# FEDERAL RESERVE BANK OF NEW YORK

# MONTHLY REVIEW

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Contents



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## Increases in the Federal Reserve Discount Rate and Reserve Requirements Against Member Bank Demand Deposits

The following statement was released by the Board of Governors of the Federal Reserve System on April 3, 1969:

In a further move against inflation, the Board of Governors of the Federal Reserve System today:

(1) Increased reserve requirements against demand deposits at all member banks by ½ percentage point, effective in the reserve computation period beginning April 17 and applicable to average deposits in the period April 3-9, inclusive.

(2) Approved action by the directors of eleven Federal Reserve Banks increasing the discount rate at those Banks from 5½ to 6 percent, effective April 4. The discount rate is the interest rate charged member banks for borrowing from their District Federal Reserve Banks.

The increase in reserve requirements will mean that the nearly 6,000 national and state member banks must set aside as reserves an additional $650 million, approximately $375 million at reserve city banks—generally the larger banks in larger cities—and $275 million at other member banks, frequently referred to as "country banks".

The action will raise reserve requirements at reserve city banks from 16½ to 17 percent on net demand deposits under $5 million and from 17 to 17½ percent on deposits over $5 million. For all other member banks the increase will be from 12 to 12½ percent on deposits under $5 million and from 12½ to 13 percent on those over $5 million. Reserve requirements against time deposits remain unchanged.

The new top rate of 17½ percent on net demand deposits is the highest since 1960. The last previous change in reserve requirements took effect in January 1968, when they were raised ½ percentage point on all demand deposits over $5 million.

The new discount rate will be put into effect tomorrow by the Federal Reserve Banks of New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. The 6 percent rate is the highest in forty years, although the rate has been as high as 7 percent in 1920-21.

The seven members of the Board were unanimous on the discount rate action, and all members of the Board voted in favor of the reserve requirement action except Governor Maisel, who stated: "I have no disagreement with the majority of the Board in either the ultimate goal being sought for the economy nor with the view that demand for output and services is continuing to rise at an inflationary pace. However, current money market relationships have, for the past five months, led to modest growth in most monetary aggregates, a sharp rise in interest rates, and a rapid reduction of bank liquidity. The existing relationships appear to me proper to sustain a long period of noninflationary growth of money and credit. I conclude that until evidence arises that the demand for funds is leading to an undesirable upward shift in the rate of monetary expansion, an increase in reserve requirements is not called for."

## The Business Situation

The major indicators of business activity point to continued inflationary pressures in the economy. The modest inventory-sales imbalance that developed toward the end of last year appears to have been largely corrected since then by a combination of small further inventory additions, large gains in sales of manufacturing firms, and a reversal of the December decline in retail sales. Industrial production continues to grow, and recent sizable increases in the labor force have been readily absorbed by the intensive demands for new workers. As a result, the unemployment rate has remained at a fifteen-year low. Looking ahead, a Government survey found businessmen planning to increase sharply their plant and equipment outlays this year, reflecting their expectations of strong demand conditions and a generally inflationary cost and price environment. At the same time, leading indicators of residential construction activity have stayed at very advanced levels despite tighter mortgage market conditions, and total construction spending has advanced to record levels. Under these conditions, inflationary sentiment remains firmly entrenched. In a further move to reduce the inflationary pressures in the economy, the Federal Reserve System on April 3 raised the discount rate to 6 percent from 5½ percent and increased reserve requirements against member bank demand deposits by ½ percentage point.

### PRODUCTION, ORDERS, AND INVENTORIES

The Federal Reserve Board's index of industrial production registered a gain of 0.4 percentage point in February to reach a seasonally adjusted 169.5 percent of the 1957-59 average. Considerable strength continues to be clearly visible in steel production and in the broad category of equipment. Iron and steel production, though growing much less vigorously than late last year, recorded a solid advance in February, and it appears that output in March was up a little further. Defense-oriented equipment output recovered in February from the previous month's strike-depressed level, and a further increase of about 1 percent in business equipment production brought the overall gain in that sector to more than 6 percent since the current upswing began in September. However, the February advance in overall industrial production was limited by further declines in the production of motor vehicles and parts and of textiles and apparel. There were also reductions in coal and crude oil output that appear to have been strike-related.

The production of consumer goods rose slightly in February. A decline in the automotive products category was more than offset by a further gain in other consumer products. In terms of unit assemblies, domestic auto production slipped to a seasonally adjusted annual rate of 8.4 million units in February from 8.7 million units in January, and apparently remained about unchanged in March. The sharp cutback in production since November, when output was at a rate of 9.2 million units, reflects efforts on the part of the industry to stem rising inventories of new cars at the dealer level.

New orders received by durable goods manufacturers jumped by 3 percent in February to a new high. The growth of the orders inflow was concentrated in the fabricated metals, machinery, and transportation equipment industries. In the latter industry, virtually all the increase was due to a large advance in orders for military aircraft. The backlog of unfilled orders on the books of durables manufacturers rose in February for the seventh consecutive month, also reaching a new peak.

At the end of last year there was some evidence that inventories might be getting out of line with sales, as the overall inventory-sales ratio for manufacturing and trade firms rose significantly. This movement was largely reversed in January, however. Manufacturers' shipments surged upward in that month, and retail sales more than recovered from their December slump. At the same time, inventories rose only marginally in both sectors. Moreover, in February, sales at retail outlets remained at the January peak, according to the advance report, and once again manufacturers' shipments advanced strongly while their inventories rose fairly moderately. Evidence that manufacturers do not consider their current inventory positions to be excessive is contained in a recent Government survey of their inventory spending plans. That survey, by the Commerce Department, found that manufacturers expect to accumulate inventories in the first half of this year at a higher rate than in 1968. The planned second-quarter increase of $2.4 billion, if it occurs, would be the largest quarterly rise in inventories since late 1966.

### BUSINESS FIXED INVESTMENT AND RESIDENTIAL CONSTRUCTION

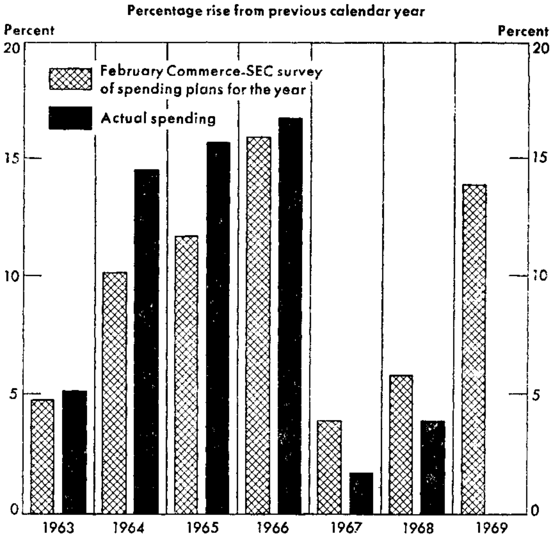
Businessmen plan to increase sharply their spending on plant and equipment this year, according to a recent survey conducted jointly by the Department of Commerce and the Securities and Exchange Commission. The findings of the survey, taken in late January and early February, indicate that capital spending will climb to an estimated $73 billion in 1969, a rise of 14 percent from last year (see Chart I). If this estimate proves accurate, the percentage growth in dollar expenditures for plant and equipment would be of a magnitude approaching the huge gains in the mid-1960's—though inflation is, of course, likely to account for a much larger proportion of the increase this year.

The survey of capital spending plans found strength spread fairly evenly among the major industry classifications. The forecast increases generally range narrowly from 10 percent for the communications-commercial-miscellaneous category to 17 percent for nondurable goods manufacturers. The railroads, which plan a 30 percent advance, are a striking exception to the general pattern. Among manufacturers, particularly large increases are planned by such important industries as chemicals, petroleum, textiles, paper, machinery and equipment, and motor vehicles. In 1968, capital expenditures declined in most of these industries. Planned capital spending by manufacturers overall is up 16 percent in 1969 after having declined last year by 1 percent.

Chart I

PLANT AND EQUIPMENT PLANS AND EXPENDITURES

Percentage rise from previous calendar year




Sources: United States Department of Commerce; Securities and Exchange Commission.

Capital spending has quite obviously been fueled since last summer by expectations of further growth in business sales and profits and further increases in capital goods prices and wage rates. Some additional impetus may also be attributable to speculation that the investment tax credit might be rescinded or reduced. These factors seem to be overwhelming the effects of the past moderate behavior of consumer spending, tightened credit conditions, and much unused capacity.

Thus, even though consumer spending has displayed only moderate growth since last summer, manufacturers reported in conjunction with the Commerce-SEC capital spending survey that they expect 1969 sales to exceed the 1968 level by nearly 8 percent, not much below last year's gain of 10 percent. The retail trade sector, moreover, expects a sales gain this year that would be even larger than the 1968 advance.

The mid-March boost in the commercial banks' prime lending rate to 7½ percent, and the sharp rise in capital market rates generally, may well cause businessmen to readjust their capital spending plans as well as give closer scrutiny to inventory holdings. However, the continued growth of internal funds available for investment spending is undoubtedly helping to buoy plant and equipment and inventory spending. Thus, despite the 10 percent tax surcharge, corporate profits after taxes climbed to a record seasonally adjusted annual rate of $52.9 billion in the final quarter of last year.

The overall capacity utilization rate in manufacturing has been about 84 percent in recent months, significantly below an average of more than 90 percent in 1966. Consequently, it seems likely that 1969 capital spending plans reflect in part a major effort by businessmen to economize on labor through more efficient facilities. Unit labor costs in manufacturing soared by 4.1 percent in 1968, and recent trends in wage rates suggest continued sharp increases in production costs.

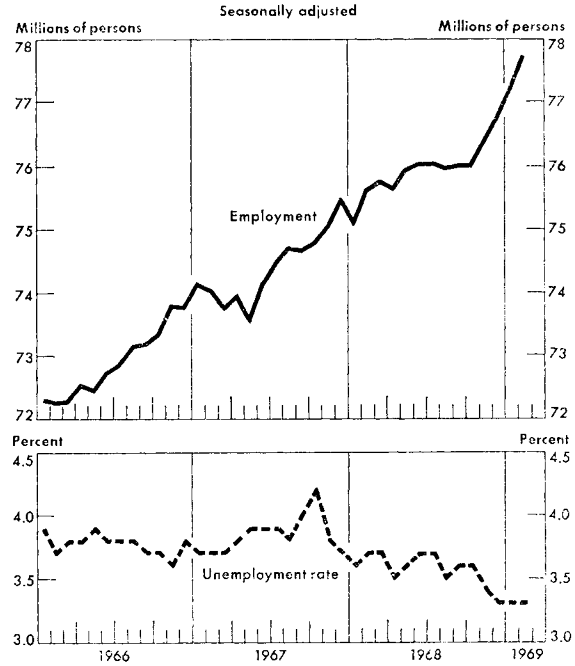
Total spending on new construction set another high in

February, rising to a seasonally adjusted annual rate of more than $90 billion. Public construction outlays increased sharply and, although private nonresidential construction activity was below the previous month's peak, it remained at a very high rate. At the same time, private residential construction rose further in February and the leading indicators of housing activity point to additional increases ahead. Housing starts in January and February averaged well above levels in the closing months of 1968. In January, starts were at an annual rate of more than 1.8 million units, and the February rate of 1.7 million was also very high. At the same time, housing permits recovered vigorously in February after a January dip.

Chart II

TOTAL EMPLOYMENT AND THE UNEMPLOYMENT RATE

Seasonally adjusted




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

### EMPLOYMENT, INCOME, AND CONSUMER SPENDING

The demand for labor remains very strong indeed. The unemployment rate in February held at the fifteen-year low of 3.3 percent (see Chart II). A further large increase in the civilian labor force was matched by an advance in employment of ½ million persons, leaving the number of persons seeking work unchanged.

Payroll employment in nonagricultural establishments rose by 335,000 persons in February, the second largest increase in a year. Even after allowance for the extra boost given the figure as roughly 60,000 strikers returned to work, the gain was exceptionally large. Payrolls rose in all the major sectors. There were substantial advances in services, government, and construction, and manufacturing employment was up considerably, largely due to settlement of a petroleum industry strike.

The downward drift of the average workweek of production workers in manufacturing continued in February. From a seasonally adjusted 41.1 hours in September, the average workweek gradually shortened to 40.1 hours in February. The decline appears to be broadly based, and nonmanufacturing sectors of the economy are apparently experiencing a shortening of the workweek as well. This development has been viewed by some observers as an indication of an easing in labor demands. The very substantial growth in employment in recent months, however, weakens the case for this interpretation. It seems more likely that firms are hiring additional workers to reduce costly overtime hours, and perhaps attempting to broaden current employment in anticipation of further tightening in the labor market.

Personal income rose by $5.3 billion in February to a seasonally adjusted annual rate of $721.4 billion. This far exceeded the $2.6 billion gain in January, when a large increase in social security contributions went into effect. Wage and salary disbursements, the major component of total personal income, climbed a substantial $4.2 billion in February. The gain, moreover, was spread very widely across the major industries.

Retail sales data for the past year have recently been revised substantially by the Commerce Department, and now give a slightly different impression of the behavior of consumer spending since last summer. The new figures show that retail demand has been somewhat stronger since last summer than was indicated by the original monthly sales estimates. Nevertheless, it still appears that the tax surcharge has indeed limited the growth of consumer demand. Total sales at retail outlets in February, according to the advance report, were about unchanged from the previous month's high and only 1 percent above last July's level. Durable goods sales, in particular, have shown little buoyancy over the past nine months; this is especially true of the automotive group. February deliveries of new domestic-model autos were given a boost by sales incentive programs and rose to a seasonally adjusted annual rate of 8¾ million units from January's 8¼ million unit rate. However, auto buying then dropped off again i

March to an annual rate of about 8¼ million units, far below the 9 million unit rate of domestic car sales last October.

#### PRICE DEVELOPMENTS

The consumer price index climbed steeply again in February, rising at an annual rate of 5 percent despite a slight decline in food costs. The prices of nonfood items soared at an annual rate of 7 percent, the most rapid increase since last October, and the durable goods component showed the largest increase for any month since November 1958. The costs of services also continued to move up at a swift pace, with medical care, home maintenance, and mortgage interest costs leading the advance.

Wholesale prices have been increasing at a sharply accelerated pace thus far this year. In March, the index of industrial commodities prices rose another 0.5 percentage point to 111.9 percent of the 1957-59 average, according to the preliminary report. This brought the increase for the first three months of the year to an extraordinarily high annual rate of 6 percent. In contrast, prices of industrial commodities rose at an annual rate of less than 4 percent over the final three months of 1968 and at a rate of less than 2½ percent in the previous nine months. Wholesale prices of farm products also moved up sharply in March to bring their increase for the year to 12 percent at an annual rate. Processed foods and feeds, on the other hand, remained fairly stable for the second month in a row, but such prices had jumped very sharply in January.

## The Money and Bond Markets in March

Pressures intensified in the bond markets during the first two thirds of March, and yields on corporate and tax-exempt bonds and long-term Treasury coupon issues generally continued their ascent to record levels. Throughout this period, market participants focused attention upon the continuing policy of fiscal and monetary restraint. With no near-term relaxation in this policy expected and with bond yields rising steadily, investors became increasingly reluctant to commit their funds to longer term obligations. However, later in the month, bond market performance improved markedly amid rising hopes that progress was being made toward resolving the Vietnam conflict and as some participants came to the view that the record high yields, particularly on corporate bonds, might have been the product of an exaggerated pessimism regarding the outlook for interest rates. Throughout the month, a strong demand for Treasury bills prevailed and their rates generally declined. These debt instruments apparently served in a time of great uncertainty as a haven for the liquid funds of a wide spectrum of investors. Special demands stemmed from the redemption of $2 billion of March tax anticipation bills as well as from the quarterly statement date and the April 1 Cook County, Illinois, tax date.

The banking system continued to experience a sharp runoff of large-denomination certificates of deposit (CD's) in March. To a considerable extent, banks compensated for funds lost in this way by sharply expanding their Euro-dollar borrowings, even at relatively high interest rates.

Market expectations were confirmed on March 17, when many of the nation's leading commercial banks raised their prime lending rate from 7 percent to 7½ percent—the fourth increase in this key rate since early December. The move triggered renewed market discussion of the possibility of new action in the pursuance of monetary restraint, including a potential increase in the Federal Reserve discount rate. These expectations were also confirmed on April 3 when the Board of Governors of the Federal Reserve System announced its approval of actions by eleven of the twelve Federal Reserve Banks raising the discount rate to 6 percent from 5½ percent. At the same time, the Board of Governors increased reserve requirements against demand deposits at all member banks by ½ percent-

### Table I

**FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MARCH 1969**

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

| Factors | Changes in daily averages—week ended on | | | | Net changes |
|---|---|---|---|---|---|
| | March 5 | March 12 | March 19 | March 26 | |
| **"Market" factors** | | | | | |
| Member bank required reserves | + 115 | + 259 | — 104 | + 269 | +539 |
| Operating transactions (subtotal) | — 4 | — 264 | — 78 | — 161 | — 507 |
| Federal Reserve float | — 134 | — 132 | + 142 | — 226 | — 350 |
| Treasury operations* | + 36 | + 97 | — 20 | — 116 | — 3 |
| Gold and foreign account | + 4 | — 31 | — 5 | — 4 | — 36 |
| Currency outside banks | + 163 | — 225 | — 424 | + 84 | — 402 |
| Other Federal Reserve accounts (net)† | — 73 | + 28 | + 227 | + 101 | + 283 |
| Total "market" factors | + 111 | — 5 | — 182 | + 108 | + 32 |
| **Direct Federal Reserve credit transactions** | | | | | |
| Open market instruments | | | | | |
| Outright holdings: | | | | | |
| Government securities | — 69 | — 15 | — 41 | — 98 | — 223 |
| Bankers' acceptances | — 1 | — 1 | — 1 | — 2 | — 5 |
| Repurchase agreements: | | | | | |
| Government securities | + 6 | — 72 | + 146 | — 11 | + 69 |
| Bankers' acceptances | — 35 | — 12 | + 31 | — 9 | — 25 |
| Federal agency obligations | + 2 | — 7 | + 9 | + 2 | + 6 |
| Member bank borrowings | — 24 | + 138 | — 97 | + 188 | + 205 |
| Other loans, discounts, and advances | — | — | — | — | — |
| Total | — 120 | + 31 | + 45 | + 70 | + 26 |
| **Excess reserves** | — 9 | + 26 | — 137 | + 178 | + 58 |
| | **Daily average levels** | | | | |
| **Member bank:** | | | | | |
| Total reserves, including vault cash | 26,950 | 26,717 | 26,684 | 26,593 | 26,736‡ |
| Required reserves | 26,783 | 26,524 | 26,628 | 26,359 | 26,574‡ |
| Excess reserves | 167 | 193 | 56 | 234 | 162‡ |
| Borrowings | 734 | 872 | 775 | 963 | 836‡ |
| Free, or net borrowed (—), reserves | — 567 | — 679 | — 719 | — 729 | — 674‡ |
| Nonborrowed reserves | 26,216 | 25,845 | 25,909 | 25,630 | 25,900‡ |
| Net carry-over, excess or deficit (—)§ | 145 | 96 | 123 | 36 | 100‡ |
| | **Changes in Wednesday levels** | | | | |
| **System account holdings of Government securities maturing in:** | | | | | |
| Less than one year | + 129 | — 154 | + 544 | + 4 | + 523 |
| More than one year | — | + 75 | — 530 | — | — 455 |
| Total | + 129 | — 79 | + 14 | + 4 | + 68 |

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 March 26, 1969.
§ Not reflected in data above.

### Table II

**RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MARCH 1969**

In millions of dollars

| Factors affecting basic reserve positions | Daily averages—week ended on | | | | Averages of four weeks ended on March 26 |
|---|---|---|---|---|---|
| | March 5 | March 12 | March 19 | March 26 | |
| **Eight banks in New York City** | | | | | |
| Reserve excess or deficiency(—)* | — 34 | 66 | — 91 | 85 | 7 |
| Less borrowings from Reserve Banks | 104 | — | 84 | 43 | 58 |
| Less net interbank Federal funds purchases or sales(—) | 420 | 1,049 | 301 | 469 | 560 |
| *Gross purchases* | *1,693* | *1,960* | *1,631* | *1,650* | *1,734* |
| *Gross sales* | *1,273* | *911* | *1,330* | *1,182* | *1,174* |
| Equals net basic reserve surplus or deficit(—) | — 558 | — 982 | — 475 | — 427 | — 611 |
| Net loans to Government securities dealers | 538 | 451 | 407 | 440 | 459 |
| Net carry-over, excess or deficit(—)† | 51 | — 11 | 43 | — 46 | 9 |
| **Thirty-eight banks outside New York City** | | | | | |
| Reserve excess or deficiency(—)* | 2 | — 3 | — | 12 | 3 |
| Less borrowings from Reserve Banks | 112 | 342 | 168 | 309 | 233 |
| Less net interbank Federal funds purchases or sales(—) | 918 | 1,222 | 1,633 | 1,186 | 1,240 |
| *Gross purchases* | *2,991* | *3,163* | *3,442* | *3,030* | *3,157* |
| *Gross sales* | *2,073* | *1,941* | *1,809* | *1,845* | *1,917* |
| Equals net basic reserve surplus or deficit(—) | —1,028 | —1,567 | —1,802 | —1,484 | —1,470 |
| Net loans to Government securities dealers | 75 | 22 | — 57 | — 116 | — 19 |
| Net carry-over, excess or deficit(—)† | 32 | 31 | 16 | 21 | 25 |

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—March 1969 | | | |
|---|---|---|---|---|
| | March 3 | March 10 | March 17 | March 24 |
| Three-month | 6.215 | 6.049 | 6.108 | 5.946 |
| Six-month | 6.342 | 6.233 | 6.221 | 6.096 |

| Maturities | Monthly auction dates—January-March 1969 | | |
|---|---|---|---|
| | January 28 | February 20 | March 26 |
| Nine-month | 6.195 | 6.307 | 6.058 |
| One-year | 6.144 | 6.234 | 6.132 |

* 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.

age point. (For full details, see the statement of the Board of Governors reproduced in full on page 75 of this *Review.*)

The tone of the money market generally remained firm in March. Most Federal funds transactions were completed in a 6⅝ to 7 percent range. Average nationwide reserve availability fell by $65 million, and member bank borrowings at the Federal Reserve Banks averaged $836 million in March, unchanged from February.

### BANK RESERVES AND THE MONEY MARKET

Although nationwide net reserve availability was little changed in early March from its late February range, pressure on reserve positions of banks in New York City increased somewhat—partly as a result of their expanded lending to Government securities dealers. On the other hand, the average basic reserve deficit of the thirty-eight major banks in other money centers was little changed from the preceding period (see Table II). The money market was firm during the statement period ended on March 5, as the leading New York banks expanded their net purchases of Federal funds, which traded predominantly in a 6⅝ to 7 percent range. At the same time, they also increased their average borrowings from the Federal Reserve Banks by $83 million to $104 million.

Over the following statement period, pressures mounted on the reserve positions of banks both in New York and in other money market centers, principally as a result of a contraction in deposits. The money market became a shade firmer, and member bank borrowings from the Federal Reserve Banks expanded by $138 million (see Table I). Most Federal funds trading occurred in a 6½ to 6⅞ percent range during the period.

The money market readily accommodated the sizable flows of funds which arose in connection with the mid-March quarterly corporate dividend and tax payment period. The tone of the money market remained steadily firm during the March 19 statement week, as banks in the large money centers managed to fill their reserve needs on a daily basis without accumulating either large reserve excesses or deficits. Federal funds traded mainly in a 6⅝ to 6⅞ percent range, while member bank borrowings from the Federal Reserve Banks declined by $97 million on a daily average basis. In the final statement period of the month, nationwide reserve availability contracted moderately but reserve distribution shifted in favor of the money market banks and no unusual pressures developed.

The volume of large-denomination CD's outstanding at commercial banks continued to contract in March. At the weekly reporting banks in New York City, the decline amounted to approximately $575 million between February 26 and March 26, while CD's outstanding at all weekly reporting banks declined by $1,173 million. At the same time, liabilities of United States banks to their foreign branches rose in March by $1,049 million, as against an increase of $213 million in February.

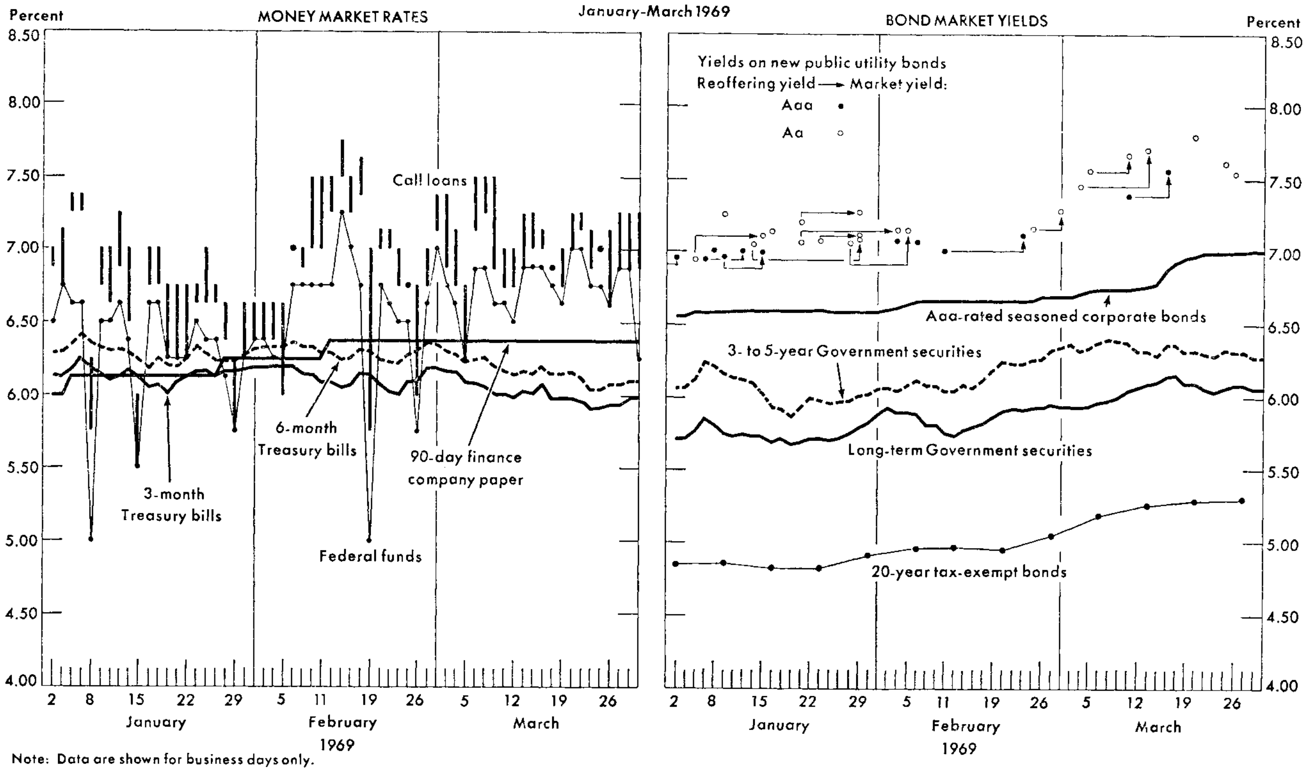
In the wake of the ½ percentage point increase in the prime rate of commercial banks that was initiated on March 17, rates on some money market instruments were adjusted upward. Rates on dealer-placed prime four- to six-month commercial paper moved ⅛ of a percentage point higher to 6⅞ percent offered, and rates on some maturities of directly placed commercial paper increased by the same amount.

### THE GOVERNMENT SECURITIES MARKET

A very cautious tone was evident in the market for Treasury notes and bonds as March began. In the early days of the month, prices generally edged lower as commercial bank offerings of coupon issues expanded, dealers seemed anxious to avoid an increase in inventories, and little significant investment demand developed. The pessimism of market observers was being fed by the apparent slow pace of the Vietnam peace negotiations, the weakness in the French franc, and the heavy tone of the corporate and tax-exempt bond markets. A somewhat better atmosphere soon developed in the intermediate-term maturity area, however, when commercial bank selling tapered off and demand improved somewhat. Participants were also moving to the view that a possible hike in the prime rate and discount rate had been largely discounted and that such changes might not occur in the immediate future, contrary to earlier expectations following the February 27 increase in the British bank rate. Thus, prices of intermediate-term Treasury issues edged higher from March 10 through midmonth. At the same time, however, prices of longer term issues continued to decline, mainly in reaction to the persisting weakness in the corporate and tax-exempt bond markets and to some switching transactions from Treasury bonds into corporate issues.

In the wake of the prime rate increase on March 17, prices of Treasury coupon issues were immediately marked sharply lower throughout the maturity range. A steadier tone quickly emerged in the intermediate-term sector, however, and prices resumed their modest upward movement. Then, on March 19, reports of a new approach to the Vietnam peace negotiations sparked price increases in the coupon sector, ranging from about $\frac{2}{32}$ to $\frac{8}{32}$ for intermediate-term issues and from $\frac{12}{32}$ to $\frac{24}{32}$ for long-term obligations. Subsequently, prices generally moved irregularly higher through March, primarily in response

**SELECTED INTEREST RATES**




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.

to renewed hopes for peace in Vietnam which stimulated short-covering demand from professional participants. Over the month as a whole, prices on most intermediate-term issues were $\frac{2}{32}$ to $\frac{27}{32}$ higher, while those on longer term issues were $\frac{16}{32}$ to $1\frac{26}{32}$ points lower.

In the Treasury bill market, a strong tone persisted in March. Over much of the month, a steady investment demand for bills emanated from a wide range of sources, including commercial banks, public funds, institutions, corporations, and professional market participants, thus keeping the market's available supply of bills scant. During the first half of March, bill rates generally declined by 5 to 40 basis points. After news of the prime rate increase reached the market, bill rates rose briefly. However, a good tone quickly reappeared, and rates resumed their downward trend from March 18 through the following week. Thereafter, rates briefly came under some renewed upward pressure but at the month end had leveled off. Bill rates closed down over the month by amounts generally ranging from 15 to 30 basis points for maturities of ninety days or longer.

On March 18, the Treasury announced that it would auction a \$1.8 billion "strip" of bills on March 25 for payment on March 31. The offering represented a \$300 million addition to each of six outstanding weekly bill issues maturing from May 8 through June 12, with subscribers required to take equal amounts of each of the reopened issues. Commercial banks bid fairly aggressively for the strip for which they were permitted to make full payment in the form of credits to Treasury

Tax and Loan Accounts, and the bills were auctioned at an average issuing rate of 5.027 percent.

At the regular monthly auction on March 26, average issuing rates on the nine- and twelve-month bills were set at 6.058 percent and 6.132 percent, respectively, 25 and 10 basis points lower than the average rates at the comparable February auction (see Table III). At the final regular weekly auction of the month held on March 24, average issuing rates for the new three- and six-month bills were set at 5.946 percent and 6.096 percent, respectively, 13 and 16 basis points lower than the average rates established at the last weekly auction in February.

## OTHER SECURITIES MARKETS

Prices of corporate and tax-exempt bonds declined steadily through most of the month in a very cautious setting. Market participants apprehensively weighed the interest rate outlook, particularly in the light of the midmonth rise in the commercial bank prime rate that had been widely expected. During the month, many recent corporate and tax-exempt bond flotations, which had encountered considerable investor resistance, were released from syndicate price restrictions with sharp subsequent upward yield adjustments. Moreover, new issues which reached the market at progressively higher yields were frequently accorded apathetic investor receptions. The high interest rate levels and the disheartening investment interest prompted reductions in the size of some offerings and postponements of other planned flotations. A significantly improved tone emerged in the corporate bond sector during the latter part of March, when participants became more optimistic about the outlook for peace in Vietnam and the reduced volume of new issues being offered at record high-yield levels drew excellent investor interest.

Price cutting was widespread, and market conditions led to the postponement of a large volume of new issues. The weak tone which predominated in the corporate bond sector during the first half of the month was vividly illustrated when a $150 million Aaa-rated telephone company flotation of 7½ percent refunding mortgage bonds was reoffered to investors on March 11 at a 7.375 percent record yield and generated very little investor interest. The issue, which featured five years of call protection, carried a yield 37 basis points higher than had a similar flotation a month earlier. On March 17, in the wake of the prime rate increase, syndicate price restrictions were removed on this slow-moving issue and the yield on the new bonds initially rose by 20 basis points to 7.57 percent. The sharp price concessions on the telephone company issue eventually attracted some investor interest to the bonds, and their yield subsequently receded moderately. On March 19, an A-rated $80 million utility company offering of 7.90 percent first and refunding mortgage bonds was marketed at par. As hopes for Vietnam peace were rekindled, this issue benefited from a more favorable market atmosphere, attracted good institutional interest, and was quickly sold. The improved tone in the corporate bond market continued throughout the latter part of the month, and prices on many outstanding issues rose from the low levels reached earlier in the period. In addition to the optimism generated by reports of secret Vietnam talks, the market responded favorably to renewed investor interest at the higher yield levels and to the lightened schedule which resulted from several postponements of sizable new issues.

In the tax-exempt sector, there was little evidence of any significant investment interest on the part of commercial banks and this factor continued to exert considerable restraint upon market sentiment throughout the month. As the month progressed, dealer inventories and new issues in syndicate were reduced sharply by the cancellation or postponement of some $475 million of new issues previously planned for March. In some cases, the cancellations stemmed from the borrowing government's inability to get underwriter bids at its statutory interest ceiling rate. Nonetheless, the calendar of new issues scheduled for offering remained high during March, and at the month end the 28-day calendar was nearly double the late February level.

At the end of March, *The Weekly Bond Buyer's* yield index of twenty seasoned tax-exempt issues was quoted at 5.30 percent, 26 basis points higher than a month earlier (see chart). Moody's index for seasoned Aaa-rated corporate bonds closed the month at 7.00 percent, 31 basis points higher than a month earlier. The Blue List of advertised dealer inventories of tax-exempt securities fell by $224 million to $345 million at the month end, as underwriters cleared their shelves in advance of the large April calendar.

# Recent Developments in the Capital Markets

The nation's capital markets were subjected to renewed strains as the second half of 1968 progressed. Early in the period, expectations that passage of the fiscal restraint legislation would lead to a scaling-down in the pace of economic activity had led to somewhat easier conditions in the financial markets. However, increasingly heavy overall demands for funds and renewed inflationary expectations among borrowers and lenders soon pushed interest rates back to record levels, and the upward trend continued into early 1969. Despite high costs of credit, the nonfinancial sectors of the economy borrowed near-record amounts in the credit markets in the last half of 1968. Net funds raised during the period by all nonfinancial borrowers totaled about $106 billion at a seasonally adjusted annual rate. This was $16 billion more than in the first half of the year, and only marginally below the peak borrowing pace set in the last half of 1967. All major classes of borrowers contributed to the heavy credit demands in the last half of 1968. Federal borrowing remained strong, despite increased revenues from the tax surcharge passed at midyear, as the Treasury borrowed to rebuild its strained cash position. Households also borrowed heavily, both in the consumer credit and residential mortgage markets.

## BUSINESS FINANCE

Nonfinancial corporations in the second half of 1968 experienced a substantial increase in funds generated internally through depreciation allowances and undistributed profits (see Chart I). However, an even greater rise in corporate spending resulted in record demands for external funds. Corporate fixed investment and inventory spending both increased in the final six months of last year, and acquisitions of liquid financial assets continued at a high level relative to earlier years.

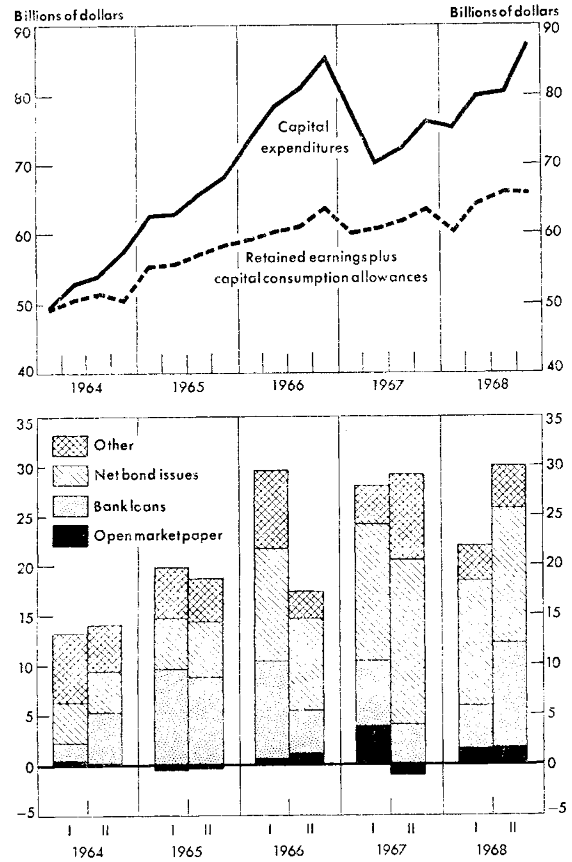
Total credit and equity market financing by nonfinancial corporations, seasonally adjusted, rose $8 billion to a new peak annual rate of $30 billion during the July-December period (see Chart I), with most of the increase concentrated in short- and intermediate-term borrowing. Gross cash offerings of new corporate bonds amounted to about $8½ billion, a decline of $½ billion from the first six months of the year and the smallest half-year volume since the second half of 1966. Moreover, the flow of both publicly offered and privately placed issues eased, with public offerings showing a somewhat greater drop than private placements. Net bond issues, however, reportedly rose slightly during the second half of the year, possibly owing to the larger volume of noncash bond issues used to effect corporate mergers and acquisitions.

Yields on new corporate bonds offered for cash receded significantly immediately following the passage of the fiscal restraint legislation in late June of last year, but rates were on the uptrend again by late summer. Toward the close of the year new postwar peaks had been reached, and rate levels moved still higher in the early months of 1969 (see Chart II). As 1968 neared an end, and heavy demands for funds persisted, investors became increasingly selective about making new commitments and underwriters encountered substantial difficulty in distributing many new issues. With individuals reluctant to make additional purchases of corporate bonds, net acquisitions by households during the July-December period fell to less than half the total during the first six months of the year. Manufacturing corporations appeared to have been especially sensitive to the rising cost of long-term financing. Their gross bond offerings fell by one fifth to $2½ billion, the smallest six-month total since the second half of 1965. Public utilities, however, raised a record amount of funds in the bond market during the second half of 1968.

Corporate borrowers placed substantially increased demands on commercial banks during the second half of 1968, as the availability of funds from that source increased greatly. Banks supplied 35 percent of the funds obtained by nonfinancial corporations in the credit and equity markets, 15 percentage points above the share supplied during the previous six months and the largest such proportion since the last half of 1965. The heightened demands by corporations for bank financing was reflected

Chart I

SOURCES AND USES OF FUNDS
NONFINANCIAL CORPORATIONS




Source: Board of Governors of the Federal Reserve System.

in an 11½ percent annual rate of increase in outstanding business loans of commercial banks during the July-December period, about half again as large as the rate of increase during the preceding six months. Furthermore, the commercial paper market continued to be an important and growing source of shorter term funds to corporate businesses during the second half of 1968. Nonfinancial corporations raised about $1¾ billion in this market during all of 1968; prior to 1966, commercial paper sales had been a negligible source of new funds for these borrowers.

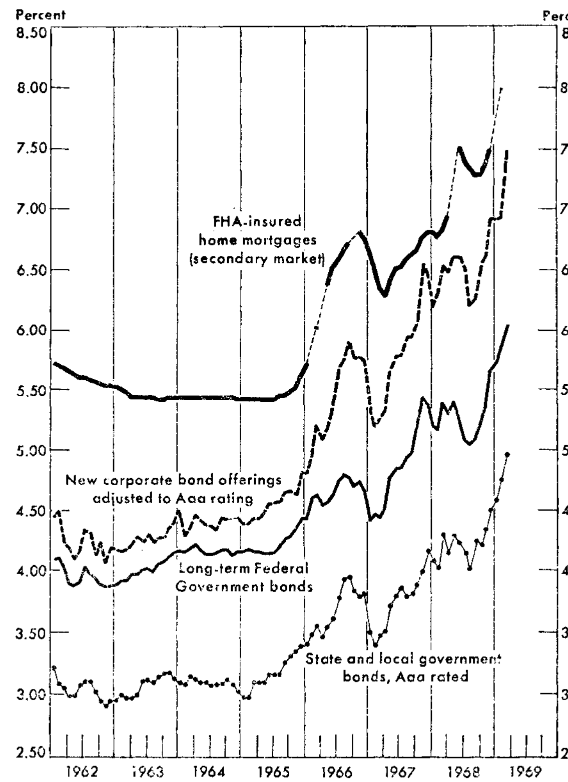
Gross new issue activity in the stock market was at a peak during the second half of 1968, both in terms of dollar volume and number of issues involved. Gross common stock offerings totaled $2.4 billion, $0.8 billion more than during the previous six months and $0.4 billion greater than the previous record for a half-year period. At the same time, over 700 new common stock issues were offered for sale during the period, a rise of almost 70 percent above the first half of the year. Nonetheless, net stock issues of corporate businesses were negative during the second half of 1968, apparently as a result of the substantial number of corporate mergers that involved the direct or indirect exchange of bonds—frequently convertible issues—for outstanding common stock.

Corporate liquidity positions were considerably improved at the year-end, reflecting heavy acquisitions of liquid assets throughout 1968. Preliminary data indicate that nonfinancial corporations added approximately $2 billion (seasonally adjusted) to their liquid asset holdings during the second half of the year. Over 1968 as a whole, corporations increased their liquid asset holdings by considerably more than in the preceding four years combined.

Corporations over the course of 1968 made marked

Chart II

LONG-TERM INTEREST RATES

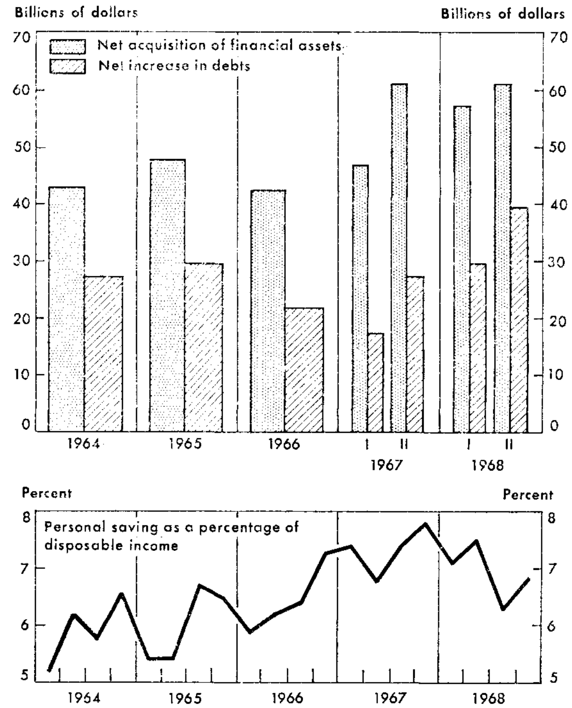



Note: Federal Housing Administration-insured home mortgage series plotted through February, all other series plotted through March.

Sources: Board of Governors of the Federal Reserve System, First National City Bank of New York, and Moody's Investors Service.

adjustments in their holdings of liquid interest-bearing assets, primarily in response to the changing relationship between rates obtainable on large certificates of deposit (CD's) issued by banks and rates on other closely similar short-term instruments. In the first half of the year, when the Regulation Q ceilings generally restricted issuing rates on large CD's to noncompetitive levels, corporations reduced their holdings of bank time deposits and acquired unusually large amounts of United States Government securities and commercial paper. By contrast, in the second half of the year, when competing market rates dropped below the Regulation Q ceilings on large CD's and banks bid very aggressively for CD money, corporations acquired record amounts of bank time deposits while their holdings of Government securities remained unchanged. Corporations in the second half of the year continued to invest large sums in commercial paper, however, as a heavy volume of new offerings kept rates on these instruments at favorable levels relative to CD's.

Chart III
HOUSEHOLD SAVING AND CHANGES IN FINANCIAL ASSETS AND LIABILITIES




Sources: Board of Governors of the Federal Reserve System and the United States Department of Commerce.

## CONSUMER AND RESIDENTIAL MORTGAGE FINANCE

Pretax personal income posted a strong gain during the second half of 1968, but increased income tax withholdings begun in mid-July sharply reduced the growth of after-tax income. The rise of consumption expenditures outstripped that of disposable income, and a substantial reduction occurred in personal saving—measured both as a percentage of income and in dollar terms. The personal saving rate fell 0.8 percentage point to 6.5 percent, the lowest half-year average since the first six months of 1966.

A significant feature of the financial behavior of households during the second half of 1968 was their heavy acquisitions of financial assets during a period when expenditure growth exceeded the rise in after-tax income. Indeed, the estimated $61 billion (seasonally adjusted annual rate) rise in the household sector's holdings of financial assets was barely below the all-time high and almost $4 billion above the gain during the first half of the year (see Chart III). Holdings of money increased strongly, while net additions to interest-bearing deposits at commercial banks and thrift institutions held at about the first-half pace.

The large further increase in the financial assets of households during the last half of 1968 reflected increased reliance on borrowings to finance their consumption and housing expenditures. In fact, the record $39½ billion (seasonally adjusted annual rate) rise in total financial liabilities of the household sector, indicated by the preliminary flow-of-funds accounts, was about one-third above the increase in the first half of the year. Consumer credit, which had expanded at a $9.2 billion annual rate during the first half of the year, rose at a record $13 billion rate during the July-December period. The expansion in consumer credit during all of 1967 totaled only $4.4 billion. Furthermore, the record $4.8 billion seasonally adjusted annual rate rise in other (nonmortgage) borrowing from commercial banks was more than double the first-half total.

Residential construction expenditures by households during the second half of 1968 remained about unchanged from the first half of the year. However, mortgage borrowing to finance home purchases was about $1 billion higher at an annual rate. This extra margin of debt increase also helped free funds for investment in financial assets or spending on consumption goods.

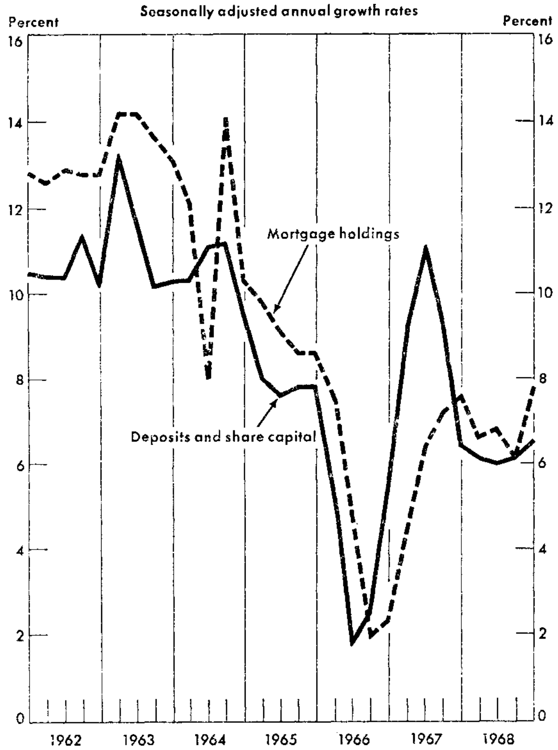
Market yields on new Federally insured home mortgage loans eased somewhat during the summer and early fall.

Before that, they had moved sharply higher in response to the ¾ percentage point increase in the maximum permissible contract rate on such loans in early May. However, rising pressures throughout the long-term capital markets pushed rates steadily upward toward the year-end and into early 1969, culminating in a second ¾ percentage point upward adjustment in the ceiling rate in late January to 7½ percent. During the second half of the year, and in fact throughout 1968, there appears to have been a trend toward placing greater reliance on nonmortgage credit to finance residential construction activity, in large part a result of the greatly increased importance of multifamily projects which afford both lenders and developers a wider spectrum of debt and equity financing instruments.

Chart IV

SAVINGS BANKS AND SAVINGS ASSOCIATIONS

Seasonally adjusted annual growth rates




Note: Deposits and share capital seasonally adjusted by the Board of Governors of the Federal Reserve System; mortgage holdings seasonally adjusted by the Federal Reserve Bank of New York. Growth rates measure the increase in seasonally adjusted levels from the end of the preceding quarter to the end of the current quarter.

Sources: Federal Home Loan Bank Board and the National Association of Mutual Savings Banks.

The pace of mortgage lending at savings and loan associations and mutual savings banks picked up somewhat on balance during the second half of 1968, about in line with a slight upturn in the growth of deposits and share capital (see Chart IV). Net mortgage extensions at savings and loan associations exceeded savings inflows by a considerable margin during the period. These institutions drew down liquid asset holdings to gain funds for mortgage lending, and they also borrowed an additional $375 million from the Federal Home Loan Banks. Moreover, the lending ability of the associations was enhanced by the Federal Home Loan Bank Board decision to reduce the minimum liquidity requirement of member savings associations by ½ percentage point to 6½ percent, effective August 1. Although the increased ceilings on residential mortgage interest rates that went into effect around midyear in several Eastern states encouraged mortgage lending at mutual savings banks during the second half, these institutions continued to acquire substantial amounts of corporate bonds during the period.

Commercial banks provided expanded support to the residential mortgage market during the second half of 1968, when their net acquisitions rose by one third to $2 billion. Although the pace of mortgage lending at life insurance companies and private pension funds also picked up slightly in the July-December period, their total acquisitions during the year trailed those during the preceding year by a considerable margin, thus continuing a trend evident since 1965.

### GOVERNMENT FINANCE

The Federal Government continued to place large demands on the nation's financial markets during the second half of the year. The enactment of the income tax surcharge in late June greatly reduced the Federal deficit, but the need to rebuild Treasury balances kept borrowing at a high level, especially in the third quarter. Thus, total net borrowing by the Federal Government amounted to an annual rate of about $16 billion in the July-December period, not much below the $17½ billion borrowing rate in the first half of the year. Direct Treasury borrowing in the securities markets actually increased a bit from the first to the second half of the year on a seasonally adjusted basis, but this increase was more than offset by a decline in borrowing by Federal agencies and a decrease in net sales of loan participation certificates.

Net borrowing by the major Federally sponsored credit agencies during the July-December period was well below the total during the first half of the year but moderately above borrowing during the comparable six months of

1967. Despite a moderate rise in advances to member institutions, the Federal Home Loan Banking System did not engage in any net new borrowing but drew on internal liquidity to finance its expanded operations. Similarly, in the second half of 1967, the Home Loan Banking System had also placed substantial reliance on internal liquidity as $525 million of outstanding borrowing was repaid while the level of advances rose slightly. In contrast, the Federal National Mortgage Association, which is now under private ownership, raised about $500 million to finance its secondary market operations during the period, sharply below the $850 million raised during the second half of 1967.

The 4¼ percent interest rate ceiling on the coupon rates of new directly issued Government bonds continued to force the Treasury to confine its financing operations exclusively to the short- and intermediate-term maturity area, thus leading to a two-month shortening in the average maturity of the marketable debt. The average maturity of the debt was four years at the end of 1968, down from five years and five months in early 1965. Moreover, although individuals were substantial purchasers of marketable Government securities on balance during the second half of 1968, sales of savings bonds continued to trail redemptions, reflecting the relatively unattractive yields available on such savings instruments vis-à-vis those on marketable issues.

State and local government borrowing expanded sharply to a new record during the second half of 1968. Gross offerings totaled $9 billion, $1.6 billion more than during the first half of the year and more than $1 billion above the previous peak for a half-year period. The pace of offerings during the July-December period was swelled by a speedup in the flow of industrial revenue issues. Under the provisions of 1968 legislation, interest income on individual issues of these securities larger than $5 million in size ceased to be eligible for tax-exempt status after last December 31.

Yields on tax-exempt securities began to ease considerably shortly before midyear, as market participants expected that enactment of the fiscal restraint legislation would give rise to somewhat easier credit market conditions. This triggered an acceleration in financing during the summer and fall that added to the pressures arising from the speedup of industrial revenue issues. The resultant congestion in the market subsequently pushed yields up to the highest levels in more than thirty years by the year-end. Moreover, these high levels were further surpassed during the early months of 1969. It is estimated that the generally unfavorable market conditions during the concluding months of 1968 caused postponements or cancellations of additional issues amounting to at least $¼ billion.

During the second half of 1968, commercial banks were virtually the only net buyers of state and local securities. Bank acquisitions, which exceeded $5 billion, accounted for more than 90 percent of the net increase in outstanding issues, up sharply from the 67 percent recorded during the first half of the year. The expanded bank investment activity which showed signs of a marked slowing near the year-end—and reversal in early 1969—offset the disposal by the household sector of an estimated $1½ billion of state and local government securities, an amount about equal to this sector's net acquisitions during the first half of the year.

## ROLE OF THE BANKING SYSTEM

The second half of 1968 witnessed a sharp increase in the share of total credit supplied by commercial banks. Preliminary flow-of-funds data for the last half of 1968 indicate that total borrowing by all nonfinancial sectors rose $16 billion to a $106 billion seasonally adjusted annual rate, and commercial bank lending mounted to $58 billion, or 54 percent of the total. This was a sharp contrast to the first half of the year when commercial banks supplied only $20 billion or 22 percent of total lending. However, the bank credit surge was associated with a marked decline in acquisitions of credit market instruments by households and businesses. Indeed, direct lending by the private domestic nonfinancial sectors dropped to an annual rate of $7½ billion in the last six months of 1968 from nearly $26½ billion in the first half of the year.

The emergence of somewhat easier conditions in the capital markets after midyear prompted commercial banks to undertake a downward adjustment in their prime lending rate in September, but growing pressure on reserves and rising demand for loans, especially from businesses which turned to banks to help finance a rapid growth in inventory accumulation during the fourth quarter, led to two increases in the prime rate in December with subsequent further adjustments effected in the first quarter of 1969 to a peak of 7½ percent in March. Moreover, the pace of expansion of commercial bank real estate loans spurted in response to a sharp rise in construction outlays and housing activity during the latter months of the year. Furthermore, while loans were expanding rapidly, commercial bank securities holdings also increased on balance during the second half of 1968 at a rate more than double that recorded during the preceding six months. However, at the year-end and in early 1969 bank liquidity positions were under increasing pressures, as banks sought to finance their loan expansion in an atmosphere of monetary restraint.

The acceleration of commercial bank lending activity during the second half of 1968 was facilitated by a sharp growth in Treasury demand deposits and in private time deposits, while the expansion in privately held demand deposits moderated slightly. Early in the July-December period offering rates on large certificates of deposit (CD's) were quite competitive with the yields available on alternative short-term market securities, and this fostered a rapid buildup in the outstanding volume of CD's. This growth subsequently tapered off and actually was reversed at the year-end, but the $3.5 billion rise in the volume of large negotiable CD's at weekly reporting member banks in the second half of the year was a marked improvement over the $1 billion decline recorded during the first half of 1968. Furthermore, although commercial banks placed additional demands for funds on their foreign branches in the face of intensifying reserve pressures, the approximately $0.9 billion rise in these liabilities during the last six months of the year was less than half of the $1.9 billion rise recorded during the first half.

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