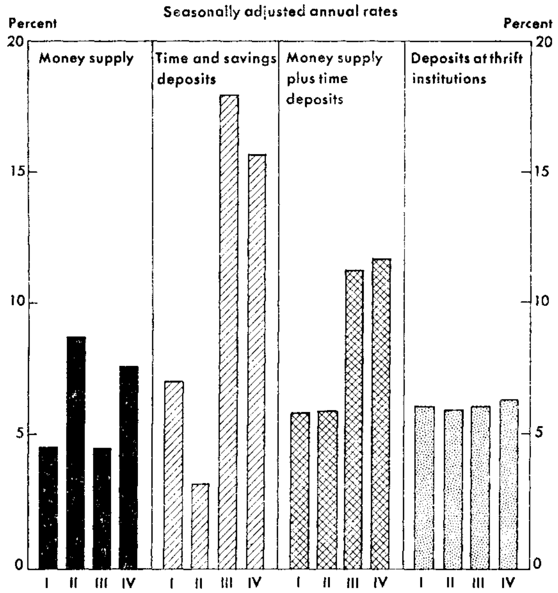
[1] For a more detailed discussion of third-quarter developments in business investment, see "The Business Situation", this *Review*, pages 27-28.

MONEY SUPPLY AND TIME DEPOSITS

The growth rate of the money supply—privately held demand deposits plus currency in circulation outside banks—accelerated in the October-December period to a seasonally adjusted annual rate of 7½ percent (see Chart I). This represented a sizable increase over the third quarter's 4½ percent expansion rate. The recent acceleration, which was especially strong in November, was in part a result of a substantial reduction in Treasury deposits at commercial banks, which added funds to the private sector. In November, Treasury deposits, which had been built up over the summer and early fall, declined by almost $2 billion. The net decline for the quarter is estimated at $1.4 billion. The rapid growth of the money stock may also have reflected increased needs for transactions balances due to the continuing high level of economic and financial activity.

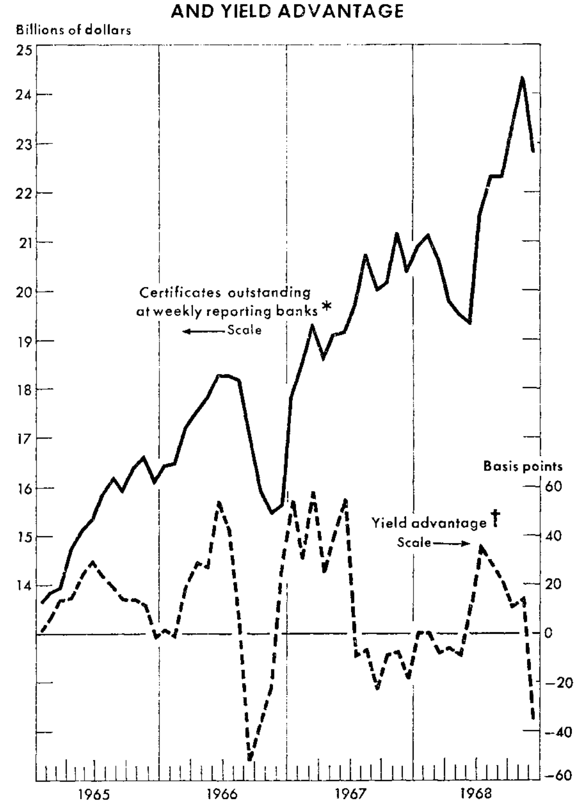
The steep climb in time and savings deposits at commercial banks that began last July and resulted in a third-quarter rise of 18 percent (seasonally adjusted annual rate) continued into the fourth quarter. However, the increase, which amounted to 15½ percent for the quarter, seemed to be moderating toward the end of the year. Most of the third-quarter advance had reflected heavy inflows in the form of large CD's. During October and November, banks were still quite successful in attracting CD's, but as market rates continued to rise, the offering rates on such deposits ran into the limitations imposed by Regulation Q ceilings. By early December, most banks were quoting the ceiling rates on all CD maturities, but these rates were generally lower than those on competing financial instruments and banks began to lose a substantial volume of deposits as the CD's reached maturity. At weekly reporting banks, which include the institutions most active in the CD market, outstanding large CD's grew in October and November by a total of $2 billion and then fell in December by $1.5 billion (see Chart II). These data are unadjusted

Chart I
1968 QUARTERLY CHANGES IN LIQUIDITY INDICATORS
Seasonally adjusted annual rates



Note: Percentage changes are based on the averages of daily figures for the last month of each quarter, except for thrift institutions. Percentage changes at the latter are based on the amount outstanding on the last day of each quarter.
Source: Board of Governors of the Federal Reserve System.

Chart II
LARGE CERTIFICATES OF DEPOSIT OUTSTANDING AND YIELD ADVANTAGE



* Outstanding on the last Wednesday of each month.
† Monthly average of most often quoted new issue rates on 90- to 179-day large certificates of deposit at nine large New York City banks less average yield on six-month Treasury bills.
Source: Board of Governors of the Federal Reserve System.

for seasonal variation, but the December decline was considerably larger than seasonal. Consumer-type time and savings deposits at weekly reporting banks increased by a total of $1.4 billion during the fourth quarter, most of the rise occurring in the month of October. This quarterly gain was virtually the same as the $1.5 billion increase during the third quarter. Although no data are available on the components of time and savings deposits at all commercial banks, the weekly reporting bank figures suggest that the rapid fourth-quarter increase in total time deposits reflected in part an increase in personal savings (which swung from a decline in the third quarter of $6.9 billion, seasonally adjusted annual rate, to a $4.3 billion increase in the fourth) and in part an increase in state and local government time deposits.

THRIFT INSTITUTIONS

The rate of growth of savings flows into thrift institutions advanced moderately in the October-December period, rising to 6.3 percent from the previous quarter's 6.1 percent. Share capital at savings and loan associations continued to grow at approximately the same 6.0 percent rate as in the third quarter, but deposits at mutual savings banks increased their growth from a 6.3 percent rate to an estimated 7.0 percent rate. The continued widening of the spread between rates on deposits at the thrift institutions and rates on comparable money market instruments presumably tended to retard flows to these institutions, but this development was apparently more than offset by gains reflecting the increased rate of personal savings. However, the largest monthly increase in flows occurred in October. As the year drew to a close, these institutions seemed to be having difficulty attracting new funds. The December growth in total deposits and shares at thrift institutions was the smallest, in absolute and relative terms, of the quarter. The sharp rise in the number of odd-lot purchases of Government securities in late December may have indicated that individual savings were being placed increasingly in money market instruments instead of in thrift institutions.

The thrift institutions increased their net acquisitions of mortgages during the fourth quarter by just over 7½ percent, up from 6 percent in the third quarter. Mutual savings banks added to their mortgage portfolios at a 6 percent annual rate, compared with a 4½ percent rate in the third quarter, while savings and loan associations increased their new mortgage lending even more sharply, the rise mounting from an annual rate of 6½ percent in the third quarter to 8½ percent in the fourth. The step-up in mortgage lending was partly a result of the demand for new housing, which remained strong in the fourth quarter despite increased financing costs. At the same time, builders and homeowners may have been accelerating their takedown of the large outstanding backlog of mortgage commitments in order to avoid the possibility of having to renegotiate terms at a later date.