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The 1970 Amendments to the Bank Holding Company Act: Opportunities to Diversify

By ALFRED HAYES
President, Federal Reserve Bank of New York

This luncheon always provides a valuable opportunity to meet early in the year and to exchange views on the problems and prospects facing us. My associates and I recognize that we gain a good deal from both the informal discussions and the formal presentations that are an integral part of these midwinter meetings. Today I propose to share with you some of my thinking about the recent bank holding company legislation in the hope that it may be helpful to your own consideration. I shall also say a few words about our present, far from satisfactory economic situation.

On the last day of the old year, President Nixon signed into law the bill amending the Bank Holding Company Act of 1956 to extend its coverage to one-bank holding companies. The new amendments, the result of almost two years of intensive Congressional review and debate, will surely have a profound impact on the structure of the nation's banking and financial markets. In my view, the law may constitute the most significant banking legislation since the 1930's.

As you know, the 1956 act excluded one-bank holding companies from Federal regulation. This exclusion became a source of public concern in the late sixties, when many major commercial banks formed one-bank holding companies. Free of Federal regulation, some one-bank holding companies acquired or established nonbank subsidiaries in order to engage in a wide variety of activities, some of which were not permitted to banks directly. In addition, a few important industrial conglomerates acquired a single commercial bank, thus mixing banking and commerce—a mixture prohibited by the 1956 act to companies holding more than one bank.

Regulated multibank holding companies, by the way, control banks with about one sixth of the nation's commercial bank deposits, while one-bank holding companies control banks with almost one third of these deposits. This concentration of deposits under the control of companies not themselves subject to regulation would alone have provided sufficient reason for the legislation. However, an even more important reason was the prospect that the traditional separation of banking and commerce might be ended. Thus, the rapid development of the one-bank holding company movement raised not only issues of bank safety and competition, but also the issue of excessive economic power—the possibility that one-bank holding companies might become nuclei of industrial-financial conglomerates which could dominate economic life in the United States. This concern was expressed by President Nixon when he endorsed the proposed one-bank holding company legislation in March 1969:

> Left unchecked, the trend toward the combining of banking and business could lead to the formation of a relatively small number of power centers dominating the American economy. This must not be permitted to happen; it would be bad for banking, bad for business, and bad for borrowers and consumers.

In the several years preceding enactment of the legislation, there was little in the pattern of acquisitions by one-bank holding companies to suggest that they might be seeking such domination. The bank-centered one-bank holding companies have appeared to be more interested in offering diversified financial services. The banks owned by large commercial and industrial firms have generally

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Note: This address was delivered before the forty-third annual midwinter meeting of the New York State Bankers Association in New York City on January 25, 1971. Mr. Hayes wishes to express his indebtedness for valuable assistance in its preparation to Leonard Lapidus, Assistant Vice President, and Ralph H. Gelder, Manager, Banking Studies Department.

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represented a small fraction of these firms' total corporate assets. In any event, the 1970 amendments ended any threat of eroding the barriers separating banks from industry. Indeed, a principal result of the legislation—and one obscured by controversy over other provisions—is to reaffirm the principle that banking and commerce ought to be kept separate.

The 1970 amendments, therefore, bring all bank holding companies under the supervision of the Federal Reserve Board and eliminate loopholes by which a group might be free of Federal Reserve regulation while maintaining effective control of one or more banks. For example, the exemption in the 1956 act that permitted the effective control of chains of banks through partnership arrangements has been eliminated. A bank may also become subject to regulation as a bank holding company if it acquires in a trust capacity controlling shares of another bank and has sole discretionary authority to vote these shares. This provision could pose unusual problems for bank managements.

The Congress did not see fit to provide to existing one-bank holding companies an ironclad exemption allowing them to retain any previously acquired or established nonbank subsidiaries. True, bank holding companies which come under regulation for the first time may continue to engage in nonbank activities which would otherwise be prohibited, provided they have been continuously engaged in them since June 30, 1968. But the Board has the power to terminate a company's authority to engage in such an activity if it finds such action is necessary to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. The Board is required to make this determination by the year-end 1972 for those newly regulated companies with banking assets exceeding $60 million. The Board also has discretion to take similar action with respect to the other newly regulated holding companies whose banks have assets of $60 million or less, if it believes the so-called "grandfather" exemption is not justified.

While I have spoken up to now only of the restrictive provisions of the legislation, the amendments should also resolve the uncertainties that have hampered banking organizations in planning expansion and do offer new opportunities to regulated holding companies to expand into fields of business related to banking. Indeed, the most controversial and bitterly contested provision of the new law centers on the standards established for Federal Reserve Board determination of those nonbanking activities which would be permitted to bank holding companies. The most critical of these standards are contained in Section 4(c)(8) of the act. I would like to discuss this section of the legislation with you today—for it is the interpretation of its provisions that will determine just how much diversification bank holding companies will be permitted, in terms both of the services they can offer and of the extent to which they can expand geographically.

Under the standards provided in this section the Board must decide if an activity is "so closely related to banking or managing or controlling banks as to be a proper incident thereto". In determining whether a particular activity is a proper incident to banking or managing or controlling banks, the Board is also required to consider whether the performance of a particular activity by a proposed affiliate "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices". In essence, then, the Board must now base its Section 4(c)(8) decisions primarily on two determinations—roughly stated, whether a proposed activity is "closely related" to banking and whether its performance by a banking organization would yield net public benefits.

The language of Section 4(c)(8) dealing with the "closely related" issue represents the key compromise reached by the House-Senate Conference Committee. You will remember that the House of Representatives in its bill took a very restrictive approach in defining permissible activities; the House proposal included the so-called "laundry list" of prohibited activities—a list containing activities such as insurance, travel services, leasing, and mutual funds. The Senate, on the other hand, rejecting the laundry list, supported a proposal suggested by the Board of Governors that would permit bank holding companies to have subsidiaries engaging in activities "functionally related" to banking, leaving the determination of the specific types of permissible activities to the best judgment of the Federal Reserve Board.

The language of the new section is a middle ground between the widely separated views of the House and Senate versions. It is probably fair to say that the legislative history fails to fix clearly the exact location within this middle ground that would indeed represent the "intent of Congress". Consequently, I would expect that the question of what is "closely related" to banking will for practical purposes be decided first by the Board and ultimately by the courts. Court review and determination is likely to occur not only pursuant to appeals by applicants but also because the new law contains a provision which grants to competitors of bank affiliates a clear right of

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standing before the Board and the courts to challenge applications filed under the act. To be sure, the Congress —if it is not pleased with the decisions of the Board and the courts—might undertake to amend the act again.

Appreciating these difficulties and the legal issues involved, I would still like to tell you what we in the New York Reserve Bank hope this legislation will permit the Federal Reserve System to do. Last May, the Federal Reserve Board through Chairman Burns expressed support for the Senate proposal. At that time, in his testimony before the Senate Banking and Currency Committee, he cited a number of activities that in the opinion of the Board would likely result in public benefit if conducted by bank holding company subsidiaries. He also indicated at that time that granting the Board authority to specify permissible activities by regulation or order would provide flexibility to adjust the list as circumstances change.

When the legislation was before the Conference Committee late last year, Chairman Burns, in reply to a letter from Congressman Patman, addressed himself again to the issues raised in Section 4(c)(8). While continuing to express support for the Senate proposal that permissible activities be "functionally related" to banking, he nonetheless offered insight into the Board's view of the "closely related" compromise wording.

He indicated that the objectives of the Board were to allow bank holding company systems to offer the kinds of bank-related services that they were likely to be able to perform conveniently and efficiently and under conditions that would enliven competition. While these results might be reached by interpretation of the proposed compromise language offered by Congressman Patman, the Board preferred certain changes in the proposed language. One of the most significant changes requested by the Board was to delete from the phrase "so closely related to the business of banking or of managing or controlling banks" the words "the business of", so that the phrase would read "closely related to banking or managing or controlling banks". The deletion of these three words—which might appear to be of small consequence—was significant because of the administrative history of the 1956 act. In the course of administering that act, the Board had interpreted the "business of banking" wording as requiring a "direct and significant connection" between the activities of the proposed subsidiary and those of the subsidiary banks of the holding company. This interpretation had the effect of limiting a bank holding company to those nonbank subsidiaries which serviced or supported the activities of the bank affiliate.

It was the Board's view last November, however, that it would not be "desirable to unduly restrict entry by nonbank subsidiaries into markets that are distinct from those served by the subsidiary banks of the holding companies". Such market extensions, the Board argued, would lessen risks of tie-ins and would promote competition. For these reasons, while the Board preferred that the phrase, "closely related", be changed to read "functionally related", it said in the following quotation that these ends could be secured by deleting the three-word phrase "the business of":

> If the conferees prefer to keep "closely related" in the language of the statute, our objective would be served by changing the words "the business of banking or of managing or controlling banks" to read "banking or managing or controlling banks".

The fact that the Committee adopted the Board's suggested revision may count importantly when the courts come to consider the issue.

In any case, I am sure that the Board will indicate very soon some of the activities it considers permissible under the new law. I am certainly hopeful that bank holding companies will be permitted to offer many financially related services. I again express my personal support—as I did last May—for permitting bank holding companies some product diversification and I plan to continue my efforts toward this end.

As I indicated earlier, Section 4(c)(8) now requires that the Board, in determining whether an activity is a proper incident to banking, consider whether its performance by a proposed affiliate "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices". In essence, this new test requires that every nonbank acquisition be found to yield positive net benefits to the public. It appears on its face to be more stringent than the statutory standards applicable to commercial bank mergers and acquisitions: Those standards permit bank regulators to approve a merger or acquisition even though competition may be lessened, unless the lessening of competition is substantial. If it is substantial, the regulator may approve the merger or acquisition only if the substantial anticompetitive effects are "clearly outweighed" by benefits to the convenience and needs of the community to be served. For nonbank acquisitions, however, each proposal must show net benefits to the public.

To what degree the language of the 1970 amendments will prove to be genuinely more severe, however, is un-

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certain. Despite the seemingly easier test for bank acquisitions, bank regulators have been loath to approve bank consolidations that would appear to have adverse competitive effects, even if not substantial, without offsetting gains to the public. Therefore, I would think that had commercial bank mergers been subject to the seemingly more severe test of net public benefit, the pattern of regulatory approval might not have been very different.

Nevertheless, the test may be construed to be more severe, and that fact suggests that banking organizations take particular care in the way in which they enter new areas of endeavor. I would surmise that leading banking organizations would probably meet regulatory resistance in attempts to acquire leading firms in nonbank fields. This would be particularly true if the holding company has the management and financial resources to enter that bank-related field *de novo* or through the acquisition of a relatively small firm. The experience of bank merger and acquisition cases suggests that it may not be an easy task for an applicant to demonstrate public convenience or efficiency offsets to damaging competitive effects.

All things considered, I am pleased with the provisions of the new law. Despite some remaining uncertainties, the new law should provide to banking organizations the basis for a significant degree of diversification of financial services and should permit companies to offer such services in geographical markets that they have never served before. On the other hand, the public benefit test may limit severely their ability to enter some geographical and service markets, except through the establishment of a *de novo* subsidiary. As banks take advantage of these opportunities, they should enhance the competitive environment of our banking and financial system and contribute to a more efficient allocation of financial resources in the economy. I also recognize that the new legislation, of course, adds greatly to the regulatory responsibilities of the Federal Reserve System. We are preparing to handle this challenge, and we hope to play a constructive role in shaping a more competitive and more efficiently functioning financial system.

Let's turn for a moment to the more general problem the entire nation faces: inflation and unemployment. Both the problem and its solution are bound to have profound effects on your own banking operations. As we look back on the past two years, we find that fiscal and monetary policies have played a major role in eliminating excessive demand pressure on the economy. Thus, one primary condition for a reduction in the rate of inflation has been satisfied—yet signs of slackening in price rises are not yet convincing, and inflation continues to be very much of a challenge, now fueled largely by grossly excessive wage settlements that bear no relation to any reasonable expectation of productivity gains. At the same time, sluggish real growth of the economy has brought unemployment into a range that is obviously worrisome and would be quite unsatisfactory over an extended period.

During these same two years, the sluggishness of business has reflected in large measure a weakening of confidence on the part both of businessmen and of consumers. This loss of confidence in turn may be attributed to slower business itself and to a variety of other factors, including perplexity over the persistence of inflation while unemployment was growing and mounting concern with international developments. Confidence was also hurt by accumulating evidence, culminating in the summer of 1970, that financial strains were placing in jeopardy large corporations that had been thought of as more or less invulnerable and were also threatening the viability of important financial markets. It was both logical and proper, under these conditions, that fiscal and monetary policies should move as they did in a distinctly easier direction in 1970, after the severe restraint of the preceding year. As we look ahead, it seems likely that fiscal policy will tend to become more expansive; and it seems clear that monetary policy will have to be applied with great caution in the face of our twin problems of inflation and unemployment. It would certainly be a great mistake to go all out for rapid economic expansion, for this would virtually guarantee a resurgence of inflation—and, in the longer run, a new and more severe problem of unemployment.

But the very need for caution in using rapid credit expansion as the way to cut unemployment to tolerable levels points up the need to search hard for means other than fiscal and monetary policies for affecting directly both unemployment and wage and price decisions. Thus, not only is it important to exploit various attacks on "structural" unemployment, it is also essential, in my judgment, to try some variant of "incomes policy" as a way of breaking the inflation spiral. While I am by no means sure what the best detailed plan should be, it does seem to me that it should be simple and easily understood, that it should set definite targets, and that it should be temporary. An effective incomes policy would certainly give monetary policy greater scope to accommodate business recovery, with all that that may imply in the way of interest rate levels and availability of credit.

I have, of course, been speaking in broad terms of our major domestic economic problems—but I would not like to leave you without touching briefly on the international aspects which are very closely intertwined with the domestic. Some of you may be tempted to think of

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our balance-of-payments problems as very remote from your day-to-day task of carrying on sound banking activities. Another possible reason for the tendency to downgrade this topic is the fact that our balance-of-payments problem has been with us in more or less acute form for some twelve years, and it hasn't yet brought on anything like disaster. And then there are others who dismiss the subject by pointing to the size of the United States economy and arguing that other countries are obliged to use the dollar as the base of their foreign trade and investment whether they like it or not, so why worry about the balance of payments? I am quite sure these are false comforts. If we continue to run huge payments deficits we shall be courting, at the very least, all kinds of restraints abroad on United States investment and trade, which are bound to react on business conditions here. And it is quite possible that continuing balance-of-payments deficits could also lead to very heavy speculative movements against the dollar. Vast foreign holdings of dollars in the Euro-dollar market and in our stock market would provide ample fuel for such speculation, and widespread effects could be felt in our financial markets as well as in business conditions in this country.

The only real hope of a better United States balance of payments lies in a successful attack on inflation, which would check imports by preventing excessive demand in the economy and would preserve the competitive position of American exports by keeping cost and price increases to a minimum. Since all the major industrial countries are suffering in greater or less degree from inflation, we could achieve real results just by doing a little better than most other countries in fighting inflation. In view of the tremendous stakes involved both at home and abroad, such progress should well justify the effort.

Nineteen-seventy was a rather discouraging year. The new year offers a great opportunity for improvement. I hope that all elements in the country, including the very influential banking community, will join forces to bring inflation under control at long last and, thereby, restore sustainable real growth in the economy.

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The Business Situation

The nation's output of goods and services declined substantially during the fourth quarter of 1970, when the automotive strike was superimposed upon an already slack economy. Inasmuch as the strike affected almost every individual component of the gross national product (GNP) accounts, it is difficult to measure the full impact of the work stoppage on GNP. Continuing a pattern which has been uninterrupted since last July, the unemployment rate rose throughout the fourth quarter, reaching the 6.2 percent mark in the final month of 1970. Although industrial production increased in December for the first time since July, virtually all the rise was related to the start-up of production at General Motors. Only spending on residential housing showed any significant advance. Whether the buoyancy in this sector will extend to others and generate an overall economic recovery depends primarily on whether there is a resurgence of consumer spending.

Despite the slowdown in business activity in the fourth quarter, the implicit price deflator for GNP rose sharply. While much of the acceleration in this indicator stemmed from technical factors associated with the automotive strike, the underlying price situation showed no apparent improvement over the rapid rate of inflation that had characterized the earlier part of 1970. Indeed, the rate of increase in consumer prices accelerated in the fourth quarter, with all components of the consumer price index (CPI) participating in this step-up. The acceleration in the price advance of nonfood commodities, which exceeded that of the other components of the CPI, was bitterly disappointing since these prices are usually the ones most sensitive to general demand conditions. At the same time, there was some slowdown in the rise of compensation per man-hour; nevertheless, the even greater fall in the growth of output per man-hour, largely the result of the GM strike, resulted in a strong advance in unit labor costs.

GROSS NATIONAL PRODUCT

The market value of the nation's total output of goods and services edged up $5.4 billion during the fourth quarter of 1970 (see Chart I) to a seasonally adjusted annual rate of $990.9 billion, according to the Department of Commerce's preliminary estimate. This increase was less than half the average rise in GNP in the preceding three quarters and was the smallest quarterly increment since the first quarter of 1967. The depressing influence of the automotive strike on the economy was sizable though difficult to quantify precisely. After allowing for the effects of inflation, the output of real goods and services fell at an annual rate of 3.3 percent in the fourth quarter. This decline, coupled with that in the first quarter, more than offset the small gains in real GNP in the interim quarters. Thus, for the year as a whole, real output fell below the production level recorded in 1969; not since 1957 had there been a year-to-year drop in real GNP.

The rate of increase of final expenditures—GNP less inventory investment—abated in the final quarter of 1970. The increase in final spending was barely half that of the previous quarter. Underlying this slowdown were outright cutbacks in consumption spending on durable goods, in business fixed investment, and in defense spending by the Federal Government. These reductions, however, were more than offset by increases in consumer spending on nondurable goods and services, in residential housing expenditures, and in state and local government spending.

Businesses' inventory investment acted as a drag on the expansion of GNP in the fourth quarter. According to preliminary estimates based mainly on data for the first two months of the quarter, the annual rate of accumulation of inventories fell by $1.4 billion to $4.1 billion, following slight accelerations in the preceding two quarters. This slowdown primarily reflects the activities of retail automobile dealers who continued to sell automotive products after the strike had begun. Elsewhere in the economy, particularly at the wholesale trade outlets and durables manufacturing firms, the pace of inventory accumulation quickened in October and November. At the same time, manufacturers' sales declined, with most of the decrease centered among durables producers, so that it appeared that inventory stocks were somewhat in excess of requirements. The increases in the inventory-sales ratios for the durables and nondurables manufacturing sectors were reversed in December, owing to a slight

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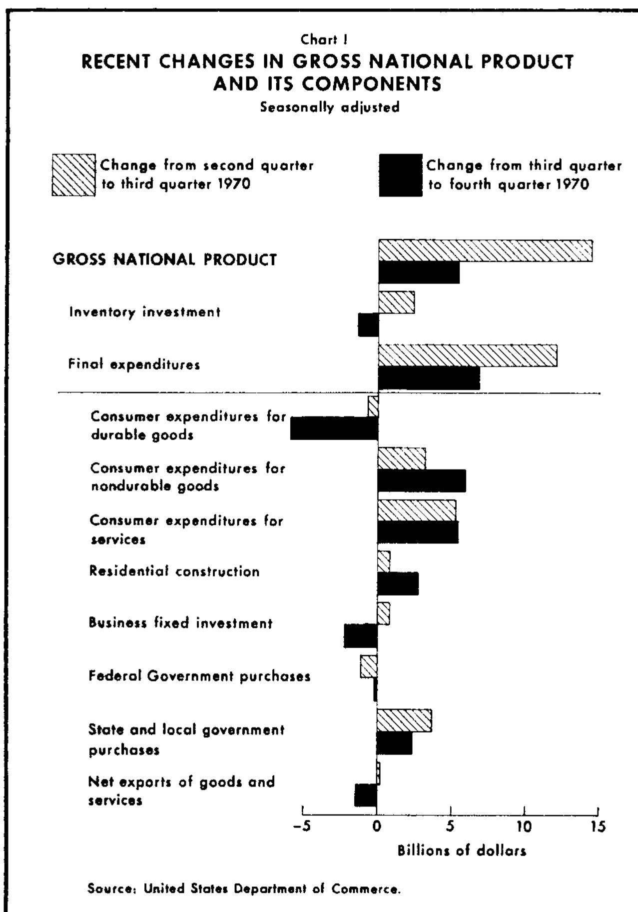
decumulation of inventories and an increase in sales in both sectors.

The growth in personal consumption expenditures dropped rather sharply in the fourth quarter. This slowing reflected the reduction in spending on durables, while outlays on nondurable consumer goods and services accelerated slightly. The 6.4 percent decline in spending on durable goods in the fourth quarter was the largest such decrease since 1951. All of the decline centered in the automotive component of durables spending, as the strike-related effects reinforced an apparently underlying weakness in automotive demand. Outlays on consumer nondurables and services in the fourth quarter increased by $11.3 billion. Looking at the year as a whole, consumer spending exclusive of durables expenditures increased slightly more than in the previous year, while durables spending posted a substantial decline, only part of which was attributable to the GM strike.

Although consumer spending slowed, it outpaced the very small $3.9 billion rise in disposable income in the fourth quarter of 1970. As a result, the personal savings rate dipped 0.3 percentage point to a still high level of 7.3 percent. During the last three quarters of 1970, the savings rate averaged 7.5 percent. This prolonged period of very high levels of personal saving is most unusual by historical standards. Whether or not the savings rate will move downward this year is one of the key factors which will determine the pace of overall economic activity over the course of the year.



Spending on residential structures expanded by a substantial $2.8 billion in the fourth quarter, the largest increase since the third quarter of 1967. This increase followed declines in the first two quarters and a small rise in the third quarter of 1970. The upward trend in spending on residential construction gives promise of extending for several months to come, according to advance indicators. For example, in the closing month of 1970, the rate at which new housing units were begun surged 18 percent and building permits issued by local authorities jumped 17 percent.

Because work progresses on a new housing structure for some time after the unit is begun, the expenditures series lags the housing starts series. Housing starts fell in the first quarter of 1970 to the lowest level since the second quarter of 1967 and have risen in each subsequent quarter, so that fourth-quarter seasonally adjusted starts were on the average 40 percent above those in the beginning quarter. Both single-family and multifamily structures have participated in this recovery, though single-family units expanded at a somewhat faster rate. Following the movement in the starts series, residential expenditures bottomed out in the second quarter and have gained momentum since then; in the fourth quarter, expenditures were 13 percent higher than those in the second. The sharply increased activity in this sector stems from the increased availability of mortgage financing as well as from the swelling of Federal housing subsidy programs. Large inflows of funds into savings institutions—the result, in part, of the high personal savings rate and declines in market interest rates which have improved the competitive position of thrift institutions—have led to some easing in the terms under which new mortgages are extended. Indicative of this trend were the December and January reductions in Federal Housing Administration-insured and Veterans Administration-guaranteed rates and the January lowering of conventional mortgage interest rates by some large New York City commercial banks.

After increasing slightly in the preceding two quarters, business fixed investment fell in the fourth quarter, the result of reduced spending on both structures and pro-

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ducers' durable equipment. The slight fall in expenditures on new business structures marks the third successive quarterly decline. Since trucks and fleet automobiles are an important component of businesses' equipment expenditures, the decline in equipment spending was due mostly to the GM strike. Thus, the resumption of production at GM is likely to boost this component of capital spending somewhat in the current quarter. Apart from the strike, however, business fixed investment spending appears to have leveled off. Separate surveys by McGraw-Hill and by the Commerce Department and Securities and Exchange Commission indicate that firms are planning to increase their plant and equipment expenditures in 1971 by a modest 1 to 2 percent; moreover, all of this increase is scheduled by nonmanufacturing firms, while manufacturers reported that they were planning a cutback in capital spending. This projected weakness reflects, among other things, the depressed level of corporate profits, sluggish sales, and the increasingly large proportion of unused capacity. After these surveys were taken, the Treasury announced its intention to ease the rules by which businesses may depreciate their capital equipment. Nevertheless, it seems unlikely that this move will spur producers' durable equipment spending significantly unless there are concurrent improvements in underlying business conditions.

Increased spending by state and local governments contributed $2.4 billion to the small gain in current-dollar GNP in the fourth quarter. This was somewhat below the rise in state and local government expenditures in the previous quarter. Taking the two quarters together, however, such spending rose at a faster rate than in any half year since the first half of 1968. This acceleration was to some extent related to the marked easing in credit market conditions which characterized the last six months of 1970. Federal Government expenditures, on the other hand, declined slightly in the final quarter of 1970, as a result of a further decrease in defense spending. This more than offset a resurgence in nondefense outlays which followed a net decrease in such spending over the three previous quarters.

PRICE DEVELOPMENTS

All of the increase in current-dollar GNP in the final quarter of 1970 stemmed from rising prices. The rate of increase of the implicit price deflator for total GNP accelerated to 5.7 percent in the fourth quarter, up considerably from the 4.5 percent average rise in the previous two quarters. Much of this acceleration resulted from the compositional shift in output associated with the strike. The implicit deflator is a weighted average of price indexes for all goods and services; the weight attached to a particular good or service is equal to the proportion of total expenditures in real terms (1958 dollars) that is spent on it in the current quarter. Since 1958, automotive prices have risen less than prices of other goods, so that the price index for autos is low relative to the price indexes for other goods and services. With the output and consumption of automotive goods depressed in the fourth quarter, the composition of output was concentrated in goods with higher price indexes. Even if all prices had remained constant in the fourth quarter, this compositional shift would still have caused the deflator to rise.

The importance of such compositional shifts in the "output mix" as a source of changes in the implicit deflator is not limited to the latest quarter. As an alternative price index, one which abstracts from compositional shifts, the weights used in computing the GNP deflator could be set equal to their value in a particular period—say, the fourth quarter of 1965—and not allowed to change. Any variations in this alternative constant-weight price index (to which class belong the consumer and wholesale price indexes) solely reflect price changes. A comparison of movements of this constant-weight price index with the implicit price deflator (see Chart II) provides a rough guide as to the importance of compositional shifts in inducing changes in the implicit deflator. While the two indexes have moved on a yearly basis along broadly similar lines, their quarterly rates of acceleration or deceleration have differed. In the fourth quarter, this constant-weight price index for total GNP rose at an annual rate of 5.0 percent, only slightly higher than the 4.9 percent average increase for the previous two quarters. Thus, as technical factors were largely responsible for the acceleration in the GNP deflator, it appears that the underlying price situation was essentially unchanged in the fourth quarter. Inflation still gave no clear sign of having yielded to the economic slowdown.

Consumer prices in December rose 6.4 percent on a seasonally adjusted annual rate basis, considerably above the 3.7 percent November advance. As the rate of increase in prices of services declined somewhat, all the December acceleration in the overall index stemmed from rising commodities prices. After falling slightly in November, food prices posted a 2.7 percent rise in December, thus contributing partly to the speedup in consumer prices. The rate of increase in nonfood consumer prices also accelerated in December to 6.7 percent, well above the 4.6 percent average monthly increase for the year ended in November. During the fourth quarter, consumer prices

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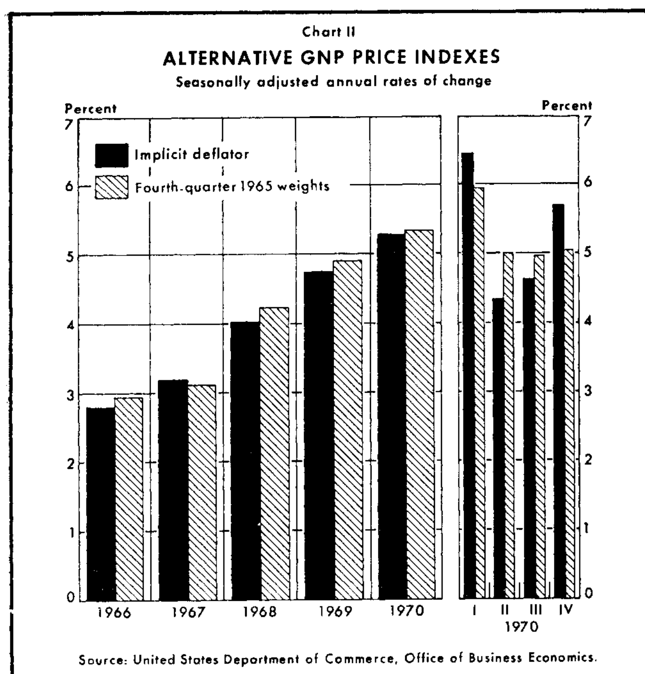

increased at a faster rate. While prices of services and food both contributed to this development, most of the quarterly acceleration stemmed from nonfood commodities prices which increased 5.8 percent in the fourth quarter, compared with the 3.9 percent growth in the previous quarter. At the wholesale level, prices increased 4.6 percent on a seasonally adjusted annual rate basis in January, after remaining unchanged in December. A sharp jump in wholesale agricultural prices entirely accounted for the January acceleration, while the rate of increase in wholesale industrial prices dropped from 4.0 percent in December to 1.7 percent in January.

PRODUCTION AND EMPLOYMENT

Following the resumption of production at GM, the Federal Reserve Board's index of industrial output climbed 1.4 percent on a seasonally adjusted basis to 163.9 percent of the 1957-59 average. Apart from the increased automotive production, it appears that the pace of the economy was little changed from the preceding month; industrial output less the automotive component nosed up only 0.1 percent and was 5.5 percent below the peak attained in July 1969. Output of motor vehicles and parts jumped 45 percent but failed to reach the pre-strike level. For the most part, this reflected the slow production start-up at GM, but production and sales of automobiles by GM's competitors were decidedly sluggish at the close of the year, leading to some employment layoffs.

The surge in automotive production was reflected in varying degrees in all the market grouping indexes. Within the consumer goods category, a decline in the production of appliances was offset by a rise in that of consumer staples, so that the index for nonautomotive consumer goods was unchanged. Thus, the 2.4 percent rise in the overall consumer goods index was attributable wholly to the automotive component. Reflecting the increase in truck production, the index for defense and business equipment edged up, while declines were registered in the production of industrial equipment, defense goods, and commercial aircraft. Finally, the materials index advanced, the result in part of increased iron and steel output stemming from the automotive start-up.

Concurrent with the fourth-quarter decline in real output, labor market conditions eased noticeably. While part of this deterioration was associated with the GM strike, the December data suggest that the easing went beyond the direct and indirect effects of the strike. In December, the unemployment rate rose 0.3 percentage point to 6.2 percent despite the resumption of production at GM. This latest rise in joblessness brought the average unemployment rate for the quarter to 5.9 percent, well above the third-quarter average of 5.2 percent and dramatically above the 3.7 percent level that prevailed in the fourth quarter of 1969. In January, the unemployment rate fell slightly to 6.0 percent.

The data for nonagricultural payroll employment also reflect some slippage during December. About 180,000 workers were added to the payrolls of nonagricultural firms. This gain was more than accounted for by the 276,000 increase in manufacturing jobs, which reflected the return to work of most of the 350,000 striking automotive workers. Nevertheless, at its December level of 18.8 million workers, manufacturing employment was still 460,000 below the August pre-strike level and was more than 1 million below the December 1969 level. Similarly, total nonagricultural employment in December 1970 failed to return to its pre-strike level and was about 600,000 below the December 1969 level. In January, total nonagricultural employment posted an increase of about 200,000, which was centered in the services and trade sectors while manufacturing employment was virtually unchanged.

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Banking and Monetary Developments in the Fourth Quarter of 1970

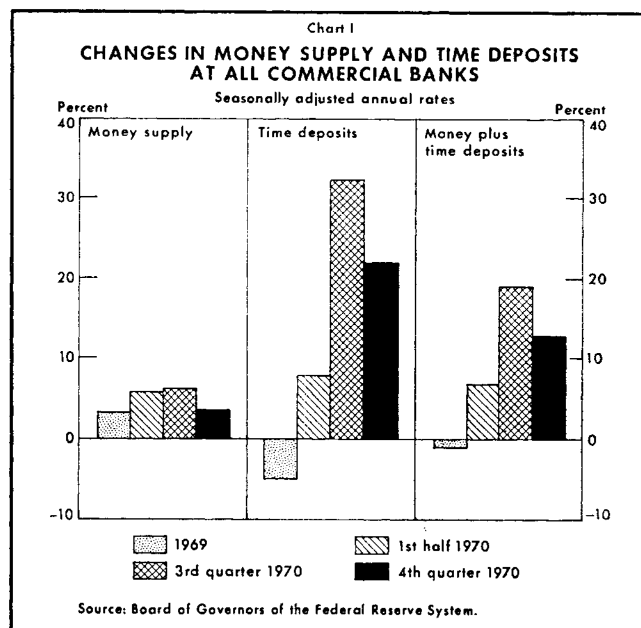
The rechanneling of credit flows through the banking system that had begun at midyear continued to be a dominant feature of banking developments in the fourth quarter of 1970. While inflows of funds through time deposits were substantial, loan demand was weak, prompting a succession of three ¼ percentage point reductions in the prime lending rate. The weakness of business loans in particular may have been intensified by the ten-week strike at the General Motors Corporation. This same factor also contributed to a reduction in the public's demand for cash balances, which in turn resulted in a slowing in the rate of growth of the money supply. Reflecting the ample availability but slackened demand for funds, short-term interest rates declined sharply over the quarter.

As a result of the sharp run-up in time deposits and the slack loan demand, commercial banks added to their securities holdings at a rapid pace. Consequently, the liquidity position of the banking system improved further, as the loan-deposit ratio declined and the liquid asset ratio increased. In a related development, the banks continued to reduce their dependence on nondeposit sources of funds by further decreasing their borrowings in the Euro-dollar and commercial paper markets.

SOURCES OF FUNDS TO THE BANKING SYSTEM

During the fourth quarter of 1970, the rate of growth of the money supply—privately held demand deposits and currency—was a modest 3.4 percent (see Chart I) as the slackness in the economy, reinforced by the effects of the strike against General Motors, restrained the transactions demand for money. Money supply expansion was particularly slow in October and November, when the seasonally adjusted annual rates of gain were 1.1 percent and 2.8 percent, respectively. Growth of the money stock rebounded in December to a rate of 6.2 percent. However, for the quarter as a whole, the rate of expansion of this monetary aggregate was appreciably below the 6 percent rate of growth achieved over the first nine months of 1970. The relatively slower growth of the money supply in the fourth quarter reflected the sluggish performance of the demand deposit component, which grew at only a 2.7 percent annual rate in the final three months of the year, while currency outside banks increased at a 5.8 percent annual rate.

In contrast to demand deposits, total time and savings deposits at all commercial banks advanced at a very rapid 21.8 percent seasonally adjusted annual rate during the fourth quarter. This brought the growth rate of total commercial bank time deposits to almost 28 percent over the second half of the year. By way of contrast, during the last six months of 1969, time deposits contracted at a 6.6 percent rate. Weekly reporting bank data, which are not adjusted for seasonal variation, indicate that time and savings deposits other than large negotiable certificates of deposit (CD's) rose by about $1.7 billion in the October-December period. The major gains were in large CD's, which rose $3.8 billion in the fourth quarter to $26.1 billion, or $1.8 billion above the late-1968 peak (see Chart II). From late June, when Regulation Q interest rate ceilings on time deposits of $100,000 or more



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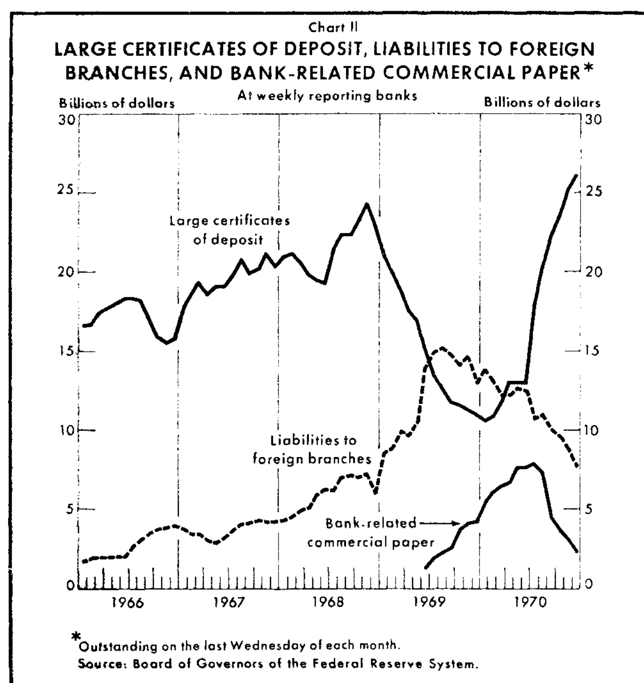

maturing in 30 to 89 days were suspended, to December 30, CD's outstanding climbed by an enormous $13.1 billion.

The strong growth of CD's during the fourth quarter reflected their enhanced attractiveness to investors, as rates of interest on competing investments declined dramatically. For example, the yield on three-month Treasury bills declined by 130 basis points over the fourth quarter to 5 percent at the end of the year. The rate on dealer-placed prime four- to six-month commercial paper fell even more sharply—by 138 basis points to 5.75 percent. As CD funds poured into the banks, offering rates for CD's were also lowered substantially. By the end of the year, such rates were well below the Regulation Q ceilings for all maturities, including those on short-term deposits that were suspended last June. Thus, the former Regulation Q ceiling on large CD's maturing in 30 to 59 days was 6¼ percent. In early July, after the suspension of the ceiling, offering rates on this maturity of CD's ranged from 7½ to 8 percent. By the end of December, however, the offering rate was down to a range of 5⅛ to 5½ percent.

With the surge in time deposits, the so-called "broad money supply"—private demand deposits and currency plus commercial bank time deposits—expanded at a seasonally adjusted annual rate of 12.7 percent over the October-December quarter. This marked the second consecutive quarter of large divergence in the growth of the narrow and broad money supply measures, for in the third quarter of 1970 the former rose at a 6.1 percent annual rate while the latter increased at a rate of almost 19 percent (see Chart I). For the year as a whole, the broad money supply grew by 11.8 percent, more than double the 5.4 percent growth of the narrowly defined money stock.

Given the heavy inflows of time deposits, commercial banks continued to shift away from nondeposit sources of funds in the fourth quarter. The amount of bank-related commercial paper outstanding, which dropped by about $3 billion in the last seven weeks of the third quarter, fell another $2.2 billion over the final three months of the year. Thus, at the end of December, bank-related commercial paper outstanding totaled $2.3 billion, far below the peak of $7.8 billion recorded in July 1970. In part, the runoff in bank-related paper was induced by the imposition of reserve requirements on funds acquired by banks from the sale of such paper.[1] Loans sold outright to affiliates of large commercial banks declined concurrently with the drop in bank-related commercial paper, falling from a level of approximately $8 billion in July to $2.7 billion at the end of the year.

United States banks considerably reduced their liabilities to foreign branches in the fourth quarter as well. Such liabilities stood just under $10 billion at the end of September, and three months later they amounted to only $7.7 billion, or just one half of their October 1969 high. In an attempt to stem the decline in Euro-dollar borrowings, the Board of Governors of the Federal Reserve System initiated a series of regulatory changes which took effect in the four-week reserve computation period ended December 23, 1970.[2] However, because Euro-dollar rates were substantially higher than rates in the domestic CD market, the relative cost of Euro-dollar borrowings to the banks was high. Thus, banks reduced their liabilities to foreign branches by an additional $1 billion in December, although some of this decline may have been due to special year-end factors. For all of 1970, liabilities to foreign branches dropped by $5.3 billion.

The adjusted bank credit proxy—a measure of bank liabilities which includes deposits subject to reserve re-

[1] See this *Review* (September 1970), page 213.

[2] For a more complete discussion of the measures instituted by the Federal Reserve Board, see this *Review* (December 1970), page 278.

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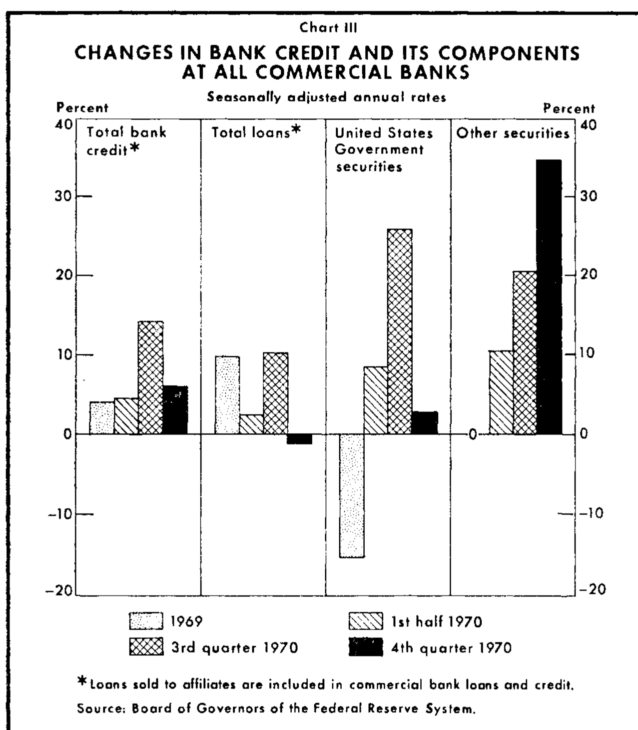
quirements plus Euro-dollar and commercial paper liabilities—expanded at a seasonally adjusted annual rate of 8.3 percent in the fourth quarter, equal to its performance for the year as a whole. Growth of the proxy proceeded very slowly in October but accelerated as the quarter progressed. The buildup in time deposits accounted for much of the increase in the proxy over the quarter.

BANK CREDIT AND LIQUIDITY

During the fourth quarter, total bank credit, excluding loans repurchased from affiliates, rose at a seasonally adjusted annual rate of 6 percent (see Chart III). This contrasts with a very sharp 14 percent rate of growth during the third quarter, when bank credit was swollen by bank lending to borrowers who were unable to roll over maturing commercial paper. Thus, while the rise in bank credit moderated from the unusually rapid pace of the third quarter, the October-December increase brought the yearly advance in bank credit to 7.4 percent, almost double the rise recorded in 1969.

A change in the composition of total bank credit which was evident in earlier months became more pronounced in the fourth quarter of 1970, as investment holdings rose markedly while bank lending contracted. Total bank loans declined at approximately a 1 percent seasonally adjusted annual rate during the October-December quarter, after expanding at almost a 5 percent annual rate over the first nine months of the year. Consequently, total loans increased by 3.4 percent for all of 1970. Commercial bank holdings of securities, on the other hand, grew at a rapid seasonally adjusted annual rate in excess of 20 percent in the fourth quarter and by 16.6 percent for the entire year. This is in sharp contrast to the 1969 experience, when securities holdings dropped by 7.2 percent as commercial banks liquidated their investments in order to obtain loanable funds.



In the fourth quarter of 1970, the buildup in bank investment holdings was concentrated in securities other than those issued by the United States Government. This category, consisting principally of obligations of state and local governments, climbed at a 34.5 percent annual rate in the October-December period, compared with the 2.8 percent rate at which banks increased their holdings of United States Government securities during the quarter. While the divergence in growth of the components of bank securities holdings was not so large for all of 1970, it was nevertheless substantial, since banks added Governments to their portfolios at a rate of almost 12 percent and increased their holdings of other securities by 20.1 percent over the entire year.

Large gains in time deposits together with slack loan demand—and particularly a weakness in business loans—contributed to the buildup in investment holdings in the fourth quarter. For the quarter as a whole, business loans outstanding at weekly reporting banks fell by $1.3 billion on a nonseasonally adjusted basis, whereas during comparable periods in 1968 and 1969 these loans increased by $3.8 billion and $3.5 billion, respectively. Reflecting this contraseasonal contraction, business loans at all commercial banks declined at a seasonally adjusted annual rate of 9.5 percent during the final quarter of 1970. This occurred despite two ¼ percentage point reductions in the prime lending rate in November and a third ¼ percentage point reduction in late December, which brought the prime rate to 6¾ percent at the year-end. This was down from 8½ percent a year earlier. Despite this sizable cut, business loans increased by only 2.0 percent in 1970 as compared with the 13.2 percent expansion in these loans in 1969.

Many factors, including the ten-week automobile strike and a sluggish level of economic activity, contributed to the weak performance of business loans. Beyond these considerations, however, the fourth-quarter contraction in these loans was partially attributable to the fact that corporations used some of the proceeds of bond flotations to retire existing short-term debt. In the fourth quarter,

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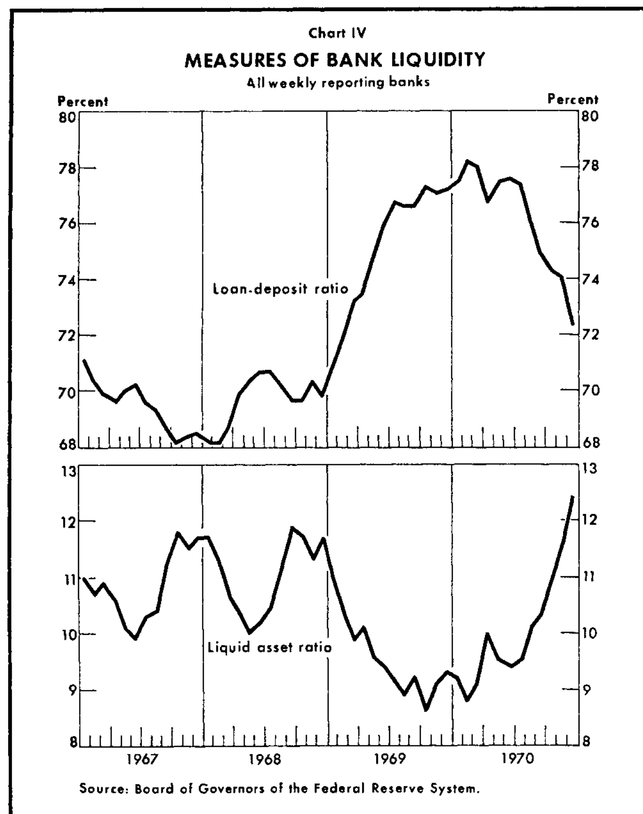

corporate borrowing in the capital market was extremely heavy. Public offerings of corporate bonds alone totaled $7.5 billion, bringing to $25 billion the total of such sales for the year. This was about $12 billion higher than the level of corporate bond flotations in 1969 and about $10 billion greater than the total in 1967, the previous record year.

Among other loan categories, the growth of real estate loans accelerated moderately from the slow pace of the first nine months of the year. Consumer loans were about unchanged on a seasonally adjusted basis in the fourth quarter, following moderate growth in earlier months of the year. Loans to nonbank financial institutions continued to increase at about the same moderate rate as during the previous nine months. The only loan category to put on a strong performance during the final three months of the year was securities loans, which rose sharply along with dealer inventories.

With loan demand weak and time deposit inflows strong, bank liquidity continued to improve in the fourth quarter (see Chart IV). The expanded loan-deposit ratio—the ratio of loans (other than loans to brokers and dealers) to deposits (less cash items in the process of collection) plus liabilities to foreign branches—decreased by about 2.7 percentage points at weekly reporting large commercial banks, reaching 72.2 percent in December. This was the lowest the ratio has been at these banks since February 1969 and, moreover, represented a significant decline from the 1970 high of 78.2 percent registered in February. Inspection of an alternative measure of commercial bank liquidity, the liquid asset ratio,[3] indicates similar marked improvement. At all weekly reporting banks, the liquid asset ratio climbed from 10.3 percent in September to an unusually high level of 12.5 percent in December.

THRIFT INSTITUTIONS

During the final three months of 1970, deposit inflows at the nation's mutual savings banks and savings and loan associations continued to strengthen, thereby extending the strong upward thrust in deposit activity that had begun in the second quarter. Total thrift institution deposits are estimated to have increased at about an 11 percent seasonally adjusted annual rate in the fourth quarter, up somewhat from the 9.5 percent rate of growth registered in the third quarter. This strong performance of deposit flows is attributable, in part, to the very high level of personal savings during recent quarters. Beyond this, however, the competitive position of these institutions improved steadily during the second half of the year, as market interest rates on instruments which compete with the thrift institutions for funds moved progressively lower.

In the fourth quarter, savings and loan associations continued to experience somewhat stronger deposit inflows than did mutual savings banks, and the growth of their mortgage holdings remained more rapid as well. Over the October-December period, deposits and mortgages at savings and loan associations both expanded at an annual rate of about 12 percent, whereas deposits at mutual savings banks rose at a rate of about 9 percent and mortgages at a 3 percent annual rate, according to preliminary estimates.

[3] The liquid asset ratio is defined as loans to brokers and dealers, loans to domestic commercial banks, Government securities due within one year, balances with domestic commercial banks, bankers' acceptances, municipal tax warrants, and short-term notes as a percentage of total liabilities excluding capital accounts.

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The Money and Bond Markets in January

During January, investor optimism regarding the future course of interest rate movements generated a resurgence and acceleration of the bond market rally that had waned in the latter half of December. Yields on intermediate-term Treasury securities declined as much as a full percentage point over the month, and long-term Treasury bond yields were down by as much as half a percentage point (see Chart I). At the same time, yields on newly issued high-grade corporate bonds declined more than a full percentage point during the month to their lowest level in more than two years. *The Weekly Bond Buyer's* index of yields on twenty municipal bonds fell 42 basis points to 5.16 percent, almost 2 percentage points below its record high of 7.12 percent posted in May 1970.

While this historic performance was taking place in the nation's bond markets, sluggish demand for short-term loans sent virtually all money market rates tumbling downward. The commercial bank prime rate was lowered from 6¾ percent to 6 percent in a series of three ¼ percentage point reductions, and two ¼ percentage point reductions of the Federal Reserve discount rate brought it to 5 percent. The bid rate on three-month Treasury bills declined 70 basis points to 4.15 percent, down nearly 4 percentage points from its peak level at the end of 1969. Similarly, rates on bankers' acceptances and commercial paper were reduced by ¾ to 1⅛ percentage points over the month.

Preliminary figures indicate that the money supply—private demand deposits plus currency outside banks—grew at an annual rate of about 3 percent in January, in line with the 3.4 percent rate of growth in the fourth quarter of 1970 but down from the 5.4 percent growth achieved in all of 1970. In contrast, the growth of the adjusted bank credit proxy, a more comprehensive measure of commercial bank liabilities, accelerated to an annual rate of about 10 percent in January from 8.3 percent over the previous quarter and for all of 1970. The divergence between the growth rates of these two aggregates was largely attributable to continued rapid growth of time deposits (see Chart II).

THE GOVERNMENT SECURITIES MARKET

The focal point of attention in the Government securities market was the Treasury's February refinancing, the terms of which were announced on January 20. The Treasury took advantage of the buoyant tone of the market to prerefund several maturities. It offered to exchange the notes and bonds maturing February 15, March 15, and November 15, 1971 and February 15, 1972 for a 5⅞ percent note due in four and one-half years or a 6¼ percent note due in seven years. Public holdings[1] of the issues eligible for the exchange totaled $19.5 billion. Preliminary results indicate that by the time the subscription books closed on January 27 holders of $10.8 billion of these issues had elected to make the exchange. "Attrition" of the February 1971 issues—the proportion of publicly held maturing notes to be redeemed for cash—was 17.4 percent, a modest figure in light of there being no short-term issue in the exchange offer. The highly successful operation resulted in a significant lengthening of the average maturity of the privately held Federal debt to about three years eight months from its level of three years five months at the end of 1970.

Prices of outstanding Government securities rose sharply during January. The market for intermediate-term issues was initially restrained by dealers' attempts to lighten their positions in anticipation of the refunding. After this initial drift, however, selling pressure subsided and the sizable demand resulting from investor confidence in the downward thrust of interest rates more than offset any lingering sales pressure. The market was also buoyed by the good reception accorded new corporate issues. Coupon issues due within one year were rapidly bid up to prices reflecting their anticipated "rights" value in the refunding. By the

[1] Other than those of the Federal Reserve Banks and United States Government investment accounts.

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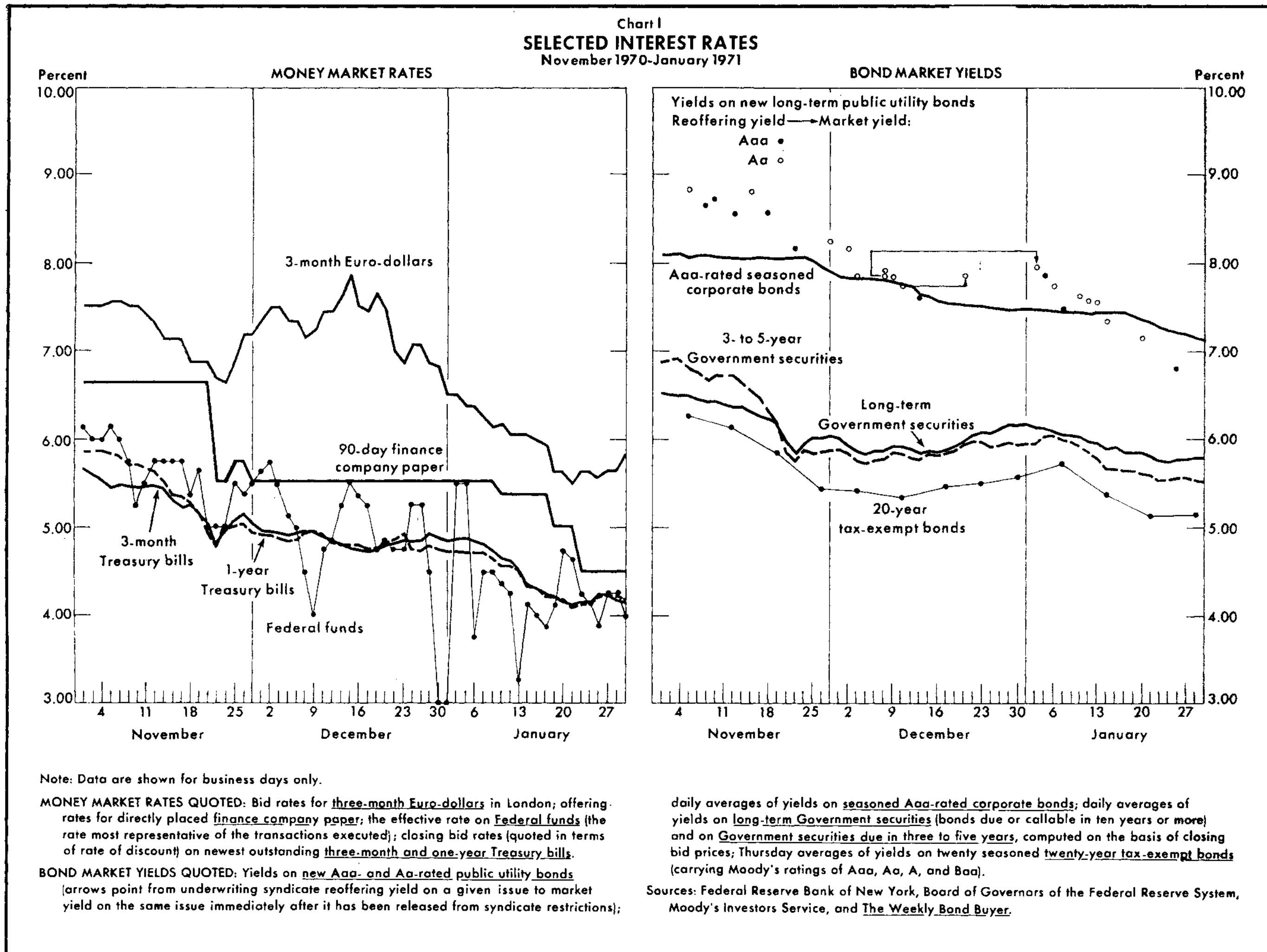

time the announcement of the refunding was made, the February 15 and March 15, 1971 notes and bonds had been bid up to prices generating negative yields. After the refunding terms became known, investor and dealer satisfaction with the Treasury's offer generated strong initial demand for the new issues, the rights issues, and the outstanding intermediates. There was particular interest in the February 1972 issues which had not been expected to be included in the refunding. Though weakness developed toward the end of the month, the new issues closed trading well above par, and the outstanding intermediates showed price appreciation of about 1 to 1½ points for the month. Prices of long-term Treasury bonds posted even larger gains, with price appreciation ranging from 2 to 4 points.

Treasury bill rates declined substantially over the month. Rates rose in the first few days of trading, largely in reaction to a reversal of window-dressing operations undertaken before the end of the year. But trading was relatively light and little selling pressure materialized, despite sizable dealer inventories. A better tone developed after the first reduction in the prime rate was announced on January 6, and yields proceeded to decline steadily, although there was some occasional profit taking. Activity became dull as the announcement of the Treasury's refinancing plans approached, with participants in this sector hesitating in the event the new offering contained a short-term issue. Rates declined sharply the day after the terms of the refunding became known, but demand was disappointing during the rest of the month. None-

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Table I
FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1971

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

Factors	Changes in daily averages— week ended				Net changes
	Jan. 6	Jan. 13	Jan. 20	Jan. 27	
"Market" factors					
Member bank required reserves	— 657	— 144	— 705	+1,008	— 498
Operating transactions (subtotal)	— 237	+ 148	+ 666	— 640	— 63
Federal Reserve float	— 250	— 676	+ 170	— 835	—1,591
Treasury operations*	+ 188	— 63	+ 108	— 275	— 42
Gold and foreign account	— 377	— 4	—	— 1	— 382
Currency outside banks	+ 319	+ 601	+ 456	+ 538	+1,914
Other Federal Reserve liabilities and capital	— 117	+ 289	— 66	— 68	+ 38
Total "market" factors	— 894	+ 4	— 39	+ 368	— 561
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+ 801	— 404	— 131	— 86	+ 180
Outright holdings:					
Government securities	+ 537	+ 19	— 236	— 65	+ 255
Bankers' acceptances	+ 2	+ 3	+ 2	— 1	+ 6
Repurchase agreements:					
Government securities	+ 185	— 327	+ 83	— 16	— 75
Bankers' acceptances	+ 26	— 40	+ 7	— 4	— 11
Federal agency obligations	+ 51	— 59	+ 13	—	+ 5
Member bank borrowings	+ 137	— 132	+ 196	— 117	+ 84
Other Federal Reserve assets†	+ 67	+ 17	+ 40	+ 34	+ 158
Total	+1,005	— 517	+ 103	— 169	+ 422
Excess reserves	+ 111	— 513	+ 64	+ 199	— 139
	Daily average levels				**Monthly averages**
Member bank:					
Total reserves, including vault cash	30,611	30,242	31,011	30,202	30,517‡
Required reserves	30,066	30,210	30,915	29,907	30,275‡
Excess reserves	545	32	96	295	242‡
Borrowings	407	277	471	354	377‡
Free, or net borrowed (—), reserves	138	— 245	—375	— 59	— 135‡
Nonborrowed reserves	30,204	29,965	30,540	29,848	30,139‡
Net carry-over, excess or deficit (—)§	210	249	63	— 12	128‡

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 January 27.
§ Not reflected in data above.

theless, rates on most bills declined by about ½ to ¾ percentage point over the month. The average issuing rate on the three-month bill fell to 4.20 percent in the final weekly bill auction of January (see Table II). This was 63 basis points below the rate set in the auction four weeks earlier and the lowest such rate since August 1967.

OTHER SECURITIES MARKETS

The strong demand for securities that prevailed throughout the money and capital markets enabled the corporate and municipal bond markets to absorb large volumes of new securities at rapidly declining rates. The yield on newly issued prime corporate bonds declined more than a full percentage point to the lowest level in more than two years, and a record volume of tax-exempt bonds was marketed at declining yields until late in the month. *The Weekly Bond Buyer's* twenty-bond index of municipal bond yields closed at 5.16 percent, 42 basis points below its level at the beginning of the month.

As the new year opened, there was some concern among corporate traders regarding the New York Telephone issue which had originally been awarded on December 14 and was still largely unsold. Pricing the securities to yield 7.60 percent in thirty-six years, the syndicate marketing the issue had refused to disband during the last week of the year—when bond trading is normally sluggish. A Northwestern Bell Telephone Aaa issue sold well on January 5 when priced to yield 7.85 percent, making it appear that the syndicate handling the New York Telephone issue would have to remove its price restrictions. But, on Thursday, January 7, after the prime rate cut had been announced, a Commonwealth Edison Aaa-rated issue was successfully reoffered at a yield of 7.45 percent, causing the New York Telephone yield to appear generous and the issue was rapidly sold out and rose to a premium.

In the municipal bond market there was evidence of investor hesitancy regarding poorer quality issues. At midmonth New York City, which has a Baa-1 rating, was forced to award $237 million of bonds at a net interest cost greater than the one it had incurred in October, despite the improvement in general market conditions. Yields on top quality tax-exempt issues declined substantially, however, as illustrated by the $121.3 million New Housing Authority issue which was awarded at a net interest cost of 4.95 percent on January 27. The last similar issue had carried a net interest cost of 5.84 percent two months earlier.

Investor resistance to rate declines began to appear toward the end of the month. A $200 million Southwestern Bell issue was only about one-quarter sold when priced to yield 6.80 percent on January 26. This left the corporate market with a formidable supply of unsold telephone bonds as it awaited a $500 million American Telephone and Telegraph Company offering scheduled for early February. In the municipal bond market, new issues also

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sold slowly late in the month, and the Blue List of advertised dealer inventories rose to nearly $1 billion from a midmonth low of about $600 million.

THE MONEY MARKET

Conditions in the money market were comfortable in January, as loan demand continued weak and System open market operations provided reserves generously. Reflecting this comfortable tone, member bank borrowings at the Federal Reserve averaged $377 million, up slightly from the December level but well below the average level of $803 million for all of 1970. The Federal funds rate averaged 4.14 percent, down 76 basis points from December, and the commercial bank prime rate was lowered from 6¾ percent to 6 percent. To bring it into alignment with other money market rates, the Federal Reserve discount rate was lowered in two steps to 5 percent, a level it had last seen in April 1968.

Table II

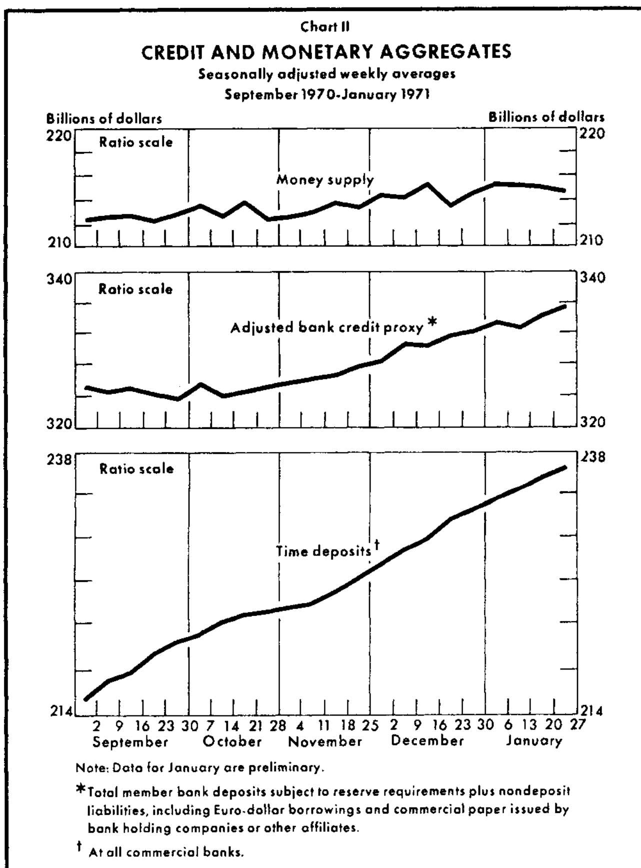
AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—January 1971			
	Jan. 4	Jan. 11	Jan. 18	Jan. 25
Three-month	4.921	4.640	4.213	4.201
Six-month	4.927	4.633	4.243	4.235

Maturities	Monthly auction dates—November 1970-January 1971		
	Nov. 24	Dec. 23	Jan. 26
Nine-month	5.083	4.949	4.268
One-year	5.009	4.886	4.248

* 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.



Note: Data for January are preliminary.

*Total member bank deposits subject to reserve requirements plus nondeposit liabilities, including Euro-dollar borrowings and commercial paper issued by bank holding companies or other affiliates.

† At all commercial banks.

Largely reflecting slow growth of private demand deposits, the money supply increased at an annual rate of about 3 percent in January, compared with 3.4 percent in the fourth quarter of 1970 and 5.4 percent for all of 1970. Time deposits continued to surge upward at about the same rapid rate as in the fourth quarter of 1970. In the four weeks ended January 27, large negotiable certificates of deposit rose by about $1 billion (not seasonally adjusted) to a record $27.1 billion. Liabilities to foreign branches were reduced by about $1 billion (not seasonally adjusted) to $6.7 billion. This decline, however, approximately matched a sale of 6 percent three-month notes by the Export-Import Bank. Such notes purchased by a bank's foreign branches may be counted in the bank's reserve-free base. The runoff in bank-related commercial paper slowed considerably in January. Such paper declined by about $300 million (not seasonally adjusted) to $2.0 billion. Total member bank deposits plus nondeposit liabilities—the adjusted bank credit proxy—increased at an annual rate of about 10 percent in January, according to preliminary figures. This compares with the 8.3 percent rate of growth achieved in the previous quarter and over all of 1970.

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