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New York City's Economy — Some Longer Term Issues

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Remarks at a panel discussion sponsored by Bernard M. Baruch College, Macy's, and The Committee on the Public Interest in New York City on November 7, 1975

As you know, this conference was organized sometime ago, and the general topic then was "challenges and opportunities of doing business in New York City". At the time I accepted the invitation to participate, I had in mind—as I'm sure most of us did—discussing the longer term problems and prospects for the basic economic health of our city. Although there were many pressing short-term problems brewing at that time, I had hoped that at least the more critical ones would have been settled by now so that we could by this time focus on the longer term. Unfortunately, that hasn't happened. Our short-term problems are obviously still very much with us, and they become even more critical with every passing week. Because these problems have been most demanding of our time and energy, none of us have had very much time to think about the longer term.

Nevertheless, I would like to take these few minutes to do just that—to focus on the longer term to see what we might hope for in the years ahead, but also perhaps to put into a better perspective some of our more pressing short-term problems. In talking about the city's financial and economic problems, I find it useful to separate them into three different, but related dimensions, somewhat parallel to the three principal types of financial statements.

To begin with, the most immediate, most acute, and shortest term problem the city faces is a problem of financing—a funding problem. This is a question of where and how the city can fund itself over the next few months. Given the levels of its short-term expenditures and income—over which there can be relatively little control within the short period we are talking about—the problem is one of cash flow.

The next dimension of the city's financial and economic problem centers on the budget and the need to balance it. Obviously, the budget problem is inextricably linked with the cash flow problem, but is quite distinct from it, just as the annual profit and loss statement is linked to, but is distinguishable from, a flow-of-funds statement. For our purposes, they must be distinguished because they require different kinds of solutions. There is no doubt that the challenge of balancing the budget is an immediate challenge and, in that sense, an immediate problem, but it cannot have an immediate solution. It is clear that the city needs time to achieve a balanced budget, although major steps have already been taken in that direction. The story of how we arrived at our present position on the budget is complicated but basically well known to all of us here. Without indulging in recriminations or trying to assign responsibilities, the important point is that we need to focus on how we can balance the budget as fast as possible. And we must recognize that it cannot be done overnight.

The third dimension of the city's financial problem, as I see it, is related to its longer term, basic economic situation. Again this is distinct both from the immediate cash flow problem and from the budget or "profit and loss" problem. It is, instead, analogous to a balance-sheet problem in that it involves analysis of the city's tangible and intangible longer run economic assets and liabilities. And it is this longer run situation that I'd like to talk about for a few minutes.

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First of all, I think it's useful to emphasize the fact that —quite apart from the greatly publicized recent problems of an unbalanced budget and the cash flow crisis—the city has for some years now suffered from an underlying economic problem. In several ways, New York shares this problem with other older cities generally, many of which have experienced a deterioration in their basic economic health over recent years. This deterioration can be measured by declines in jobs and in population, either absolutely or in relative terms. It is also reflected in various measures, some very intangible, of the "quality of life". The reasons for this general tendency—which really has to do with what I would call "natural" forces—are to be found simply in the evolution of the economic structure of our society. For example, the further development of transportation and telecommunications facilities has diminished the value of being located physically within large cities such as New York. Moreover, as the scale of cities has grown with growth in the general population, there have been increasing costs of congestion within the large cities. Over the years, there has also been a rising proportion of old and deteriorating physical plant, both publicly and privately owned. Such forces, by themselves, could be expected to cause problems for large cities in terms of economic growth over time. However, with good planning, such forces should be manageable and do not fully account for the acute crisis in which this city now finds itself.

In many ways, these natural forces of change seem to have been reinforced by governmental policies that have set in motion flows of businesses, jobs, and people that have tended to weaken the underlying economic strength of the city. For example, many Federal and state road construction programs have, in effect, subsidized the suburban areas by facilitating transportation and encouraging the emigration of businesses and families to the suburbs. At the same time, the relatively high levels of welfare benefits and public services have led to what, in effect, has been a subsidized in-migration of poor rural families, many of whom have only limited skills for coping productively with urban life. This pattern of population movement simultaneously increased the cost of social services in the city, and it also reduced—at least in the short run—the average economic productivity of its work force. No doubt the urbanization of this largely rural population will in the long run greatly benefit the nation. In the meanwhile, however, its costs have been borne disproportionately by New York and other similar cities. These costs have been reflected in disproportionately high tax rates, and these in turn—by driving out businesses, jobs, and relatively well-off taxpayers—have served to erode further the city's economic base. And, at the same time, of course, this has aggravated the more immediate problem of the city's budget.

What are the solutions to these kinds of problems—problems that are caused by government policies? Obviously, we can look for the answers in the government policies themselves. Without in any way trying to be exhaustive, it's easy to point to a few areas for obvious consideration.

In the first place, at the level of the Federal Government, the first thing that comes to mind is the possible federalization of our welfare system. In a nation whose population enjoys a high degree of mobility, a welfare system that permits disparate rates of support, and exerts an uneven burden on taxpayers, is bound to create severe problems and inequities in particular localities—and that has been the case in New York City.

Another area that needs some rethinking is the possible regionalization of some governmental services that are now paid for primarily by the city. Of course our problem in New York is complicated by the fact that our local region crosses state lines. But there is already a precedent for regional approaches—such as the MTA—and transportation obviously comes to mind as a possibility.

Another possibility deserving exploration is the assumption by the state of functions now paid for by the city that are treated as state functions in other parts of the country. For example, there has been mention of the court system and the penal system.

The fourth area that comes to mind relates to the policies of the city itself. To what extent have public policies of the city had the net effect of eroding its economic base? One policy that is often mentioned in this connection is the controversial subject of rent control. There are many sides to this question, but it certainly deserves further close analysis and study from an economic point of view. There are many other public policies that need reexamination, and indeed many of them are being looked at anew. One of the very basic questions, of course, relates to tax policy, and here, as with many of these other issues, we are faced with a dilemma. On the one hand, it is clear that a burdensome level of taxes will encourage the movement of businesses and population from the city. At the same time, tax revenues are an essential ingredient in coping with the city's immediate budgetary problems.

This is a most important issue. One of the challenges we face is that some solutions to the city's narrow budgetary problems may well prove inconsistent with solutions to its longer term problems. If at all possible, we should try to avoid short-term budgetary solutions that would worsen the longer term economic situation. And of course, in the longer run, any measure that weakens the city's economic

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base will ultimately feed back on the budgetary position adversely. It is not difficult to imagine a vicious cycle of budgetary changes that could in the end worsen budgetary problems even further. And this is especially relevant when we consider the capital budget, which is clearly an investment in the future.

Seen in this longer term prospective, it will not be easy to find satisfactory solutions to the immediate budgetary problems that the city faces. Simply increasing revenues by raising taxes, or simply cutting expenditures by reducing services, if nothing else is done, will have a long-range adverse effect. The real trick, and the real solution, to the budget problem as well as the long-term problem is to maintain the services—and the capital expenditures—that are essential to the city's longer term economic health but at a reduced cost. We should not let ourselves be deluded that the only way to reduce costs is to reduce output. Our aim should be to lower costs by increased productivity, increased efficiency, and the use of operations improvement methods. If we are able to do that in the shorter term, we should be able to preserve our economic base from further deterioration in the future. At the same time, of course, we urgently need to go to work on some of the longer term problems—problems that require changes in governmental policy—to strengthen further our economic base over the longer run and put us back on the path of long-term economic growth. There is no doubt that the city has the potential for the needed growth. Our basic assets are strong. While there has been some deterioration, it has been from a very high base. There is still much underlying strength in the city and, given the chance, that strength can show itself once again in the years ahead.

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The Business Situation

Economic activity has advanced sharply in recent months, but the upward impetus is still rather narrowly based. In the third quarter, the increment in gross national product (GNP) in real terms was the largest in twenty years. Over half of this gain, however, was attributable to the marked slowdown in the rate of inventory liquidation. Expansion in consumption spending, especially on durable goods, accounted for the rest of the increase. Elsewhere, there was barely any movement, as the small increases and decreases recorded for the other components of real aggregate demand were largely offsetting. Nor are there any clear-cut signals of developing strength in these other spending components. Looking ahead, once the inventory imbalance has been eliminated, it appears that the pace of the economic recovery will for a time be keyed closely to the growth in consumption spending.

While there continues to be a good deal of variability in the monthly price data, the overall rate of inflation was about 7 percent at an annual rate in the third quarter. This is a bit higher than the rate of inflation in the previous quarter but is still a substantial improvement over the double-digit increases recorded last year. However, the acceleration of wholesale industrial commodity prices in the past six months, together with the flare-up of these prices in October, is a worrisome development which suggests that the prospects for a significant slowdown in the near term are anything but certain. Whereas the huge overhang of inventories had fostered some moderation in price increases earlier in the year, this imbalance has been largely eliminated. Moreover, after having tapered off a bit, the rate of growth of wages appears to have quickened somewhat in recent months, and fuel and energy prices have been rising at a slightly faster pace.

GNP AND RELATED DEVELOPMENTS

According to preliminary estimates compiled by the Department of Commerce, the market value of the nation's output of goods and services (GNP) rose in the third quarter at a 16.8 percent annual rate of increase. Measured in terms of 1958 prices to correct for changes in the price level, the increment in real GNP amounted to a hefty 11.2 percent rate, up from the 1.9 percent rise of the previous quarter and the biggest quarterly gain in twenty years. Nevertheless, real GNP was still almost 5 percent below the peak recorded at the end of 1973.

Contributing most to the third-quarter surge in GNP was the sharp slowdown in the pace of inventory liquidation (see Chart I). Indeed, the slower runoff of business inventories accounted for more than half of the total gain in real GNP. In fact, the monthly data on the book value of business inventories (which are, however, measured differently than in the national income accounts) showed a sizable accumulation occurring in August for the first time since last January. Moreover, the August increase was broadly distributed throughout the trade and manufacturing sectors, the only exception being in the durables manufacturing industries. This pattern suggests that much of the inventory overhang has now been eliminated. Further corroborating evidence can be gleaned from the recent behavior of the ratio of real nonfarm business inventories to real final sales of the business sector. This ratio jumped to a record peak at the end of 1974; since then, it has declined steadily to about the level of the first half of last year. While imbalances still exist within certain segments of the economy, notably the durables manufacturing sector, it does look as though the inventory liquidation process will have run its course in the next few months. Once the inventory correction has been completed, the speed of the economic recovery will then be paced by the strength in real final sales.

In the third quarter, final expenditures—equal to GNP less the change in business inventories—moved ahead at a 4.4 percent annual rate in real terms, just about equal to the growth of the previous quarter. The sizable advance in consumption spending more than accounted for the increase in real final sales. Among the other components of aggregate demand, there were small increases and decreases which were largely offsetting, on balance.

Buoyed by the vigorous economic recovery, the one-shot 1974 tax rebates, the special payments to recipients of social security, and the 1975 tax reductions, disposable personal income has staged a fairly strong comeback since

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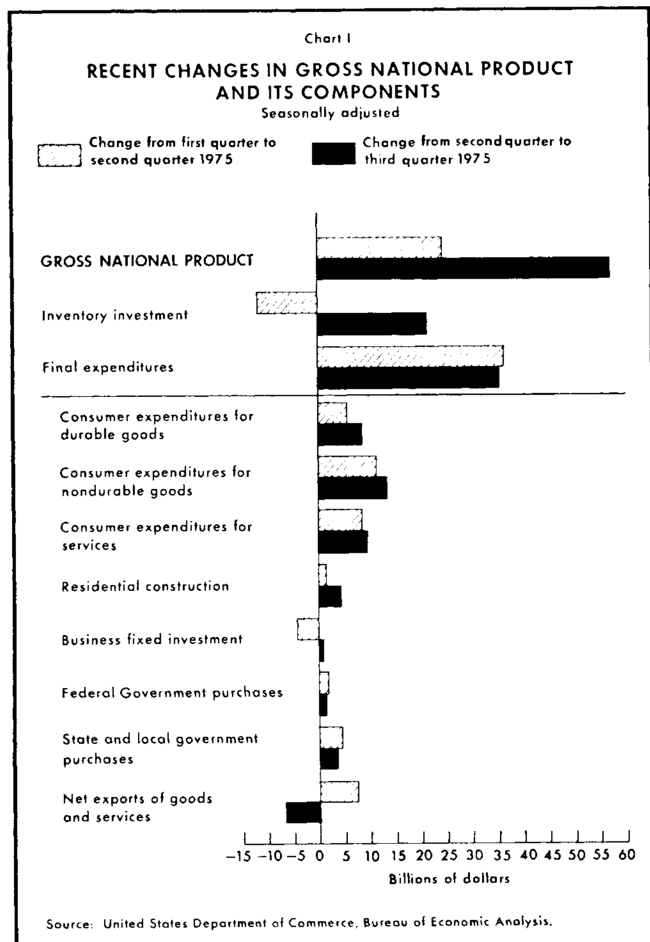

the beginning of the year in real terms. As of the first quarter, real disposable income had fallen 4.1 percent below the peak attained at the end of 1973, by far the largest postwar cyclical decline on record. Since then, real disposable income has rebounded sharply, though only half the real loss has been recouped.

In retrospect, the decline in real disposable income over the last two years appears to have been distributed unevenly among workers. Much of the decline can be attributed to the effects of the recession on employment, including the unusually sharp rise in the proportion of part-time to total employment, rather than a drop in the real wages of those full-time workers who have remained employed. Indeed, there has been some confusion over this point. Compounding the confusion is the fact that, according to data collected by the Bureau of Labor Statistics in its payroll survey, average weekly earnings have risen at a slower rate than the consumer price index since 1973 (see Chart II, but note that these are annual observations recorded as of May in each year). In large part, however, the erosion in this measure of the real wage has stemmed from compositional changes within the employed work force. First, while there had long been an uptrend in the proportion of part-time to total employment, the recently ended recession exacerbated this trend greatly, as many formerly full-time workers had to settle for part-time employment along with a sharp cutback in their weekly earnings. Second, for many years including the last few, the full-time work force has been composed of proportionately more women and young workers, both of whom tend to earn less than their adult male counterparts. Adjusted for changes in the age-sex composition, it turns out that the average weekly earnings of full-time workers, after accounting for the effect of inflation, fell only 4 percent between 1973 and 1975 (see Chart II). This was about half of the decline experienced by average weekly earnings in real terms, as measured by the establishment survey. It should be mentioned, however, that these estimates of weekly earnings are measured on a before-tax basis and, therefore, do not take into account the effect of inflation on workers' aftertax earnings. That is, even if consumer prices and before-tax wages do grow at the same rate, the progressivity of the personal income tax structure implies that workers will still experience a reduction in their real aftertax earnings. To some extent, of course, the legislated decreases in the 1975 personal income tax rates have partly offset this effect.

Spurred by the continuation of the recent gains in disposable income, real consumption spending advanced at a 7 percent annual rate in the third quarter, a shade higher than that of the preceding quarter. Consumption outlays have been the dominant factor in the current economic recovery. Since the opening quarter of the year, the expansion in real consumption expenditures has accounted for over two thirds of the total increment in real GNP. Even more importantly, the pickup in consumption has facilitated the liquidation of the huge overhang of inventories.

Consumer outlays on durables advanced briskly in the third quarter. Historically, no doubt because these purchases are postponable and often involve replacements, real consumption spending on durables has tended to move in a pronounced procyclical fashion (see Chart III). In recessions, the largest cutbacks in consumption spending occur in purchases of durable goods. In turn, during the ensuing recoveries, real durables outlays snap back vigorously. Indeed, in the four previous cyclical recoveries, the expansion in real consumption durables sales has averaged a bit more than 20 percent in the four quarters after the cyclical trough. The official date of the trough of the

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most recent recession has not yet been posted by the National Bureau of Economic Research, but it will probably be located in the second quarter since that is when industrial production bottomed out. Hence, given this tentative dating, the current resurgence in real consumer durables spending has to date surpassed those experienced in all previous postwar upturns, except for the 1970-71 recovery which was bolstered by the aftermath of the General Motors strike during the last quarter of 1970. Whether this rapid pace will be sustained in the months to come remains to be seen. Indeed, although the average level of domestic automobile sales in the third quarter was well above that of the preceding three months, the monthly sales pattern has been fairly flat from July to October.

In real terms, residential construction outlays posted a healthy advance in the third quarter, following a minuscule rise in the previous quarter and the precipitous two-year slide before that. The third-quarter increase in real residential construction outlays reflected a higher level of housing starts, compared with the level of the previous quarter.

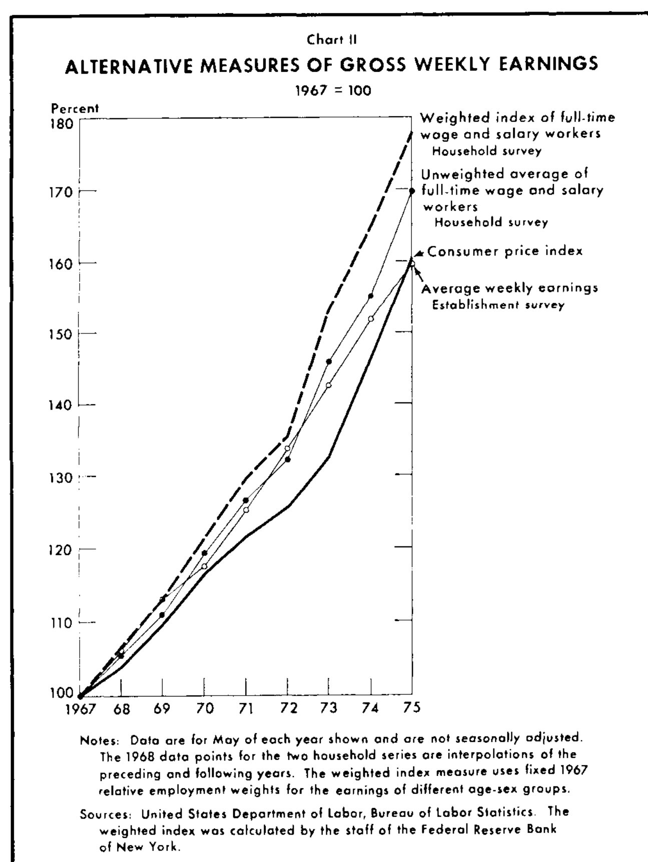

Chart II
ALTERNATIVE MEASURES OF GROSS WEEKLY EARNINGS
1967 = 100

Notes: Data are for May of each year shown and are not seasonally adjusted. The 1968 data points for the two household series are interpolations of the preceding and following years. The weighted index measure uses fixed 1967 relative employment weights for the earnings of different age-sex groups.

Sources: United States Department of Labor, Bureau of Labor Statistics. The weighted index was calculated by the staff of the Federal Reserve Bank of New York.

Housing starts were running at a 1.25 million unit annual rate in the July-September period, up from the 1 million unit rate averaged in the first half of the year. However, housing starts in September, the most recent month for which data are available, were essentially unchanged from the July level. In the third quarter, mortgage interest rates, which had been at very high levels by historical standards, edged up further. The average yield on Federal National Mortgage Association home-mortgage commitments rose about 80 basis points from the end of June to the end of September, although it declined about 20 basis points in October. While the high rates currently prevailing on home mortgages make them an attractive investment from the viewpoint of thrift institutions, they do tend to discourage potential home buyers from undertaking such long-range commitments. In addition to high mortgage costs, prospective homeowners may be concerned about the rapid run-up in the prices of fuels and utilities.

In the third quarter, business fixed investment spending was virtually unchanged in real terms from what it had been in the April-June period. This leveling off marks the end of a steep year-long contraction in real outlays on plant and equipment, which left these expenditures about 17 percent below what they had been a year previously. It is interesting to note that, in past cyclical recoveries, a turnabout in real outlays on plant and equipment has occurred either in the same quarter or one quarter after the business-cycle trough.

It remains to be seen, however, whether the pattern of real capital spending in the current recovery will turn out to be consistent with historical experience. To some extent, businesses may lately have boosted their capital spending in response to the temporary increase in the investment tax credit. This increase is due to lapse at the end of the year. Even if extended, however, the higher investment tax credit is not likely to exert much additional stimulus to capital spending, unless business conditions continue to improve in other respects. Indeed, capital spending within the key manufacturing sector remains weak, judging by the recent behavior of net new capital appropriations by the nation's 1,000 largest manufacturers. On a seasonally adjusted basis, net new appropriations have declined steadily from the peak of $15.9 billion recorded in the third quarter of 1974 to $8.8 billion in the second quarter of this year, the latest period for which data are available. In view of the significant lags separating appropriations, orders, and actual expenditures, the recent drop in net new appropriations has probably not yet had its full depressive effect on manufacturers' actual outlays on plant and equipment. Nevertheless, there seems to be a rather large backlog of unspent

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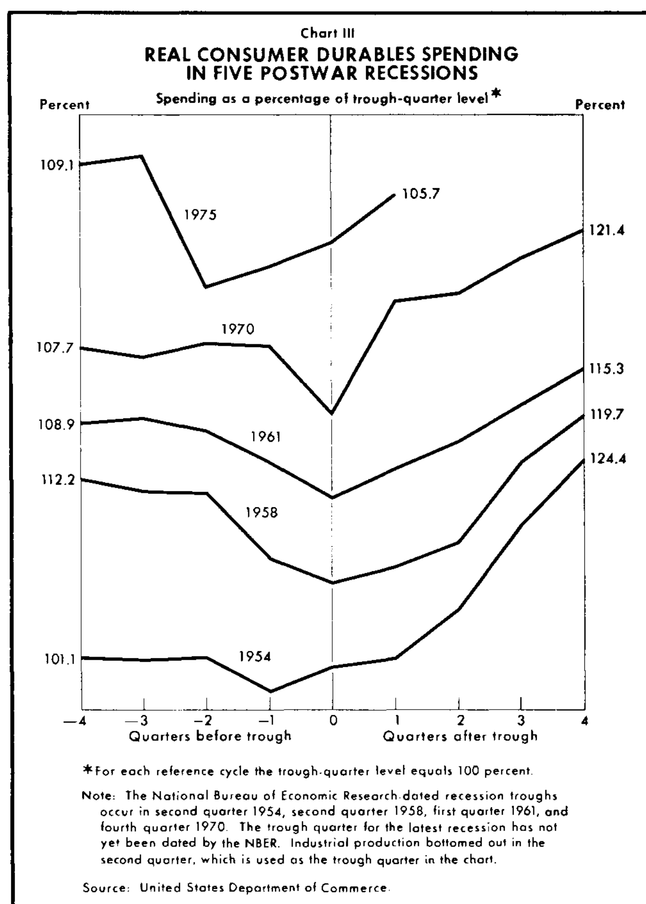

Chart III
REAL CONSUMER DURABLES SPENDING IN FIVE POSTWAR RECESSIONS
Spending as a percentage of trough-quarter level*

*For each reference cycle the trough-quarter level equals 100 percent.

Note: The National Bureau of Economic Research-dated recession troughs occur in second quarter 1954, second quarter 1958, first quarter 1961, and fourth quarter 1970. The trough quarter for the latest recession has not yet been dated by the NBER. Industrial production bottomed out in the second quarter, which is used as the trough quarter in the chart.

Source: United States Department of Commerce.

appropriations, suggesting that firms have lately been postponing projects rather than canceling them. Hence, if there were a pickup in the pace of real final sales, this would be an incentive for businesses to decide to go ahead with their postponed projects. The rundown in the backlog of unspent appropriations would impart added momentum to investment spending but probably not before the end of the year.

Net exports declined in the third quarter in both nominal and real terms, as imports of goods and services posted a larger advance than exports. Modest increases in this spending component in three previous quarters had acted as a stabilizing influence, albeit a minor one, just as it has in most postwar recessions.

PRICE SITUATION

Although erratic monthly movements in the recent price data have made their interpretation difficult, it nevertheless appears that the overall annual rate of inflation in the third quarter was about 7 percent. As measured by the GNP implicit deflator, prices of goods and services advanced at a 5 percent annual rate. However, the fixed-weight GNP price index, which is unaffected by compositional shifts in output, rose at a 7.2 percent seasonally adjusted annual rate, compared with 5.5 percent in the second quarter. In the previous postwar recoveries, price increases generally continued to moderate in the period immediately following the trough in industrial production. Hence, at this early point in the recovery, a significant acceleration in inflation would be an unusual and unlikely occurrence. Yet any further slowdown in the rate of inflation will be severely constrained by the underlying pressure from wages and materials costs.

Consumer prices rose at an 8.2 percent seasonally adjusted annual rate in the third quarter, up from the 5.8 percent advance in the previous quarter. Food prices increased at an 11.8 percent annual rate, mostly because of the large spurt in July. Similarly, nonfood commodity prices climbed at a 7.2 percent annual rate, also reflecting a July spurt and much more moderate advances in the last two months of the quarter. Prices of services exhibited modest gains through the months of the third quarter except in September when the large gain posted was primarily the result of the subway fare increase in New York City. Thus, while the third quarter's rate of price inflation was higher than the previous quarter, price gains tended to be moderate in the last two months of the quarter. In part, the midsummer flare-up in nonfood prices may have reflected an unsustainable slowing of price increases in the last months of the second quarter as firms were attempting to get out from under the very substantial inventory overhang.

At the wholesale level, there was a resurgence in inflation in October, following the very moderate advance in the previous month. The October run-up in wholesale industrial prices amounted to a rapid 14.4 percent annual rate and was paced by large price increases for milled steel products, new passenger cars, textiles and apparels, and lumber and wood products. Including the October spurt, wholesale industrial prices have steadily accelerated over the past six months. While this pattern probably in part reflects the unsustainably low price increases recorded in the second quarter, when so many firms were doggedly trying to get out from under the massive overhang of inventories, the prolonged upward thrust in the rate of inflation in wholesale prices is a rather worrisome development. Also, the wholesale prices of farm products and of processed foods and feeds posted a rather big increase in October, moving ahead at about a 20 percent annual rate.

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WAGES, PRODUCTIVITY, AND EMPLOYMENT

Recent data indicate that the pace of wage increases quickened somewhat in the third quarter. Compensation per hour worked in the private nonfarm economy rose at an 8.5 percent seasonally adjusted annual rate, up 1 percentage point from the rate of growth over the first half of this year but below the quarterly increases posted in 1974. Output per hour worked, which typically exhibits the largest advances in the early part of the recovery period, moved ahead at a 9.4 percent seasonally adjusted annual rate. As a result of these changes, unit labor costs edged downward at a 0.8 percent annual rate in the third quarter.

According to data gathered by the Labor Department on major collective bargaining settlements, the average effective wage of approximately 10 million unionized workers has risen at a 9.6 percent annual rate over the first nine months of the year, about the same as the 9.4 percent increase recorded in 1974. The average effective wage adjustment reflects first-year increases negotiated in the current quarter, deferred increases under earlier contracts, and cost-of-living raises accumulating under current and previous contracts. There was a sharp run-up in the effective wage rate in the third quarter, due to a substantial increase in cost-of-living adjustments as well as to larger deferred increases. For the entire private nonfarm economy, average hourly earnings—which are conceptually similar to the effective wage adjustments in the unionized sector—advanced at a seasonally adjusted annual rate of 7.1 percent, above the rate of increase in the first two quarters of the year. A better indicator of the level of wage rates in the private nonfarm economy, however, is the adjusted average hourly earnings series, since it abstracts from fluctuations in average hourly earnings which are attributable to interindustry shifts in employment and variations in overtime hours in manufacturing. In terms of quarterly averages, the adjusted average hourly earnings series posted a seasonally adjusted annual rate of growth of 8.3 percent in the July-September period, up slightly from the 7.8 percent increase during the first half of the year but below the 9 percent rise in 1974.

Nonfarm employment posted increases in both the household and payroll surveys in the month of October. However, a substantial increase in the labor force combined with a large reduction in agricultural employment resulted in a 0.3 percentage point increase in the civilian unemployment rate. According to the payroll survey of establishments, seasonally adjusted payroll employment increased by 217,000 workers in October, marking the fourth consecutive month of healthy payroll gains. As in previous months, manufacturing payrolls played an important role in the rise, accounting for about half of the October increase. The remainder of the rise was distributed between the services and government sectors. In the separate survey of households, nonagricultural employment moved ahead by 147,000 workers. However, agricultural employment fell by 124,000 workers in the month so that civilian employment was little changed on balance. At the same time, the labor force posted a substantial gain of 252,000 workers, and the seasonally adjusted civilian unemployment rate rose by 0.3 percentage point to 8.6 percent of the civilian labor force.

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The Money and Bond Markets in October

Interest rates in the money and bond markets declined sharply during October. The broad-based rally was precipitated by substantially easier conditions in the Federal funds market which emerged early in the month. Besides the lower trading range for Federal funds, market sentiment was affected favorably by a reduction in reserve requirements on longer term time deposits. Also adding to the improved tone of the markets were continued slow growth in the monetary aggregates and indications that the remaining Treasury debt financing for the year would be easily manageable.

Virtually all sectors of the money and capital markets participated in the rally, including the market for high-grade state and local government obligations. The demand for lesser quality municipal securities, however, continued to be adversely affected by New York City's fiscal crisis. The city narrowly escaped default at midmonth, but considerable apprehension remained over whether default could be avoided by early December or perhaps even in mid-November. At the end of October, amidst Congressional debate over providing Federal aid or loan guarantees to the city, President Ford announced his intention to veto Congressional legislation that would aid New York City prior to a default. In response to his announcement, large negotiable certificates of deposit of commercial banks (CDs) and high-quality municipal securities gave up some of the gains posted earlier in the month and yields on Treasury bills experienced additional moderate declines.

According to preliminary data, the narrow money stock (M_1) declined in October, following modest gains in the previous three months. Growth of the more broadly defined money stock (M_2) was sluggish, although the expansion of consumer-type time and savings deposits accelerated slightly. The bank credit proxy experienced moderate growth in October for the second consecutive month, with a substantial increase in the average level of large negotiable CDs outstanding.

THE MONEY MARKET AND THE MONETARY AGGREGATES

Interest rates on Federal funds and other short-term financial instruments moved sharply lower in October (see Chart I), while member bank reserve positions eased somewhat (see Table I). The effective rate on Federal funds averaged 5.82 percent during the month, down 42 basis points from September's average. Rates on 90- to 119-day dealer-placed commercial paper fell by about 1 percentage point to close the month at 5.93 percent, and rates on ninety-day bankers' acceptances declined 1 percentage point to 5.8 percent. Large negotiable CDs maturing in ninety days traded in the secondary market at 6.16 percent at the end of the month. This rate was 87 basis points below the rate at the end of September though slightly above the rate in the period immediately preceding the President's announcement about aid to New York City.

Business demand for short-term credit continued weak in October. Commercial and industrial loans at large commercial banks, after adjustment for normal seasonal variation, grew at a moderate rate during the month. In spite of this growth, the volume of loans remained almost $10 billion or about 7 percent below the level of one year earlier. Following declines in other market rates and reflecting the continued sluggishness of loan demand, most money center banks lowered their prime lending rate by ¼ percentage point to 7¾ percent. A further move to 7½ percent was initiated as the month ended.

The latest available data indicate that the growth in the monetary aggregates has continued to be unusually sluggish. Indeed, during the four-week period ended October 29, seasonally adjusted M_1—private demand deposits adjusted plus currency outside commercial banks—declined by 3.1 percent at an annual rate from its average level during the four previous statement weeks. This brought the annual growth rate in M_1 over the past thirteen weeks to less than

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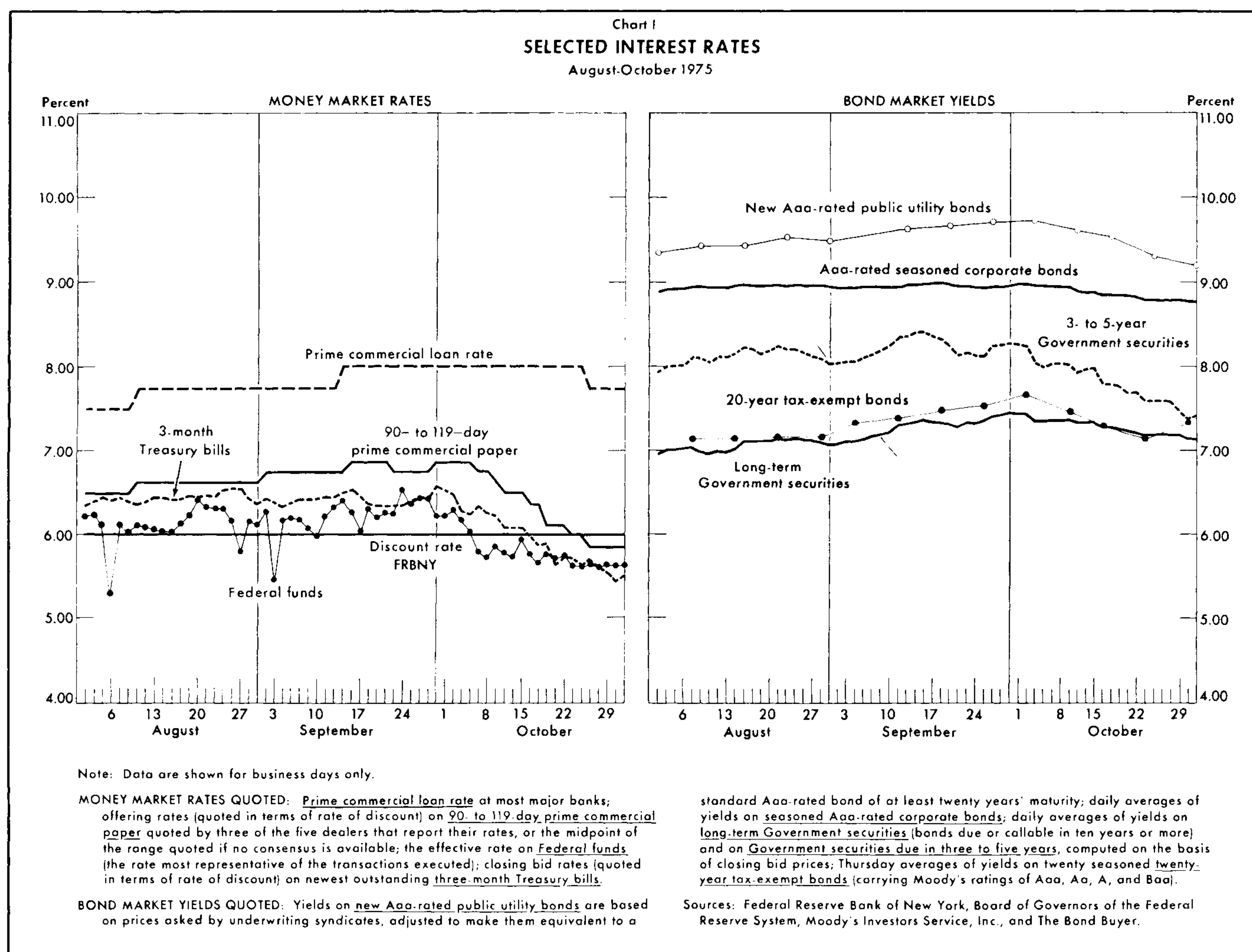
1 percent (see Chart II). Because of a moderate expansion in consumer-type time and savings deposits at commercial banks in October, M_2—M_1 plus time deposits other than large negotiable CDs—posted a modest gain. During the first four statement weeks of the month, M_2 averaged 4 percent at an annual rate above its average during the four statement weeks ended September 24 and 4.6 percent above its average during the four weeks ended thirteen weeks earlier. The adjusted bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—also experienced modest growth in October. The proxy advanced 4.6 percent at an annual rate in the first four statement weeks of the month from its average level over the four previous statement weeks.

On October 15, the Federal Reserve announced a reduction in reserve requirements on member bank time deposits with maturities of four years or more from 3 percent to 1 percent. The new reserve requirement is subject to the condition that the average of reserves on time and savings deposits at any individual bank must not be less than 3 percent, the minimum specified by law. The reserve ratio applies to deposits in the week beginning October 16 and will affect required reserves in the statement week beginning October 30. About $550 million of reserves is expected to be released by this action.



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Prime commercial loan rate at most major banks; offering rates (quoted in terms of rate of discount) on 90- to 119-day prime commercial paper quoted by three of the five dealers that report their rates, or the midpoint of the range quoted if no consensus is available; the effective rate on Federal funds (the rate most representative of the transactions executed); closing bid rates (quoted in terms of rate of discount) on newest outstanding three-month Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new Aaa-rated public utility bonds are based on prices asked by underwriting syndicates, adjusted to make them equivalent to a standard Aaa-rated bond of at least twenty years' maturity; daily averages of yields on seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields on twenty seasoned twenty-year tax-exempt bonds (carrying Moody's ratings of Aaa, Aa, A, and Baa).

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, Inc., and The Bond Buyer.

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Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, OCTOBER 1975

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

Factors	Changes in daily averages—week ended					Net changes
	Oct. 1	Oct. 8	Oct. 15	Oct. 22	Oct. 29	
"Market" factors						
Member bank required reserves	— 402	+ 646	— 67	— 167	+ 133	+ 143
Operating transactions (subtotal)	—2,244	+1,807	+2,261	—1,239	—2,245	—1,660
Federal Reserve float	— 405	+ 95	+ 365	+ 79	— 349	— 215
Treasury operations*	—2,373	+1,588	+2,788	— 470	—2,567	—1,034
Gold and foreign account	+ 8	+ 42	— 105	+ 95	— 20	+ 20
Currency outside banks	+ 665	— 417	— 693	— 773	+ 851	— 367
Other Federal Reserve liabilities and capital	— 140	+ 499	— 94	— 169	— 160	— 64
Total "market" factors	—2,646	+2,453	+2,194	—1,406	—2,112	—1,517
Direct Federal Reserve credit transactions						
Open market operations (subtotal)	+2,798	—2,764	—1,934	+ 935	+2,418	+1,453
Outright holdings:						
Treasury securities	+ 826	— 201	— 610	+ 167	+1,484	+1,666
Bankers' acceptances	+ 16	+ 12	— 5	+ 2	+ 21	+ 46
Federal agency obligations	+ 113	+ 281	—	—	+ 284	+ 678
Repurchase agreements:						
Treasury securities	+1,618	—2,505	—1,069	+ 689	+ 569	— 698
Bankers' acceptances	+ 120	— 145	— 150	+ 41	+ 44	— 90
Federal agency obligations	+ 105	— 206	— 100	+ 36	+ 16	— 149
Member bank borrowings	+ 186	— 343	— 65	+ 60	— 138	— 300
Seasonal borrowings†	+ 10	—	— 8	— 3	— 2	— 3
Other Federal Reserve assets‡	+ 83	+ 203	+ 104	+ 126	+ 88	+ 604
Total	+3,067	—2,904	—1,895	+1,121	+2,369	+1,758
Excess reserves‡	+ 421	— 451	+ 299	— 285	+ 257	+ 241

	Daily average levels					Monthly averages§
Member bank:						
Total reserves, including vault cash‡	35,454	34,357	34,723	34,605	34,729	34,774
Required reserves	34,988	34,342	34,409	34,576	34,443	34,552
Excess reserves	466	15	314	29	286	222
Total borrowings	581	238	173	233	95	264
Seasonal borrowings†	74	74	66	63	61	68
Nonborrowed reserves	34,873	34,119	34,550	34,372	34,634	34,510
Net carry-over, excess or deficit (—)‖	7	196	32	106	3	69

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Included in total member bank borrowings.
‡ Includes assets denominated in foreign currencies.
§ Average for five weeks ended October 29, 1975.
‖ Not reflected in data above.

THE GOVERNMENT SECURITIES MARKET

Yields on all maturities of Government obligations declined dramatically during October in direct response to an apparent easing in the Federal Reserve's stance with respect to interest rates. With an increased availability of Federal funds, inventory financing costs for dealers declined and bill rates adjusted sharply downward. Continued slow growth in the monetary aggregates was viewed as providing additional latitude for the Federal Reserve in pursuing its longer range targets, and some market participants interpreted the reduction in reserve requirements as a further sign of easing. Against this background, prices on coupon-bearing Treasury obligations were bid up substantially. Demand for Treasury issues was augmented by increased investor preferences for high-quality securities and by moderate financing needs of businesses.

On October 22, the Treasury announced its borrowing needs for the remainder of 1975. The Treasury indicated that it expected to raise between $8 billion and $11 billion of additional cash before the year-end, with $1.1 billion obtained in auctions of notes and bonds late in October. Only $500 million to $1.5 billion of the remainder would be financed by the sale of additional coupon issues later in the quarter, with the rest to be raised as additional amounts in Treasury bill auctions. Despite the substantial supply of new Treasury bills forthcoming, bill rates, which had declined throughout the month, continued their decline as a result of generally optimistic market sentiment. At the end of the month, the President's announcement about New York City apparently led buyers of CDs and municipal securities to place relatively more of their funds in Treasury bills and other high-quality assets, and this may have enlarged the decline in bill rates. Moreover, the Treasury did not offer a short-term issue in the refunding of the November 15 issues on October 29 and, with rates already on a downward trend, many holders of the November 15 issues may have reinvested in short-term securities in advance.

The average yield at the monthly auction of 52-week bills on October 15 was 6.60 percent, 74 basis points less than the average yield at the corresponding auction in September (see Table II). At the weekly auction on October 24, the average yields on three- and six-month bills were 5.69 and 5.97 percent, down 86 and 101 basis points respectively from the last auction in September. Over the month as a whole, yields on most bills fell 95 to 160 basis points.

Yields on Treasury coupon securities, reflecting the improvement in market conditions, fell sharply during October. Early in the month, $2.5 billion of 38-month

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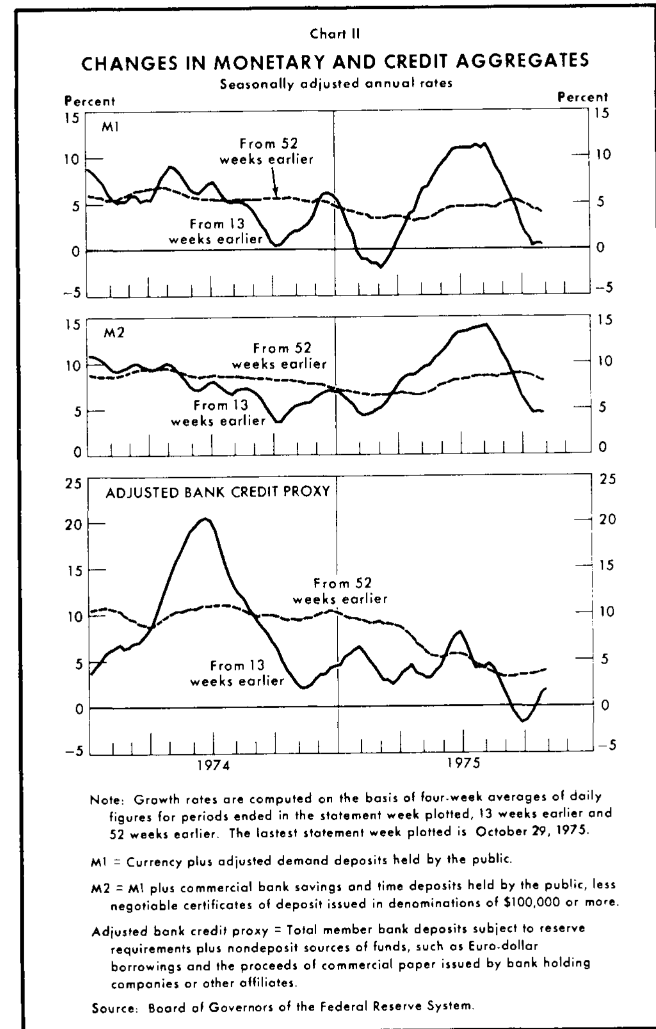
notes was auctioned with an average yield of 8.14 percent. At midmonth, $3 billion of two-year notes was auctioned with an average yield of 7.55 percent. This was 89 basis points lower than the yield at an auction of $3 billion of two-year notes on September 16. A $2.5 billion auction of seven-year notes on October 29 resulted in a yield of 7.92 percent, while on the following day $1 billion of 25-year bonds was auctioned to return 8.25 percent. Over the month as a whole, the index of yields on intermediate-term Government securities fell 85 basis points to 7.43 percent. The yield on the 8½ percent Treasury bond of 1994-99 fell to 8.18 percent at the end of October, down 46 basis points from its level at the end of September.

In the major agency financing of the month, the Federal Land Banks issued $650 million of 42-month bonds with a yield of 8.55 percent and $435 million of ten-year bonds with a yield of 8.8 percent. The issue was very well received. Over the month, yields on agency securities dropped in concert with yields on Treasury issues, and prices on the Federal Land Bank bonds moved to substantial premiums. At the end of the month, yields on short-term agency securities declined further in response to the President's announcement.



Note: Growth rates are computed on the basis of four-week averages of daily figures for periods ended in the statement week plotted, 13 weeks earlier and 52 weeks earlier. The lastest statement week plotted is October 29, 1975.

M1 = Currency plus adjusted demand deposits held by the public.

M2 = M1 plus commercial bank savings and time deposits held by the public, less negotiable certificates of deposit issued in denominations of $100,000 or more.

Adjusted bank credit proxy = Total member bank deposits subject to reserve requirements plus nondeposit sources of funds, such as Euro-dollar borrowings and the proceeds of commercial paper issued by bank holding companies or other affiliates.

Source: Board of Governors of the Federal Reserve System.

OTHER SECURITIES MARKETS

The tone of the corporate bond market improved considerably during October, primarily reflecting the indications of some easing in monetary policy. With few new financings and with the upcoming calendar of bond flotations light relative to the first half of 1975, yields declined steadily over the month. This pattern was reflected in three recently marketed Aaa-rated telephone issues. At the end of October, a $100 million financing of 37-year debentures was priced to yield 9.06 percent. This yield was appreciably below those of two earlier issues, a 9.60 percent yield offered on a $200 million issue of 33-year debentures at the beginning of October and a 9.70 percent yield on $125 million of forty-year bonds in September. At midmonth, a $300 million issue of Aaa-rated industrial debentures due in twenty-five years was priced to yield 8.90 percent and was sold quickly. Several Aa- and A-rated securities also sold well, with yields 50 to 75 basis points below those of comparably rated issues brought to market one month earlier.

In the market for tax-exempt securities, high-quality issues followed the general move toward lower yields while some lower grade securities responded directly to developments surrounding the effort of New York City to avoid default. On October 17, a default by the city was averted only after a last-minute agreement by a union of municipal employees to purchase $150 million of Municipal Assistance Corporation obligations with pension funds. Later in the month, attention centered on Washington, where Congressional proposals for Federal assistance for the city met mixed reviews. At the end of the month, President Ford announced that he would veto any Congressional proposal that would provide Federal aid to the city to avert a default. As an alternative, the President proposed legislation modifying Federal bankruptcy laws to give the courts sufficient authority, if necessary, to preside over an orderly reorganization of the city's financial affairs.

Significant concern also emerged over New York State's extensive involvement in the city's financial problems.

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Amidst these developments, yields on the general obligation bonds of the state traded in the secondary market several percentage points above yields on comparably rated obligations of other tax-exempt borrowers. In addition, the ratings of a number of the issues of New York State agencies were lowered by the major investor services, and these agencies became unable to market additional securities. In other evidence of investor concern for quality, the Massachusetts Housing Finance Agency was required to reduce the size of a planned $31.1 million issue of bonds to $12.4 million. In a negotiated underwriting of these bonds, which carry only the state's moral obligation, $1.5 million of the issue was priced to yield from 6 percent in 1978 to 8.50 percent in 1995 and the remaining $10.9 million was priced to return 9 percent in thirty-seven years.

Following the downward movement in yields for government and corporate debt, returns on Aaa-rated issues of state and local governments moved sharply lower over the month. This improvement is reflected in the terms on the month's two major Aaa-rated tax-exempt issues. On October 1, the State of Oregon marketed $125 million of bonds, with yields ranging from 5.25 percent on the 1981 issues to 6.70 percent on the 1993 issues; these are some of the highest yields ever paid on tax-exempt obligations with an Aaa rating. Three weeks later, the State of Maryland sold $85.9 million in bonds, with yields ranging from 4.20 percent in 1978 to 5.70 percent in 1990 or about 1 percentage point less than the yields on the Oregon securities. After the President's announcement, prices on Aaa-rated municipal securities gave up about one third of their previous gains for October. The Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds fell to 7.36 percent on October 29 from its record level of 7.67 percent on October 1. The Blue List of dealers' advertised inventories rose by $49 million and closed the month at $684 million.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—October 1975			
	Oct. 6	Oct. 10	Oct. 20	Oct. 24
Three-month	6.239	6.045	5.887	5.685
Six-month	6.571	6.243	6.156	5.974

	Monthly auction dates—August-October 1975		
	Aug. 20	Sept. 17	Oct. 15
Fifty-two weeks	7.331	7.338	6.601

* Interest rates on bills are quoted in terms of a 360-day year, with the discounts from par as the return on the face amount of the bills payable at maturity. Bond yield equivalents, related to the amount actually invested, would be slightly higher.

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