

FEDERAL RESERVE BANK OF NEW YORK



MONTHLY REVIEW

MAY 1969

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The Business Situation

Economic activity continues to expand at an inflationary pace. Preliminary estimates indicate a \$16 billion rise in gross national product (GNP) in the first quarter of 1969, little changed from the expansion in late 1968. Consumers and businesses both stepped up their spending during the first three months of 1969, even though faced with higher tax payments and rising interest rates. The pickup in consumer spending was accompanied by a sharp reduction in personal saving; the saving-income ratio dropped a full percentage point to 5.8 percent. While consumer spending has been erratic over the past year, with periods of large increases alternating with small gains, the size of the latest quarter's rise was surprising in view of the dampening influence of higher social security deductions from paychecks beginning January 1 and large final payments due on 1968 income taxes. The broad-based strength of demand throughout the economy indicates that the existing anti-inflationary package of fiscal and monetary restraints has not yet achieved the goal of slowing the inflationary process. Though some indicators of business activity have recently moderated a bit, most remain at record or near-record levels, and price inflation shows no signs of abatement.

GROSS NATIONAL PRODUCT IN THE FIRST QUARTER

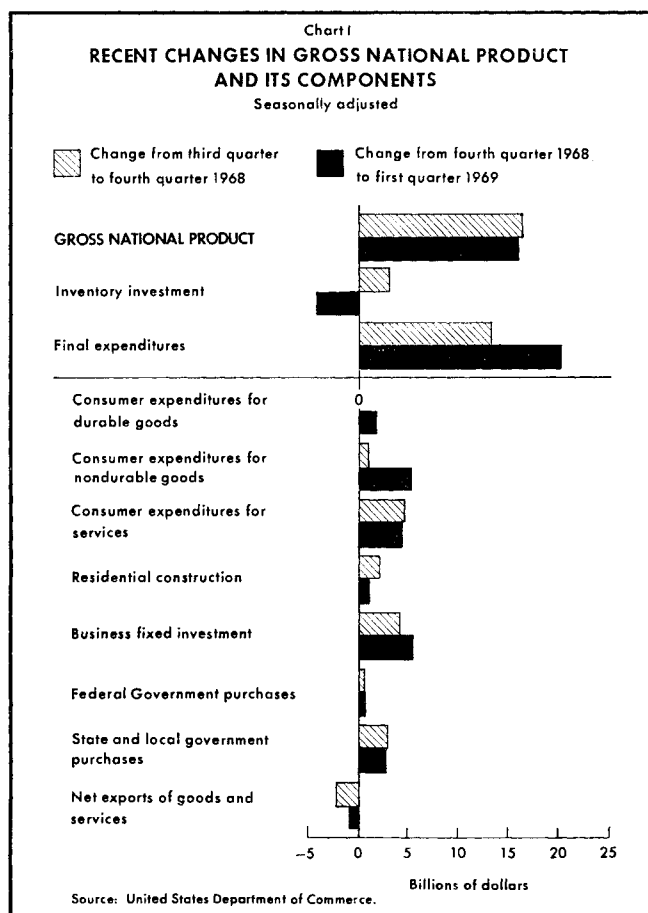
According to preliminary Department of Commerce estimates, the nation's total output of goods and services increased by \$16.0 billion in the first quarter of 1969 (see Chart I), reaching a seasonally adjusted annual rate of \$903.4 billion. The unexpectedly large first-quarter gain amounted to 7.2 percent at an annual rate, only slightly less than in the fourth quarter when GNP grew by \$16.4 billion. A higher proportion of the latest quarter's advance, however, was due to price inflation, a factor which since early 1968 has been accounting for an ever-increasing share of the growth in GNP. As measured by the GNP

price deflator, the overall price level rose 4.2 percent at an annual rate in the first quarter, the sharpest rate of gain so far in the current expansion. The proportion of the rise in gross national product attributable to real growth in output—that is, exclusive of price effects—was only 40 percent, smaller than in the fourth quarter and, indeed, smaller than at any time since the beginning of 1967. Real output rose by less than 3 percent at an annual rate, compared with an average increase of about 6¼ percent in the first half of 1968 and about 4¼ percent during the latter half of the year after the tax surcharge went into effect.

The major sources of strength in GNP during the first quarter of 1969 were consumer spending and business fixed investment. As a result, the growth in final demand—that is, total expenditures exclusive of inventory investment—amounted to \$20.2 billion, substantially greater than in late 1968. By contrast with late 1968, when inventory investment accounted for a significant part of the overall expansion in GNP, accumulation of inventories in early 1969 was held back by the steep climb in final sales.

The first-quarter surge in consumer outlays was centered primarily in purchases of nondurable goods, which rose by \$5.4 billion, the second largest increase in more than three years. Expenditures for services moved ahead by \$4.4 billion, in line with their recent growth trend. Contributing least to the advance was consumer spending on durables—particularly for automobiles. Outlays for consumer durables increased by \$1.8 billion, a large share of which was for furniture and appliances.

The performance of consumer durables sales through the early months of 1969 has been related in large measure to weak automobile sales. From a seasonally adjusted annual rate of just over 9 million units in October, dealer sales of new domestic-model cars slipped 10 percent to a rate of about 8¼ million units in March, and data for April indicate sales of new cars continued at that pace.



According to preliminary statistics, retail sales rose at an annual rate of 6.6 percent from the final quarter of 1968 to the first quarter of 1969. Most of this gain occurred during the month of January when retail buying was recovering from the sharp December slump. Sales did continue to edge up during February to an all-time high, but then eased about 1 percent in March according to the latest estimates.

Businessmen stepped up their capital spending during the first three months of the year. Business fixed investment rose to an annual rate of \$99.8 billion, \$5.5 billion more than in the final three months of 1968. Reflecting the capital investment boom in evidence since mid-1968, as well as rising prices, the growth in capital outlays—particularly for new plant—has accelerated in each recent quarter. The latest increase was the largest on record and conforms with recent surveys of business plans pointing to a 13 or 14 percent increase in capital spending during 1969. Repeal of the 7 percent investment tax

credit, as recently proposed by President Nixon, would undoubtedly modify these plans, since this credit now provides an estimated \$3 billion of annual tax savings for businesses. However, over the near term, the extent of this modification is likely to be fairly moderate. An important mitigating influence is the substantial backlog of unused investment credit carried over from prior years. Moreover, the credit applies only to equipment and, hence, its repeal would have only an indirect effect on spending for additional plant. In any event, dampening of investment plans due to repeal of the credit on equipment ordered after April 21 is not likely to show up quickly in the statistics for business fixed investment. These figures reflect outlays for plant and equipment put in place, and such spending totals can lag behind investment decisions and the placement of new orders by many months.

Spending for residential construction moved ahead in the first quarter by \$1.1 billion to an annual rate of \$32.7 billion, reflecting the rising trend of new housing starts beginning in the second half of 1968. Despite higher interest rates and personal taxes, the demand for new housing was strong enough to bring the annual rate of housing starts to a peak level of 1.8 million units in January (after adjustment for seasonal influences). Thereafter, the starts rate retreated to 1.5 million units in March. Most of the recent drop was in single-unit structures; there has been little slowing in the rate at which new apartment buildings are begun. The decline after January may reflect simply a movement away from an unsustainably high rate which represented an aberration in a highly volatile series. On the other hand, some of the recent moderation may have been a reaction to tighter credit conditions, higher personal tax payments this spring, and sharply rising construction costs, especially for lumber.

Inventory investment in the first quarter of 1969 is estimated to have been at an annual rate of \$6.4 billion, substantially below the previous quarter's \$10.6 billion. The cutback accompanied a pronounced pickup in sales by manufacturers and retailers in the first three months of 1969. Sales increases were especially strong for manufacturers of durable goods whose sales volume, on an annual basis, was \$13 billion higher than in the final quarter of 1968. Similarly, the annual rate of sales at retail outlets in the beginning months of 1969 rose by almost \$6 billion from the fourth-quarter rate. As a consequence, the inventory-sales ratios for durables manufacturers and retailers backed off a bit from their year-end highs.

Increased spending by governments at all levels contributed \$3.2 billion to the overall gain in GNP during the January-March period, almost the same as in the previous three months. In both quarters, the contribution of the

Federal Government to the overall rise was small, reflecting the distinct slowing in the growth of Federal spending—particularly for defense purposes—that has been in evidence since mid-1968. Total Federal purchases of goods and services rose by only \$0.6 billion in the first quarter, while state and local spending was up by \$2.7 billion.

The remaining component of GNP, net exports of goods and services, dropped \$1 billion to a level of zero in the first quarter of 1969. The further deterioration in the level of net exports was, of course, principally due to the extended dock strike which affected ports along the Eastern Seaboard and the Gulf Coast. About 50,000 longshoremen were involved, most of whom were out until February 22, though workers at Boston and the Gulf Coast ports remained out until March 31. With resumption of port operations, a sharp recovery of net exports is expected in the second quarter.

EMPLOYMENT, INCOME, AND OUTPUT

Labor market conditions were very tight during the first quarter of 1969, with employment at all-time highs and unemployment rates at exceptionally low levels. For the quarter as a whole, the civilian labor force and civilian employment were each up by about 1.2 million persons from the preceding three-month period, compared with average quarterly increases in each aggregate of about 300,000 persons during 1968. Most of the quarter's gain occurred in the first two months of 1969. The March employment increases were considerably smaller because of weakness in the agricultural sector. During that month, the unemployment rate moved fractionally higher to 3.4 percent from the 3.3 percent rate of the previous three months, because of an increase in the volatile rate for teen-agers. Rates of unemployment for the various major adult groups remained at near-record lows throughout the quarter. In April, however, the unemployment rate increased further to 3.5 percent, as unemployment among adult men and women rose fractionally. Total civilian employment fell in April by 160,000 persons, seasonally adjusted, while the civilian labor force dropped a smaller 45,000.

For workers on the payrolls of nonagricultural establishments, a breakdown of the first quarter's increase in employment reveals the same trends. The March advance of 197,000 persons was two-thirds as large as the gains of 300,000 to 350,000 registered in the two preceding months. In general, all industry groups shared in the first-quarter job expansion, but the largest gains occurred in trade, services, the government sector, and manufacturing.

In April, however, the decline in total civilian employment was accompanied by a very small 34,000 increase in the number of employees at nonagricultural establishments.

Accompanying the broad-based gains in employment during the first quarter was another decline in the average workweek of manufacturing production workers, which reached its low for the quarter in February because of heavy snow storms. The workweek lengthened again during March to 40.8 hours, and preliminary data for April indicate the workweek remained about unchanged at 40.7 hours. There was little change in the utilization rate of industrial capacity in the first quarter. The factory operating rate stood at 84.1 percent, compared with 84.2 percent the previous quarter. This stability was the result of a decline in the operating rate for advanced processing industries offset by a rise in that for primary processing industries, such as steel.

Wage and salary disbursements rose \$11.5 billion between the fourth quarter of 1968 and the first quarter of 1969, in line with the large gain in employment. Higher payrolls were evident in all major industry divisions. This latest expansion brought total personal income (seasonally adjusted at an annual rate) to an average level of \$721.4 billion for the quarter and to \$726.7 billion for March.

The latest statistics for industrial production show that the volume of industrial output gained sharply in March after two months of comparatively moderate increases, due in part to output disruptions caused by strikes. The Federal Reserve Board's index of industrial production rose in March by 0.6 percent to reach a seasonally adjusted 170.5 percent of the 1957-59 average. Virtually all major industries shared in the expansion but, as in February, the nonconsumer sector was in the forefront. Gains were particularly large in mining and in the production of defense equipment and steel. The sharp 4.7 percent gain in defense equipment output was the second such monthly increase. It reflected recovery from a strike of 18,000 aircraft workers in January, and was probably also related to a very large increase in new orders placed with the aircraft industry during February. Total mining output was also up strongly, rising 2.3 percent in the wake of a settlement of the petroleum workers' strike. In addition, steel production continued its very strong recovery from the reduced levels of output last summer, and new orders for steel remain high.

The production of consumer goods also expanded during March but by considerably more modest proportions. Nonetheless, the March gain was somewhat more buoyant than in February, as production levels of household durables and apparel rose. The month's higher output level was also influenced by the fact that automobile produc-

tion, which has been drifting downward since November, registered a more modest decline in March than in preceding months. However, in April, domestic auto production fell further as scattered strikes held assemblies well below scheduled levels.

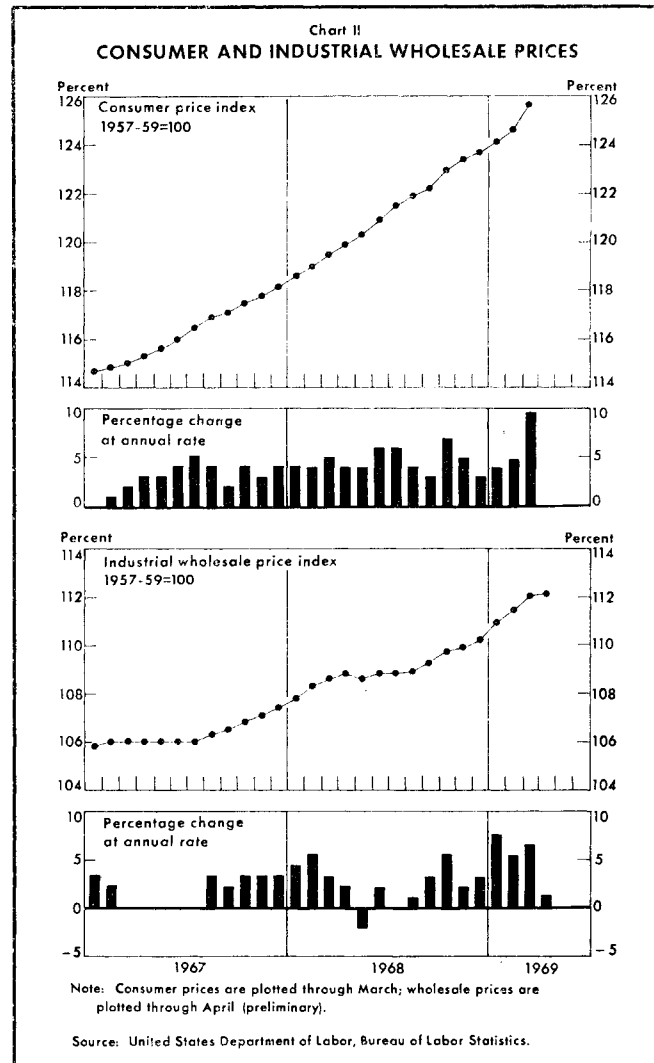
Revised statistics indicate that new orders received by manufacturers of durable goods in March were 2½ percent smaller than February's record level. Most of the decline was in orders for aircraft and parts which fell 19 percent from their high February level, a particularly sharp cutback even for this volatile series. Orders for motor vehicles and parts were also down but, in general, orders for most other types of durable goods held firm. Moreover, the backlog of unfilled orders totaled \$85.2 billion, up slightly from the previous month.

PRICE DEVELOPMENTS

Consumer prices rose over the first three months of the year at an annual rate of 6.1 percent and wholesale prices at 6.9 percent, in both cases considerably faster than in the closing quarter of 1968. The data for March, moreover, show that the consumer price advance accelerated to an extraordinary annual rate of 9.6 percent (see Chart II), the steepest monthly gain since 1951 when the Korean war inflation was at its worst.

The March surge in consumer prices was twice as rapid as that in February and also double the rate of gain in 1968 as a whole. Moreover, prices advanced on a broad front, although increases were most pronounced in home-ownership costs such as mortgage interest rates, in used car and gasoline prices, and in the costs of medical care.

The wholesale price index stood in March at 111.7 percent of the 1957-59 average, up 6.5 percent, at an annual rate from the preceding month. The index for industrial commodities rose at a 6.5 percent rate, with price increases in lumber, pulp and paper, fuels, metals, and machinery providing the most push. Overall farm prices rose even more steeply, at an annual rate of 7.6 percent. For April, preliminary data point to a more moderate advance in the wholesale index. The April estimate puts the overall wholesale price index at 111.9 percent of the



1957-59 average, up at an annual rate of 2.1 percent from March. Agricultural commodities are estimated to have risen very steeply, while industrial commodities advanced at a quite modest pace to 112.1 percent of the 1957-59 average, reflecting a reversal of the earlier sharp run-up in lumber and plywood prices.

Banking and Monetary Developments in the First Quarter

Bank credit and money supply expansion slowed sharply in the first quarter in response to the Federal Reserve System's policy of restraint. Two weeks before the quarter began, the Federal Reserve discount rate was raised $\frac{1}{4}$ percentage point to $5\frac{1}{2}$ percent and open market policy was tightened substantially. Furthermore, the Regulation Q ceilings that set the maximum rates which commercial banks may pay on time and savings deposits were kept unchanged at levels curtailing the banks' ability to renew these deposits as they came due, especially in the case of large-denomination certificates of deposit (CD's).

The System's tightening of monetary conditions in late 1968 was reflected in a number of first-quarter developments. Bank credit growth slowed sharply in the first quarter to a $1\frac{1}{2}$ percent annual rate, and the rate of increase in the narrowly defined money supply dropped to 2 percent. By contrast, in the last half of 1968 bank credit rose at a 15 percent annual rate and the narrow money supply rose 6 percent. Daily average deposits subject to reserve requirements—the bank credit proxy—declined at a 5 percent annual rate in the first quarter, after increasing at a 13 percent pace in the last half of 1968. Banks, however, were able to offset nearly half of the first-quarter decline in deposits by increasing their Euro-dollar borrowings. Interest rates on corporate, municipal, and long-term Government bonds moved steadily higher in the first quarter, as did rates on commercial paper. As reserve positions came under increasing pressure, Federal funds rates climbed and member banks borrowed heavily at the discount window. Euro-dollar rates also moved up, as some of the larger banks borrowed heavily in this market in an attempt to replace funds lost through rundowns in large CD's. Commercial banks began to lose large CD's in mid-December, when holders switched to other, higher yielding investments, and continued to lose them in large amounts throughout the first quarter. Nonetheless, banks increased their real estate and consumer loans at rapid rates, and business loans grew at the fastest clip since the second quarter of 1966. Faced with heavy loan demand and substantial losses of large

CD's, commercial banks twice raised the prime rate during the first quarter, bringing it to a record $7\frac{1}{2}$ percent on March 17. With loans increasing rapidly and CD liabilities declining, banks were forced to sell large quantities of United States Government securities and to limit greatly their acquisitions of other investments.

Despite monetary and fiscal restraint, the economy continued to expand at an inflationary pace during the winter months. As a result, shortly after the end of the first quarter the Board of Governors approved actions by the directors of the twelve Federal Reserve Banks further increasing the discount rate to 6 percent. In an additional move against inflation, the Board of Governors increased reserve requirements against all member bank demand deposits by $\frac{1}{2}$ percentage point—an action that increased required reserves by about \$650 million.

INTEREST RATE DEVELOPMENTS AND MEMBER BANK RESERVE POSITIONS

Most market interest rates moved higher during the first quarter, increasing from already high levels. The bank prime rate—the interest rate which commercial banks charge their most creditworthy corporate borrowers—had been increased twice in December, to $6\frac{1}{2}$ percent on December 2 and then to $6\frac{3}{4}$ percent on December 18. In early January the prime rate was raised further to 7 percent, and in mid-March was moved up again to a record $7\frac{1}{2}$ percent. Yields on most municipal, corporate, and long-term Government bonds also increased during the first quarter, but by somewhat smaller amounts. Yields on Government securities maturing in three to five years rose 34 basis points over the quarter to an average of $6\frac{1}{3}$ percent in March, while new issue rates on high-grade corporate bonds rose about 55 basis points to $7\frac{1}{2}$ percent in March. Rates on prime four- to six-month commercial paper rose more steeply, climbing 65 basis points to 6.8 percent in March. Throughout the quarter, most often quoted bank offering rates on large CD's were uniformly at their Regulation Q ceilings, which range from $5\frac{1}{2}$

percent on the shortest maturities to $6\frac{1}{4}$ percent on the longest.

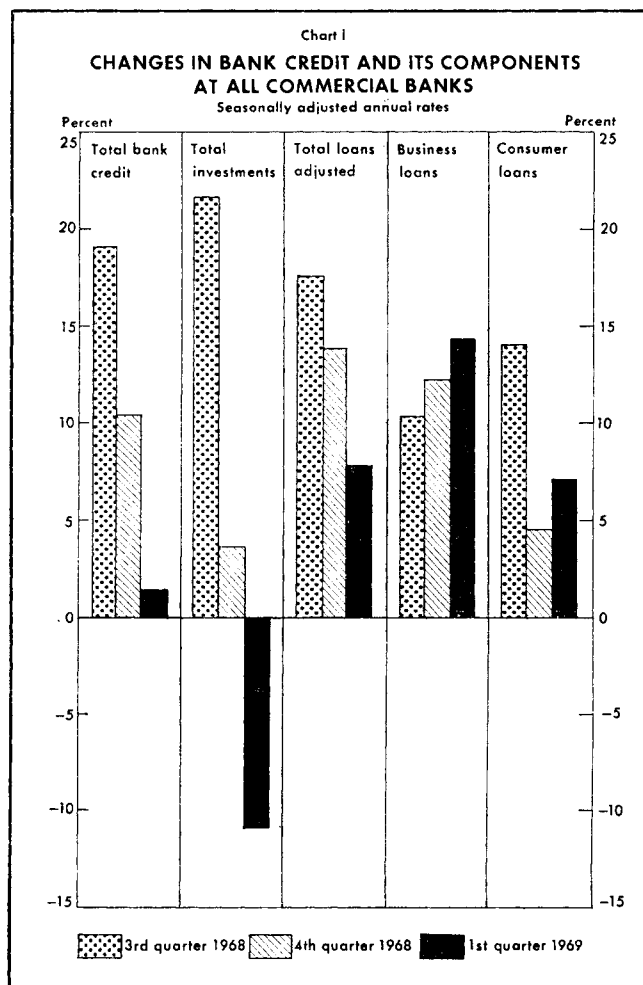
Treasury bills provided an exception to the general upward trend in market interest rates in the first three months of the year. Rates on three-month Treasury bills, which had reached a record $6\frac{1}{4}$ percent in late December, fell slightly over the quarter to just under 6 percent by the end of March. The low level of new Treasury borrowings, together with a broadly based demand for bills, helped reverse the strong upward pressure on bill rates that had prevailed throughout the last quarter of 1968.

Reserve positions of member banks came under greater pressure during the quarter, and discount window borrowings increased substantially. Reserves required to be held against demand and time deposits fell \$233 million from December to March. However, nonborrowed reserves—those supplied through open market operations—dropped \$605 million. Consequently, member banks found it necessary to increase their borrowings at Federal Reserve Banks from an average of \$752 million in December to \$918 million in March. At the same time, member bank excess reserves were reduced from an average of about \$450 million in December to a 37-year low of \$180 million in March. These developing pressures on marginal reserve positions were associated with a steady rise in interest rates on Federal funds, which climbed from an average of 6.0 percent in December to 6.8 percent in March.

BANK CREDIT

The growth of total commercial bank credit slowed sharply to a seasonally adjusted annual rate of $1\frac{1}{2}$ percent in the first quarter (see Chart I). Bank credit growth had been at a 19 percent annual rate in the third quarter of 1968, but had dropped to about half that pace in the final three months of the year. The further decline in the rate of bank credit expansion during the first three months of this year was reflected in a large reduction in bank holdings of Government securities together with a sizable decline in securities loans. Consumer, business, and real estate loans continued to expand rapidly in response to strong credit demand associated with rapid economic growth and continued inflationary expectations. Thus total loans, excluding securities loans, expanded at an 11 percent rate with business loans leading the advance. Total investments were reduced at an 11 percent rate, the first overall contraction of investments since 1966, with all the drop attributable to net sales of United States Government securities.

Commercial banks reduced their holdings of Government securities at a 30 percent seasonally adjusted annual rate during the quarter. This was the most rapid rundown



of banks' Government securities portfolios in at least two decades, and it left their total dollar holdings of these securities at the lowest level in nearly two years. Sales of securities were particularly rapid in February, when loan demand was at its peak for the quarter. However, banks continued to be net sellers of Government securities in March despite takings of sizable amounts of the March 3 Treasury bill offering, which could be purchased by crediting Treasury Tax and Loan Accounts. Banks in the first quarter continued to add to their holdings of other securities, principally tax-exempt municipal bonds, but additions to these investments dropped to a third of the pace set in the preceding six months.

Heavy nonbank demand for Treasury obligations in the first quarter and a low level of Treasury borrowing contributed to a reduction in the inventories of Government securities dealers. Municipal bond dealers also cut back

their inventories as prices trended lower in that market. Additionally, the demand for stock market credit fell, as the problem of delivery "fails" moderated substantially and as speculative activity subsided. Consequently, bank securities loans fell at an extremely rapid 62 percent annual rate from December to March. As is usually the case, securities loans moved in a quite erratic week-to-week pattern during the quarter. Thus, although the trend was strongly downward, there were several brief periods when securities loans outstanding were increased. Generally these increases were associated with Treasury financings, during which Government securities dealers temporarily added to their inventories.

Business loans grew at a seasonally adjusted 14½ percent annual rate in the first quarter of 1969, the most rapid quarterly increase since the second quarter of 1966. This heavy business loan demand was probably related to a variety of factors. Spending for inventories and plant and equipment was substantial during the first quarter, leading to heavy business demand for funds generally. In addition, tax payments in January and March absorbed large amounts of corporation funds. Finally and perhaps most importantly, it is probable that businesses borrowed heavily in January and February in anticipation of higher cost and reduced availability of credit at banks. In this connection, business loan growth moderated sharply in March, especially following the midmonth prime rate rise, though growth in April appears to have again been sharp.

Bank real estate and consumer lending also expanded strongly during the first quarter, although real estate lending slowed somewhat from the pace set last fall. Real estate loans increased at an 11¾ percent annual rate, compared with a 14 percent fourth-quarter gain. Construction activity advanced strongly in the first quarter, contributing to the further expansion of mortgage loans despite the increased pressures on banks' loanable funds. Consumer loans outstanding grew at a fairly rapid 7 percent seasonally adjusted annual rate, up from the 4½ percent fourth-quarter increase. In the first quarter, consumer borrowing reflected the step-up in consumption expenditures in the face of greatly reduced growth in disposable personal income. Moreover total consumer borrowing from all sources increased more rapidly during the first quarter than did consumer borrowing from banks.

The loan-deposit ratios of banks moved higher during the first quarter, reflecting the pressures on bank liquidity that arose from strong loan demand and reduced deposit growth. For all commercial banks the ratio of loans to deposits reached 66 percent in February and 67 percent in March. Both levels exceeded the previous postwar record reached in the fall of 1966. At the New York City

weekly reporting banks, loan-deposit ratios jumped from 80 percent in December to 88 percent by the first quarter's end, more than 6½ percentage points above the highest 1966 levels. However, this latter development can be placed in better perspective by including Euro-dollar borrowings in the denominator of the ratio since, among New York banks especially, these borrowings were a major source of funds for new loans during this quarter. Inclusion of such liabilities in the denominator reduces the March loan-deposit ratio for New York banks to 75 percent, slightly below the 1966 peak measured on the same basis.

MONEY SUPPLY AND TIME DEPOSITS

The daily average money supply—privately held demand deposits plus currency in circulation outside banks—grew at a 2 percent seasonally adjusted annual rate over the first quarter, much below the 6½ percent rate for the preceding twelve months. The first-quarter money supply increase was comprised of a ½ percent annual rate gain in private demand deposits and a 7½ percent rate of increase in the currency component. This slowing of money supply growth appears for the most part to have reflected the tighter monetary policy prevailing since last December. Treasury deposits with member banks increased \$0.7 billion during the quarter, but this development probably contributed little to the slowing of the private money supply since increases in Treasury balances ordinarily reduce private money holdings substantially less than dollar for dollar. There may, however, have been some reduction in the demand for money balances associated with the sharp decrease in the volume of stock market transactions during the quarter.

After large gains in the summer of 1968, time and savings deposit growth at commercial banks slowed in the closing months of the year and then became negative in January when banks lost large CD's in volume (see Chart II). CD losses moderated later in the quarter, but nevertheless totaled \$4 billion for the period from the end of December to the end of March. By early last December, market offering rates on new CD's had reached the ceilings imposed by Regulation Q, and rates on other short-term securities continued to rise. In late December, six-month Treasury bills yielded over 60 basis points more than 90- to 179-day CD's, and three-month Treasury bills were yielding about 80 basis points more than CD's of less than 90-day maturity. By the end of the first quarter, rates on Treasury bills had moderated somewhat, and their yield advantage over CD's, though still wide, had dropped to about 30 basis points in the case of six-month bills and

about 45 basis points in the case of three-month bills. Savings deposits also declined marginally during the quarter, other time deposits rose somewhat, and total time and savings deposits contracted at a 6½ percent annual rate.

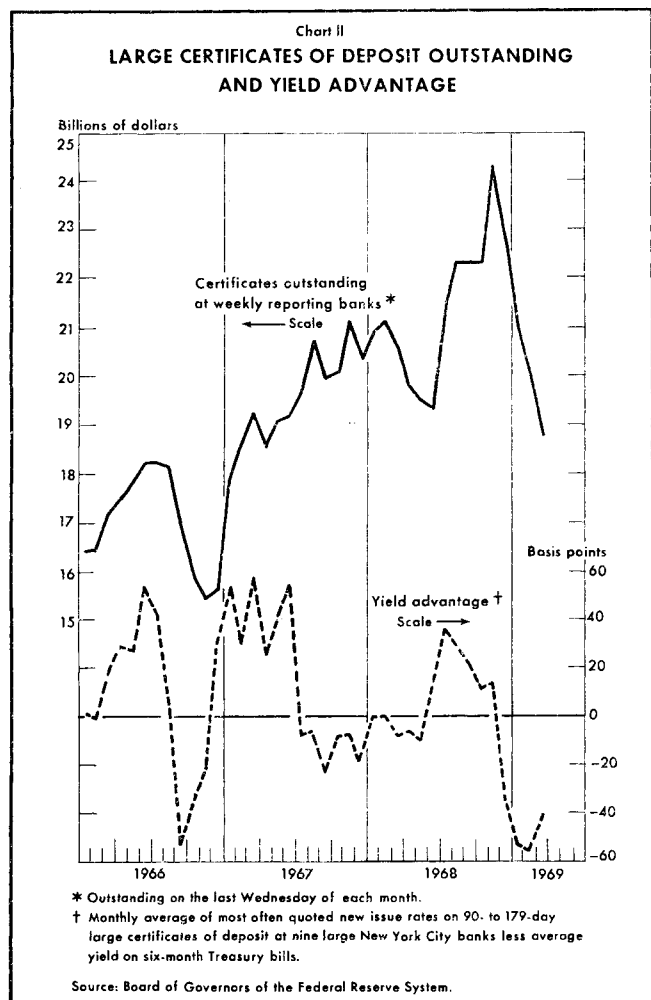
In an effort to regain the deposits lost through the CD runoff, the larger commercial banks—particularly those

in New York City—borrowed heavily in the Euro-dollar market. Large commercial banks in New York City increased their liabilities to their foreign branches by about \$2.5 billion during the quarter, even though Euro-dollar interest rates remained near or above 8 percent. All commercial banks with overseas branches registered an increase in Euro-dollar liabilities totaling \$3.9 billion. While Euro-dollar borrowing may have little or no impact on aggregate banking system resources, this offshore market has increasingly become a major vehicle by which funds are reallocated within the domestic banking system, especially in periods when Regulation Q ceiling rates on large CD's place severe pressures on the larger banks in the country.

THRIFT INSTITUTIONS

The growth of savings accounts at thrift institutions was little changed in the first quarter despite a sharp reduction in overall consumer saving. Share capital at savings and loan associations and deposits at mutual savings banks together registered a seasonally adjusted annual-rate increase of 6 percent, not significantly different from that of the preceding quarter. Savings and loan associations maintained their recent growth trend of about 6 percent, while mutual savings bank deposits slowed to a 6¼ percent annual rate of increase following an accelerated 7 percent gain in the fourth quarter of last year. Thus, the thrift institutions so far appear to have been little affected on balance by the increased monetary restraint exerted by the Federal Reserve System.

The sustained growth of savings capital at the thrift institutions has permitted their mortgage lending—principally on residential properties—to increase at a solid pace. The mortgage portfolios of the savings and loan associations rose at an annual rate of 8.4 percent in the first quarter, after seasonal adjustment, while mutual savings banks' mortgages climbed 6.2 percent. In both cases, these latest increases were slightly higher than average 1968 gains.



The Money and Bond Markets in April

During April the money market was subjected to pressure from greater monetary restraint and from unusually large reserve drains around midmonth. The Federal funds rate and other short-term interest rates advanced in the wake of the April 3 announcement of increases in the Federal Reserve discount rate and reserve requirements on demand deposits at member banks. (For details, see the statement of the Board of Governors reproduced in full on page 75 of the April issue of this *Review*.) Accompanying the firmer money market conditions that emerged during the month were variations in day-to-day rates which reflected some fairly abrupt shifts in the distribution of reserves between money center and other banks. In large part, these fluctuations were due to wide swings in the size and distribution of Treasury cash balances around the mid-month tax date. After mid-April, however, short-term Treasury bill rates began to reverse the upward movement which had occurred earlier, and by the month end rates were below March 31 levels.

Sentiment in the bond markets, particularly in the corporate sector, continued to improve, and some feeling developed that yields had already hit their peaks for the year. New issues were aggressively sought for a time at declining yields, prices of outstanding bonds rose sharply, and the market resisted such potentially bearish price influences as a rebound in the volume of new offerings, the report of a strong first-quarter advance in gross national product, and new trouble with North Korea. The marked revival of expectations that lower interest rates lay ahead stemmed from a growing belief that the anti-inflation programs of the Federal Reserve and the Administration, including the proposed repeal of the investment tax credit, would prove effective. Renewed optimism over progress toward a settlement in Vietnam worked in the same direction. By the month end, however, the rally began to lose steam as money market rates remained high and signs of a slowing of price inflation remained sparse.

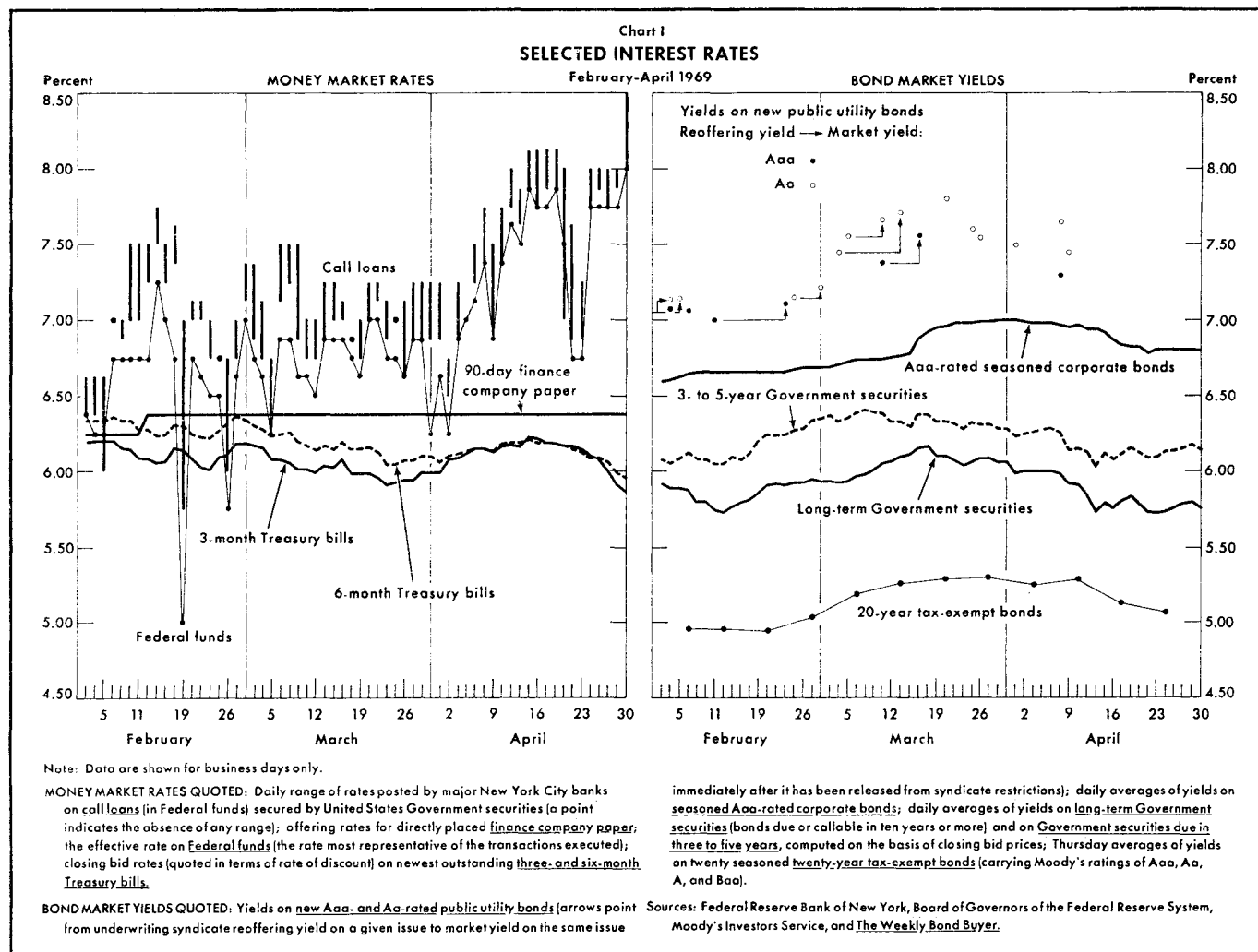
BANK RESERVES AND THE MONEY MARKET

Increased pressure on bank reserves during April was apparent in some increase in member bank borrowings

from the Federal Reserve Banks and a marked rise in the prevailing range of Federal funds rates. For April as a whole, borrowings at the discount window averaged approximately \$1 billion, a rise of close to \$80 million from March. Since excess reserves declined on balance, net borrowed reserves in April advanced \$160 million to \$860 million.

The Federal funds rate, after having remained mostly in a 6½ to 6¾ percent range in March, moved up to a 7 to 7½ percent range following the announcement of the discount rate and reserve requirement increases in early April (see Chart I). About midmonth the rate rose further to around 7¾ percent. The distributional effects of the Treasury operations on the major money market banks were quite pronounced during April. Chart II records the pattern of basic reserve deficits during the February-April period for the past three years. The early- to mid-April jump was far more than seasonal in 1969 and, indeed, the \$2¾ billion rise during the two-week period was one of the sharpest on record. The major money market banks, in seeking to cover their combined deficit of over \$4½ billion, were instrumental in bidding up the Federal funds rate. While a subsequent reversal of the skewed distribution of reserves brought a temporary respite, Federal funds continued to trade at 7¾ percent or above for most of the last half of the month. Indeed, on April 30, the final day of a statement week, some transactions at rates as high as 9½ percent were reported.

Reserve management in April had to deal with the effects of the increase in reserve requirements and with recourse to temporary Federal Reserve credit by the Treasury to bridge the gap between receipts and expenditures. At the beginning of April, Treasury balances were inadequate to cover net outlays until the inflow of tax receipts after midmonth. As a consequence, funds flowing into large banks for the account of the Treasury were withdrawn daily, and remaining cash shortfalls were financed by the sale of special certificates to the Federal Reserve. Thus, reserves were redistributed from money center banks to others, and at the same time credit extended to the Treasury by the System was creating new reserves which had to be offset by open market operations. As corporate



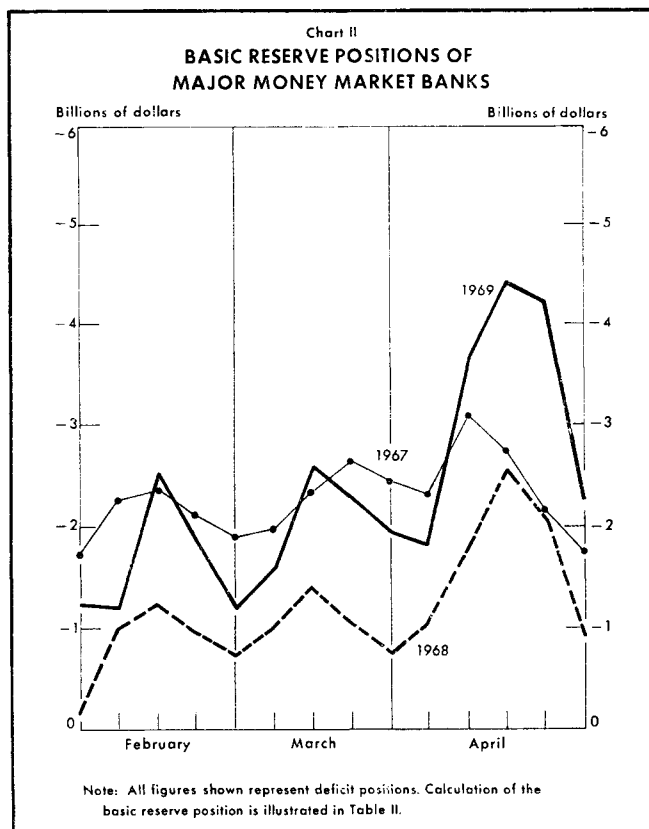
tax payments began to flow in at midmonth, balances in Tax and Loan Accounts at commercial banks were restored and indebtedness to the Federal Reserve was repaid. In sum, Treasury cash management operations provided about \$1 billion in reserves in the week ended on April 16 and then withdrew around \$1.2 billion during the succeeding week as operations were reversed (see Table I).

Confronted with the need to absorb a substantial volume of reserves in the week ended on April 16, and to reverse direction in the following week, the System resorted extensively in the earlier week to matched sale and purchase transactions. These operations involved sales of Treasury bills by the System to dealers under agreements to repurchase during the next week. Initially, then, these

transactions absorbed reserves, and the impact tended to fall on money market banks, where reserve pressures were already great. The $\frac{1}{2}$ percentage point boost in reserves required against member bank demand deposits applied to deposits in the week that began April 3. Because of the two-week lag in reserve settlement, however, the full impact was delayed until the week beginning April 17, when this action accounted for about \$650 million of the total rise of \$940 million in required reserves for that week.

In spite of these reserve pressures, monetary aggregates were buoyant. Total deposits subject to reserve requirements (the bank credit proxy) rose about 6 percent (seasonally adjusted annual rate) in April after a 5 percent drop in the first quarter. Adjustment to include liabilities to foreign

branches would have more than halved the first-quarter decline, but would not have altered the April results much (although sales of assets by domestic banks to their foreign branches introduced some distortion). Liabilities to foreign branches, which had advanced about \$3.9 billion in the first three months of 1969, registered a drop of \$200 million in April. This reversal coincided with a slowdown in the rate of decline in time deposits at commercial banks. While large certificates of deposit continued the slide that has taken place throughout 1969, liquidations in April were little more than seasonal. Indeed, total time deposits on a seasonally adjusted basis were about unchanged in April after a drop of 6½ percent in the first quarter. Following a 2 percent rise in the first quarter, the money supply registered a surprising 13 percent annual-rate gain in April. Part of this upsurge was related to a sharp, temporary fall in the amount of cash items in process of collection. In turn, this drop was associated with a lull in transactions involving foreign banks, which were closed for holidays both before and after the Easter weekend. This kind of aberration also occurred in 1968, but on a somewhat smaller scale.



THE GOVERNMENT SECURITIES MARKET

In the market for Government securities most yields declined on balance during April, although some bill rates were higher during the first half of the month. The upturn was attributable in part to bank sales of issues acquired in late-March Treasury offerings and to money market pressures which increased dealer financing costs. Many bill rates initially jumped from 5 to 9 basis points in reaction to the April 3 announcement of monetary policy actions, although bills due after six months soon retraced most of the rise.

After midmonth, upward impulses subsided and rates worked lower. The Treasury announcement that \$200 million of the maturing April 30 bill would not be refunded, public fund demand, and reinvestment of the proceeds of maturing tax anticipation bills contributed to the improved performance. Long bills tended to benefit somewhat from the increased confidence that monetary and fiscal measures attacking inflationary pressures would be effective in the long run. Participants also anticipated that the Treasury's May refinancing operation would generate strong demand for bills. As a consequence, the yield curve in the bill market was flat during much of the latter half of the month, and the six-month bill sometimes traded slightly below the rate level of the three-month bill. At the regular monthly auction on April 24, average issuing rates on the nine- and twelve-month bills were set at 5.98 and 5.93 percent, respectively, 8 and 20 basis points lower than comparable rates at the auction a month earlier (see Table III). At the close of the month, the quoted rates on three- and six-month maturities were 5.87 and 5.96 percent bid, respectively, down 12 and 14 basis points from March 31. Rates for most other bills registered net declines of from 2 to 17 basis points in April.

Long-term markets were bolstered by the prospect of intensified monetary and fiscal attacks on inflation and by optimism about a resolution of the struggle in Vietnam. Participants focused on the positive aspects of changes in the discount rate and reserve requirements, expecting that such actions would contribute to price stability and, in time, to lower interest rates. Later in the month further improvement was generated in the capital markets by the President's recommendations for tax action. The view emerged that the elimination of the 7 percent investment tax credit might inhibit corporate capital expenditures and thereby contribute to a reduction of inflationary pressures and a contraction in the volume of corporate borrowings in the capital markets. The strong performance of the corporate bond market during the month gave a boost

Table I
FACTORS TENDING TO INCREASE OR DECREASE
MEMBER BANK RESERVES, APRIL 1969

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

Factors	Changes in daily averages— week ended on					Net changes
	April 2	April 9	April 16	April 23	April 30	
"Market" factors						
Member bank required reserves	- 79	+ 57	- 89	- 940	- 169	-1,220
Operating transactions (subtotal)	- 259	- 7	+ 390	+ 221	- 310	+ 35
Federal Reserve float	- 291	+ 249	+ 41	+ 683	- 770	- 88
Treasury operations*	+ 50	+ 119	+ 380	- 427	- 194	- 72
Gold and foreign account	+ 25	- 15	+ 29	+ 5	+ 2	+ 46
Currency outside banks	+ 55	- 90	- 189	- 160	+ 591	+ 207
Other Federal Reserve accounts (net)†	- 97	- 270	+ 130	+ 119	+ 61	- 57
Total "market" factors	- 338	+ 50	+ 301	- 719	- 479	-1,185
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+ 126	+ 135	- 192	+ 397	+ 364	+ 830
Outright holdings:						
Government securities	+ 51	+ 57	- 559	+ 819	+ 280	+ 648
Bankers' acceptances	+ 2	+ 3	- 1	+ 2	- 2	+ 4
Special certificates	-	+ 96	+ 627	- 723	-	-
Repurchase agreements:						
Government securities	+ 52	- 7	- 211	+ 223	+ 4	+ 61
Bankers' acceptances	+ 11	- 5	- 33	+ 56	+ 26	+ 55
Federal agency obligations	+ 10	- 9	- 15	+ 20	+ 56	+ 62
Member bank borrowings	+ 232	- 248	- 187	+ 374	- 17	+ 154
Other loans, discounts, and advances	-	-	-	-	-	-
Total	+ 361	- 116	- 378	+ 770	+ 347	+ 984
Excess reserves	+ 23	- 66	- 77	+ 51	- 132	- 201

	Daily average levels					
	April 2	April 9	April 16	April 23	April 30	
Member bank:						
Total reserves, including vault cash	26,695	26,572	26,584	27,575	27,612	27,008†
Required reserves	26,438	26,381	26,470	27,410	27,579	26,856†
Excess reserves	257	191	114	165	33	152†
Borrowings	1,195	947	760	1,134	1,117	1,031†
Free, or net borrowed (-), reserves	- 938	- 756	- 646	- 969	- 1,084	- 379†
Nonborrowed reserves	25,500	25,625	25,824	26,441	26,495	25,977†
Net carry-over, excess or deficit (-)§	136	130	125	41	85	103†

	Changes in Wednesday levels					
	April 2	April 9	April 16	April 23	April 30	
System account holdings of Government securities maturing in:						
Less than one year	+ 326	+ 144	- 578	+ 409	+ 876	+1,177
More than one year	-	-	-	-	-	-
Total	+ 326	+ 144	- 578	+ 409	+ 876	+1,177

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 on April 30.

§ Not reflected in data above.

Table II
RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS
APRIL 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on					Averages of five weeks ended on April 30
	April 2	April 9	April 16	April 23	April 30	

Eight banks in New York City											
Reserve excess or deficiency(—)*	18	—	7	—	35	41	—	32	—	3	
Less borrowings from Reserve Banks	—		75		84	201		63		85	
Less net interbank Federal funds purchases or sales(—)	—	159	888	1,807	1,435	293	853				
Gross purchases	1,332	1,833	2,382	2,202	1,558	1,861					
Gross sales	1,491	946	575	767	1,265	1,009					
Equals net basic reserve surplus or deficit(—)	177	—	970	—	1,926	—	1,595	—	388	—	940
Net loans to Government securities dealers	440	948	1,010	780	645	765					
Net carry-over, excess or deficit(—)†	38	35	11	—	24	14	15				

Thirty-eight banks outside New York City												
Reserve excess or deficiency(—)†	3	23	—	149	—	1	—	23	—	29		
Less borrowings from Reserve Banks	489	486	367	429	288	412						
Less net interbank Federal funds purchases or sales(—)	1,452	2,202	2,136	2,201	1,521	1,902						
Gross purchases	3,293	3,607	3,630	3,430	3,047	3,401						
Gross sales	1,841	1,405	1,494	1,229	1,526	1,499						
Equals net basic reserve surplus or deficit(—)	—	1,939	—	2,666	—	2,652	—	2,631	—	1,832	—	2,344
Net loans to Government securities dealers	—	95	80	218	124	—	5	64				
Net carry-over, excess or deficit(—)†	31	29	43	14	17	27						

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—April 1969				
	April 1	April 7	April 14	April 21	April 28
Three-month	6.065	6.167	6.195	6.175	6.053
Six-month	6.136	6.185	6.191	6.164	6.043

Monthly auction dates—February-April 1969			
	February 20	March 26	April 24
Nine-month	6.307	6.058	5.977
One-year	6.234	6.132	5.931

* Interest rates on bills are quoted in terms of a 360-day year, with the dis-
counts 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.

to prices of Treasury coupon issues. Momentum tapered off toward the end of the month, however, prompted by some profit taking and hesitation in the face of the upcoming announcement of the Treasury refinancing operation. On April 30 the Treasury announced that it would offer holders of issues maturing May 15 and June 15 a choice of a 6¾ percent note, due in fifteen months and priced to yield 6.42 percent, or a seven-year 6½ percent note, priced at par. For the month as a whole, yields on three- to five-year issues were down 14 basis points, and long-term yields fell 29 basis points.

OTHER SECURITIES MARKETS

In the corporate bond sector new issue yields, which had begun to slide in mid-March, continued to decline throughout most of April. Although sporadic price corrections provided temporary interruptions, the underlying condition of the market was improved. After facing considerable resistance to new offerings in March, underwriters encountered renewed investment demand in April. As a consequence, inventories were considerably lightened, and, with a lower prospective supply of new offerings, aggressive bidding for new issues developed. At the same time that technical conditions improved, investors also appeared to be heartened by the new round of anti-inflation measures, and once again optimism over Vietnam peace spread through the market. Buoyancy was somewhat deflated late in the month, however, by the enlargement of dealer positions and by the announcement of very strong consumer price advances in March.

The revival in the corporate bond market appears to have commenced with the very strong reception of an \$80 million Consolidated Edison issue, offered on March 19

to yield 7.90 percent. Subsequent financings, most of which carried some form of call protection, were offered at successively lower yields, and many traded at premiums after initial distribution. Some of the flotations had been postponed from the congested period of early March. One of the highlights in April was the excellent reception of a \$75 million noncallable mortgage bond issue offered by Commonwealth Edison at 7.30 percent for three- and five-year maturities. This response prompted other borrowers to shorten maturities of their offerings. The short term to maturity was an innovative feature, attractive to investors and less costly to borrowers than comparable financing at commercial banks. However, investor enthusiasm ebbed at the month end, when more inflationary evidence came to light, and new bond offerings in both short and long maturities began to encounter resistance.

The tax-exempt sector also rallied, but the recovery was generally more limited than that in the corporate sector. The ability of commercial banks, facing severe reserve pressures, to add materially to tax-exempt holdings was thought questionable—particularly in light of strong business loan demand. Furthermore, investors expressed uncertainty about the tax status of these securities in view of the tax-reform measures now under consideration by the Congress. Finally, the numerous postponements recorded in March were still overhanging the market, and it was considered likely that a large volume would be offered if new issue rates edged much below 5 percent. The breach of that level in the earlier upsurge had prompted changes in financing plans, in many cases because borrowers were subject to 5 percent interest-rate ceilings. At the end of April, *The Weekly Bond Buyer's* index of twenty municipal bond yields was 5.09 percent, a drop of 21 basis points over the month.

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