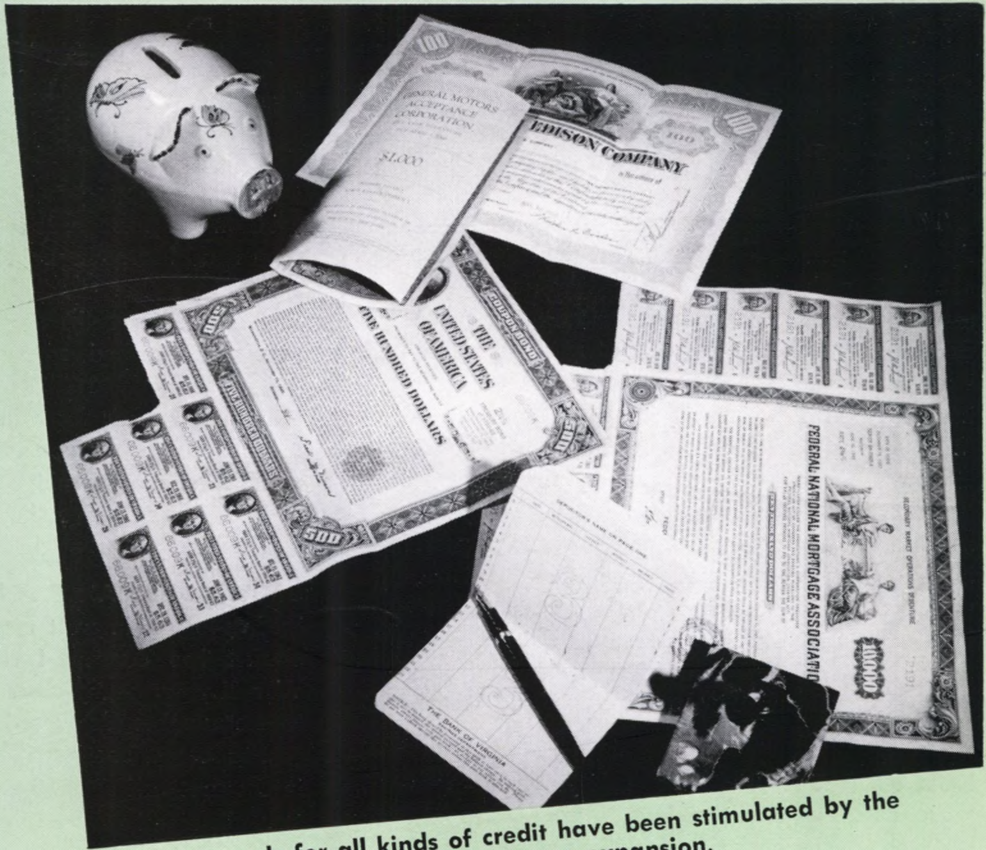
MONTHLY REVIEW



Demands for all kinds of credit have been stimulated by the vigorous business expansion.

FEDERAL RESERVE BANK OF RICHMOND AUGUST 1959

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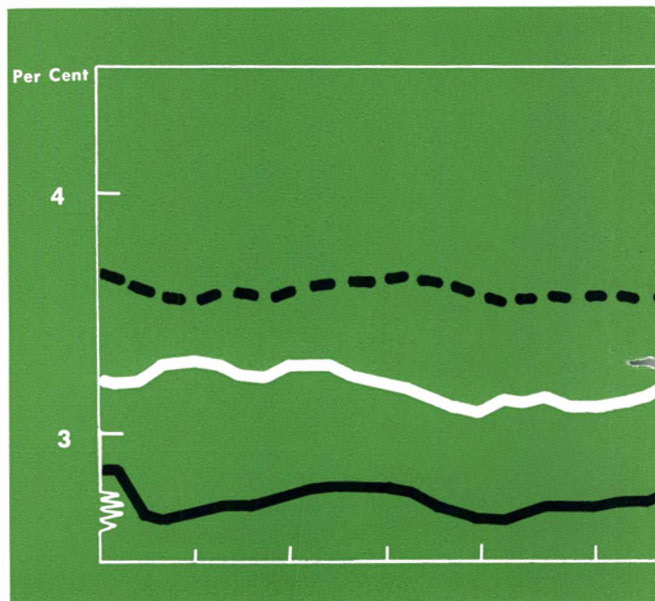
PROSPERITY AND CREDIT



The current cost of borrowing has been spotlighted by news coverage of recent congressional debate over the interest rate ceiling on five-year and longer U. S. Government bonds. As vigorous expansion has brought the economy to a high and widespread rate of activity, demands for credit have multiplied. Virtually all the loanable funds made available to the economy in the first half of 1959 were supplied by savers—by the giving up of purchasing power by individuals, businesses, and others. The creation of new purchasing power by the commercial banking system has been drastically reduced from last year's recession ameliorating abundance. As a result, total credit demands have exceeded available funds and have pushed interest rates to new post-World-War-II highs.

HOW HIGH IS HIGH? At mid-July, corporations, with top credit ratings, were paying over 4½% for funds acquired with new long-term bond issues. U. S. Government long-term bonds were yielding a little better than 4⅛%, and tax-free municipal securities were bringing investors better than 3½%. You, as an investor, may not feel that these are very high rates of return to be earning on your money. But everything is relative—relative to the point of view and relative to past experience.

From the point of view of Aaa (Moody's) corporate borrowers the 4½% they were paying at mid-July was the highest since the mid-1930's. As a matter of fact, throughout the entire 12 years from 1940 through 1951 top-rated corporations paid, on the average, less than 3% on their long-term bond borrowings. However, in longer perspective, the average yield on Aaa corporate bonds stayed well above 4% during the 1920's and early 1930's and, indeed, rarely dropped below 5% in the six years from 1919 to 1924. Experience is somewhat similar for other classes of bond borrowers. Interest rates are "high" relative to experience since the mid-1930's, but when viewed in longer perspective they are a long way from establishing new records.

GROWING DEMANDS FOR FUNDS In spite of having to pay interest rates in excess of any the market has demanded during the post-World-War-II years, many types of borrowers have been to the markets for record volumes of funds.

The largest borrower in the securities markets in the first half of 1959 was Uncle Sam. In the first six months of the year the U. S. Treasury issued $14 billion of securities for cash. However, much of this money found its way back to the markets by being used to pay for maturing issues, $9 billion of marketable securities being redeemed for cash in this period. Another $3 billion of Tax Anticipation securities were redeemed by credit against tax liabilities. In the first half of July the Treasury went to the market for an additional $5 billion of new money. Thus the Federal Government's marketable debt outstanding rose by approximately $7 billion in the first six and a half months of 1959.

State and local governments raised an estimated

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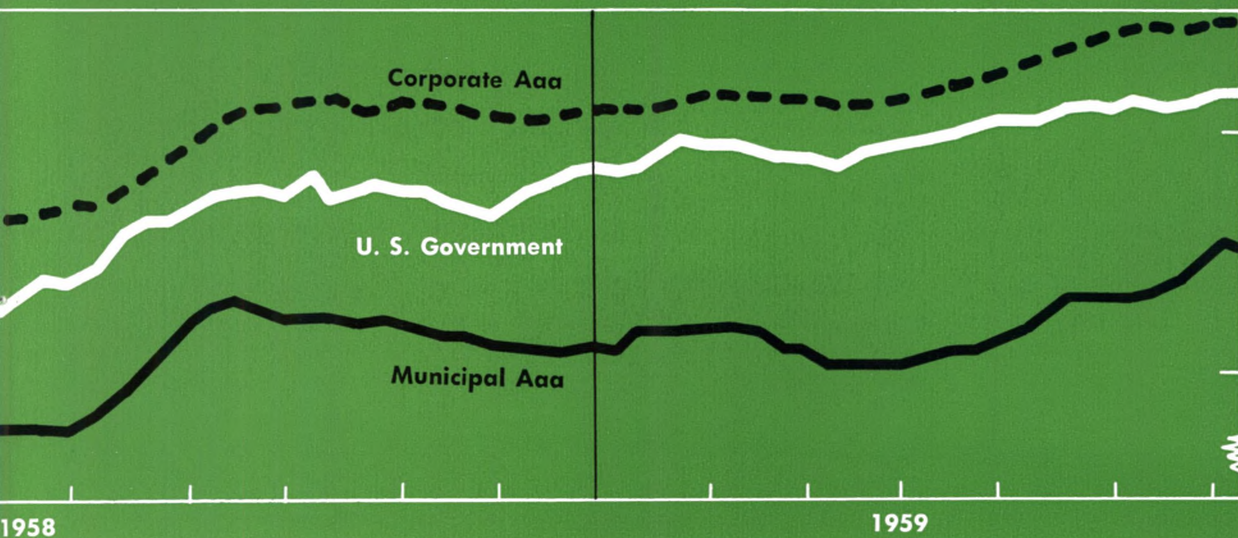

$4.6 billion of new money with long-term bonds in the first half of the year. This topped the previous record of $4.5 billion raised in the first half of 1958 and was way above the $3.5 billion borrowed in the first half of 1957.

Corporations are estimated to have raised about $4.7 billion of new money in the first half of 1959. They were the only class of borrowers in the capital markets which had a substantially lower level of bond borrowing this year than in immediate past years.

Not only have huge sums of money been raised in the bond markets, but also other credit users have been demanding increasing sums directly from lenders. Consumers increased their instalment indebtedness during the first five months of the year by $1.2 billion. Demand for mortgage funds increased mortgage indebtedness over the first five months of the year by over $7 billion.

Growing demand for credit is a necessary and desirable aspect of economic expansion—as long as the utilization of credit does not provide an inflationary level of total spending. So long as borrowers' demands are met by the giving up of spending by savers, credit spending does not represent an increase in total spending. In the first half of 1959, although a huge total of credit has been made available to borrowers, it has come predominantly from savers—relatively little has come from the creation of new money by the banking system.

COMMERCIAL BANKS UNDER PRESSURE At the heart of the financial structure lies the nation's gigantic commercial banking system. Commercial banks have control over more than $230 billion of assets, more than double the dollar volume of assets controlled by any other single class of financial institution. A much more significant feature about our commercial banking system than the dollar volume of assets it controls is its ability to add to the purchasing power of borrowers through extending them loans or purchasing their securities without, at the same time, reducing someone else's purchasing power. Other financial institutions receive their loanable funds entirely from savings—the giving up of purchasing power—by individuals, business firms, and others. When they make loans to their customers or purchase securities, they are simply transferring purchasing power from one group—the savers—to another group—the borrowers.

The ability to create new purchasing power rests on the availability of reserves to the banking system in excess of reserves already tied up to support existing deposits. Looking at member banks of the Federal Reserve System, which at midyear 1959 had 84.3% of deposits at all commercial banks, their total reserves fell seasonally by approximately one-half billion dollars over the first half of the year.

Indicative of the pressure under which commercial banks have been operating over much of the first half of this year is the increased recourse by member banks to loans from the Federal Reserve Banks. During the month of December

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1958 weekly averages of daily borrowings by member banks from Federal Reserve Banks ranged from $414 million to $790 million. In contrast, during June of this year weekly averages of daily borrowings ranged from $849 million to $979 million. In the first half of July, borrowings averaged over $1 billion and equaled 5½% or more of required reserves.

The need for borrowing from the Reserve Banks stemmed not only from the reduction in total reserves available to member banks but also from the fact that during most of the first half of the year they were faced with a very strong demand from their customers for loans. From the beginning of the year through June 24, total loans outstanding at member banks increased by $5.3 billion. Member banks had to sell securities in order to meet this loan demand. During the first six months of the year they disposed of $5.2 billion of U. S. Government securities. An almost steadily declining bond market during the first half of the year added to the pressures on the banks as they faced sizeable losses in the securities markets in attempting to raise funds there to meet their customers' requests for loans. More and more banks resorted to borrowing, both from the Federal Reserve, correspondent banks, and from other commercial banks in the Federal Funds market, in order to avoid losses in the securities markets. The Federal Reserve Banks made it more costly for member banks to borrow from them by twice raising their discount rates during the first half of the year, from 2½% to 3% and then to 3½%.

CONSUMERS—EAGER BORROWERS IN 1959 Individuals demanded and got a larger dollar volume of instalment credit for consumer purposes in the first five months of 1959 than in the similar period in any year since the first consumer loan was negotiated. Of the $18.4 billion of new loans made, however, $17.2 billion was supplied by repayments on outstanding loans. The net increase in instalment credit outstanding, therefore, amounting to $1.2 billion, was well below the record $1.6 billion net increase in the first five months of 1955. Lenders have been unusually busy in 1959 processing consumer loans. Although a large proportion of the funds needed to meet consumer demands for credit came from repayments on loans previously made, the extension of nearly $1.2 billion of loans beyond the amount available from repayments added to the demand pressures being felt by financial institutions, particularly commercial banks.

Commercial banks were the big lenders in the consumer instalment credit field in early 1959. The increase in consumer instalment loans at banks of $838 million from January 1 through the end of May equaled over three-fourths of the net increase by all lenders. Figures supplied weekly by a number of large member banks indicate that this expansion in consumer loans continued through June and into July.

The purchase of automobiles was the primary purpose of consumer borrowing in the first five months of 1959. The net increase in automobile loans by all lenders amounted to $860 million.

Lenders extended a larger amount of instalment credit for consumer purposes in the first five months of 1959 than in the similar period in any other year.

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Loans for other consumer goods, such as home appliances, power mowers, outboard motors, and the like actually declined by $96 million during the five-month period. Loans for home repair and modernization increased just slightly, but other personal loans—for consolidation of bills, medical expenses, vacations, and the like—increased by a substantial $347 million.

MORTGAGES ATTRACT BIG MONEY Home builders and realtors have been sending a swelling tide of home buyers to the mortgage lenders—commercial banks, insurance companies, mutual savings banks, savings and loan associations, mortgage companies. In the first four months of the year $10 billion of mortgages of $20,000 or less were recorded, the highest total ever racked up for this period of the year. Home builders started work on 690,700 new private units in the first six months of this year, putting new home construction just short of the all-time record established in 1950. A continuation of this high rate of new construction in the months ahead is indicated by contracts awarded for residential construction which totaled a record $7.1 billion for the first five months of 1959.

One of the principal suppliers of mortgage funds in 1959 has been the savings and loan associations. Savings and loan associations accounted for $3.9 billion—well over one-third—of total mortgage recordings of $20,000 or less in the January-April period this year. Commercial banks, too, have been faced with heavy demand for mortgage loans and accounted for $2 billion of the recordings figure. Figures supplied by weekly reporting member banks indicate a continuation of commercial bank mortgage lending through the first half of the year.

ECONOMIC SIGNIFICANCE OF TIGHTER CREDIT

Higher costs and tighter availability of credit reflect the rapid shifting of the economy from recovery in the summer and fall of 1958 into strong expansion in 1959. As shown above, demands for credit to participate in the business growth have multiplied insistently. As borrowers' demands expand to match and then to exceed the loanable funds supplied by savers, further increase in the amount of spending which is based on credit must rest on the creation of new purchasing power by the commercial banking system. In recession and the early stages of recovery, it is appropriate that new purchasing power be pumped into the economy to stimulate production and employment. During rapid expansion, however, and with high employment of existing resources, the creation of new purchasing power exerts inflationary pressures within the economy. During the year 1958, on the basis of reserve funds made available by reductions in reserve requirements and by other Federal Reserve actions, commercial banks increased their loans and investments by $14.5 billion. In the first half of 1959, in contrast, as quickening expansion exerted demand pressures on available resources, reserve availability to the banking system was held in check with the result that total loans and investments of all commercial banks were increased by less than $1 billion.

With new home construction near peak levels, mortgage lenders have faced and met an insistent demand for purchase money in 1959.

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NTEREST IS A PRICE To the borrower, interest is a cost. To the lender, 's income. To both, it's a price—the price for the use of money. And ke other market transactions, lending money involves not only benefits or the "seller" and costs for the "buyer" but also costs for the "seller" nd benefits for the "buyer." The "buyer's" (borrower's) gain is the right o spend somebody else's money today—quite a profitable option at mes. The "seller" (lender) sacrifices both the pleasures of spending his noney today and the advantages of holding cash instead of a risk asset.

NTEREST RATES ARE DETERMINED BY SUPPLY AND DEMAND Like other rices, interest rates are determined by supply and demand—the supply nd demand for credit. When individuals, businesses, governments, and thers try to borrow more than the combined volume of credit banks nd savers make available either directly or through financial institu- ions, rates rise. When the opposite occurs, they fall. Among those orces that affect interest rates are Federal Reserve actions designed to nfluence the supply and demand for credit so as to contribute to price tability, high levels of employment, and economic growth.

NTEREST IS A MEANS OF ALLOCATING RESOURCES Here in the United States, our land, labor, and capital goods are used to produce what indi- viduals, businesses, governments, and others demand in the market. Those things they want most are turned out in larger quantities; those tems further down their scales of preference are produced in limited umbers or not at all. Interest rates play a vital role in this allocative rocess as lenders channel funds into those uses that promise them the ighest returns. Those that borrow—like all other spenders—influence the se of resources by the manner in which they spend their borrowed funds.

NTEREST

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MARINAS
parking lots for pleasure boats

The dockmaster turned from the fuel pump to wave a cabin cruiser into an empty slip. "One out of every 25 people in the country owns a boat," he said, "and sometimes I think they are all trying to get in here on the same Saturday night."

Despite his feigned annoyance, he looked with obvious satisfaction at the long rows of gleaming white hulls topped by shiny mahogany and brass. A partner in a newly opened marina, he viewed each boat's skipper as a sure buyer of gas, oil, and food and possibly of marine supplies, storage, and repairs. In addition, each craft carried potential customers for the restaurant and motel that bulked large in his business.

NATURAL HABITAT The geography of the Fifth District makes it especially suited for a boating center. Chesapeake Bay, the North Carolina sounds, and the coastal rivers of South Carolina are the route of the Intracoastal Waterway, and they provide access to a vast system of bays and tidal rivers. Increasingly their banks are dotted with marinas, stopover points for a substantial stream of traffic to and from Florida and home base for an ever-growing fleet of boats.

The many lakes that dot the District states are in turn dotted by pleasure boats with churning wakes behind them. Generally smaller than the salt-water fleet, these boats are the trailer-borne craft that travel overland for an hour or so before taking to the water. Berthing for them is less important, but marinas provide needed launching ramps and cranes, gas, accessories, and food.

YACHTS FOR THE MANY Weekend sailors have multiplied at an amazing rate since World War II. The more than seven million recreational boats in the country belong to people of all incomes who now enjoy what was once a rich man's pastime.* Marinas have shared in this booming business of pleasure boating.

The outboard motor and small boat have been the key to the spread of boating, and autos towing small boats are now common sights on the highways. There are currently, however, some half-million larger outboard and inboard motor boats and auxiliary sailboats. These are large enough generally to require berthing space and to enable their owners to take overnight cruises.

These two aspects are the keys to the success of the marina. Boats too large to be loaded on a light trailer must find a home berth in protected waters. There the craft requires a watchman to protect against thieves; it needs gas and oil conveniently available, and it occasionally must have engine repairs and a new finish on exposed wood. It provides a continuing market for boating accessories, and in cold climates it needs wintertime storage on dry land. These are the essentials a marina provides its customers.

In some metropolitan areas, a shortage of berths has led prospective boat purchasers to require a lease on a slip, pen, or anchorage as a condition for buying a new boat. Virtually everywhere new marinas find waiting tenants for their berthing facilities, as boat sales continue to outrun the expansion of marinas.

WATERWAY HOTELS Some private boats are large enough to encourage overnight cruising but too small to be completely self-sufficient. The complete marina offers a restaurant to relieve the seagoing cook and sleeping accommodations to give seafarers a change from their less spacious quarters. Thus at one stop the transient skipper

*A comment fictitiously attributed to J. P. Morgan was, "If you must ask the cost of a yacht, you can't afford to own one."

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and his crew find a protected berth, food, fuel, and a break in their holiday routine.

The fact that boating is a holiday activity has encouraged an increasing note of luxury in marina accommodations. Food and drink offered at the restaurants frequently are comparable to that of top-quality establishments in the city. Motel-type sleeping quarters are well above minimum standards of comfort, and recreational facilities sometimes include swimming pools and children's playgrounds.

The holiday nature of boating has also influenced the location of marinas. The biggest market for permanent berthing naturally lies in or as near large cities as possible. These cities near marinas get other forms of business from the crews of pleasure boats. A day's sight-seeing ashore provides welcome variety to an extended cruise. City shops and department stores, doctors and dentists meet pressing needs of the waterway tourists.

Marinas give every indication of being a growth industry. Rising trends of leisure time and personal income underlie the favorable prospects for this service industry.

With the Pentagon as a backdrop, the Columbia Island Marina in Washington provides a secure berth and ready access to the nation's capital. The Cavalier Yacht and Country Club at Virginia Beach offers an 18-hole golf course and a swimming pool, in addition to the more usual marina facilities. Where pine trees once grew, the Atlantic Yacht Basin was dredged alongside the busy Albemarle and Chesapeake Canal, a link in the Intracoastal Waterway. The City of Charleston, S. C., operates the Municipal Yacht Basin, a half-mile from the center of the city.

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Bank Reserves and Vault Cash

Much has been written recently about legislation which would:

> authorize the Federal Reserve Board to permit banks to count vault cash as reserves. . .
>
> change to 10%-22% the range within which reserve requirements for reserve city banks can be set. . .
>
> provide that central reserve city banks be reclassified as reserve city banks in three years.

Indeed, this legislation might have been enacted by the time this issue of the *Monthly Review* reaches your desk.

DID YOU KNOW. . .that you affected your bank's required reserve account when you deposited your "take-home pay" on the 1st? That a change in your bank's reserve requirements influences its action on your loan request? That you, as a bank customer, help to determine the amount of cash your bank must keep in its vaults?

RESERVES SUPPORT DEPOSITS If your bank is one of the more than 6300 members of the Federal Reserve System, it is required to keep on deposit with its Federal Reserve Bank funds equal to specified percentages of its net demand and time deposits. Hence, each change in the amount you keep in your checking and/or savings account is reflected in your bank's reserve at the Fed.

Now, as in all the nearly half a century since the Federal Reserve Act was approved, a member bank's location largely determines whether it is a central reserve city, a reserve city, or a "country" bank. And its classification is directly related to the percentage of demand deposits it must keep in its reserve account, for the Federal Reserve Board is authorized to specify what that percentage shall be (within a given range) for each class of bank. Currently, the permissible range for central reserve city banks is 13%-26%; for reserve city banks, 10%-20%; for "country" banks, 7%-14%. Provisions of recent legislation would raise the upper limit for reserve city banks to 22%, and, on reclassification, central reserve city banks would be subject to the 10%-22% range applicable to reserve city banks.

RESERVES AT WORK The amount of reserves banks have to maintain is a major factor in their being able to grant, or having to refuse, requests for loans. The amount of funds available to banks for lending and investing largely depends on the proportion of their deposits the Fed says they must set aside as required reserves.

When funds are released through reductions in reserve requirements as one aspect of a Federal Reserve policy of monetary ease, banks are in the market for loans and investments which will turn their surplus funds into income-producing assets. Conversely, when reserve requirements are raised in keeping with a policy of restraint and a larger proportion of deposits goes to keep reserves at their required level, banks retrench—screen loan applications more carefully, reduce investments.

CURRENCY AND COIN The cash which a bank must have to meet the day-to-day needs of its customers is in addition to the reserves it must keep on deposit with its Federal Reserve Bank. Every customer who cashes a check, draws out money to meet a payroll or to take care of other business or personal expenses, reduces the bank's "vault cash." Such over-the-counter activities, and the length of time it must wait to receive cash from its Reserve Bank to replenish its funds dictate the amount of currency and coin your bank customarily keeps on hand.

If a bank is fairly near its Reserve Bank, amounts needed to replenish its vault cash can be secured quickly and easily, hence cash on hand can be kept close to the minimum needed for actual transactions. However, a bank more distant from its Reserve Bank might have to wait until the next day or longer for the money to arrive, hence would have to carry a larger amount of cash lest it be caught short. For instance, during the last half of June, "country" banks held over one-half the $2.2 billion cash in the vaults of member banks. Their vault cash averaged 3.7% of their net demand deposits. By contrast, vault cash of reserve city banks averaged only 1.8% of net demand deposits; that of central reserve city banks, less than 1%.

If vault cash could be counted as required reserves, funds available to banks for loan and investment expansion would depend upon required reserves relative to deposits, rather than on required reserves plus vault cash relative to deposits. This would eliminate any inequity among member banks which results from the bearing their geographical location has on the amount of cash they need to keep on hand.

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The Fifth District

Favorable reports of recent business activity emphasize the continuing progress of economic expansion in the Fifth District. Manufacturing man-hours worked in June in both durable and nondurable goods industries continued the steady growth which has been apparent since the first of the year. Textile mills entered the second half of the year with order backlogs and inventories at quite satisfactory levels, and the industry is reportedly in its strongest position in many years. Employment on construction projects rose again in June to a new high for the year. Monthly gains in construction employment, adjusted for seasonal influences, occurred in five of the first six months of this year. The relatively high spring volume of sales by Fifth District department stores was maintained in June, and incomplete reports indicate that the July figure rose to an all-time high. Loan demand at District member banks has continued very heavy, about matching the rapid expansion in 1955 and running much stronger than in other recent years.

MAN-HOURS UP AGAIN Man-hours in manufacturing industries in the District in June rose 0.8% from May; all states showed gains except Maryland. Industries with increases over the May level were machinery, stone, clay and glass, apparel, paper, textiles, lumber, and printing.

Total nonfarm employment in the District in June held about even with the May level, after adjustment for seasonal factors. Gains in Maryland, Virginia, and West Virginia just about balanced declines in the Carolinas. An increase in manufacturing employment was offset by a drop in the nonmanufacturing section. Declines in nonmanufacturing employment occurred in the transportation, communication, and public utilities group and in government, and offset gains in mining, construction, trade, and service industries. The rise in employment in the coal mines of West Virginia brought about the first gain in District mining employment this year.

CROP PROSPECTS The crop outlook at midsummer indicated that this year's total output will be somewhat smaller than last year's bumper harvest. Weather throughout the month of June was much less obliging than a year ago. Good soaking rains—"million dollar rains," farmers called them—finally fell over the drought-stricken areas during the first half of July. Many crops have since taken on new life, but some—such as early corn—had been damaged beyond recovery.

Corn and hay prospects July 1 were well below last year's bountiful harvests and promised to show the biggest decline from 1958 of all the major crops. Pastures also suffered sharply from the dry, hot weather and at midyear were far short of the lush conditions of a year ago. By contrast, July conditions pointed to sizable production gains over last year for all small grains—wheat, rye,

This year's District cotton acreage is 66% larger than last year's but one-third below the average of the past ten years.

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oats, and barley. Biggest increase—more than one-fifth—will be recorded by the wheat crop.

Total tobacco production now shaping up looks to be only slightly smaller than last year. Only the flue-cured and Virginia fire-cured types are expected to be below a year earlier, but prospective per-acre yields are lower than last year's levels for all District tobaccos except burley.

Fruit prospects vary considerably, both by type of fruit and by areas of production. Peach growers are expecting production to be about 10% under last year but two-fifths above average. Apple producers on the other hand are looking for about the same size crop as in 1958, about one-fifth larger than average.

Though production estimates of three principal District crops—cotton, peanuts, and soybeans—are not yet available, crop acreages and developments to date provide excellent cues. Cotton acreage—two-thirds above 1958 and the largest since 1956—chalked up by far the biggest gain over last year of all planted acreages. Cotton on the whole withstood the dry, hot weather better than other crops, but boll weevil infestation is reported to be at a higher level than at the same time last year. Peanut acreage is practically unchanged from a year ago. The crop appears to be in good shape, and prospects range from good to excellent. Soybean acreage continued to expand to reach an all-time high. The crop has made favorable progress and generally appears to be in fair to very good condition.

INVENTORIES DOWN; BACKLOGS UP The present situation in the textile industry is described as the strongest in many years. Mills have exceptionally large backlogs of orders for the rest of this year. In many cases they have booked all of their production of standard goods for this year. Inventories are at very low levels through all channels of the industry.

Weaving mills resumed production at near-capacity rates after the vacation closings. Dyeing and finishing mills are also operating at a high level with backlogs at these mills up 30-40% over a year ago. Market activity picked up somewhat after the vacation season but buying of cotton gray goods was generally quiet. The slower market is considered normal for July. However, prices have continued firm and the tone of the market is strong. In some cases prices have been increased even in limited trade because of the scarcity of goods.

Prices are firm for industrial textiles. Buying has been mostly for third quarter but some orders have been placed as far ahead as October. The present strong situation for industrial textiles is partly due to changing some looms from industrial fabrics to drapery and apparel fabrics rather than to ordering in large volume by industrial users.

Many mills weaving synthetic fabrics either limited or postponed vacations because of pressure for delivery of goods to finishing plants. These mills are heavily sold ahead for third quarter and into fourth quarter. The large backlogs of orders have limited sales of synthetic fabrics although fairly slow buying has continued. Prices were increased on rayon filament fabrics reflecting increased yarn prices. Shipments of acetate yarn and rayon in June totaled 98 million pounds—up 2% from May and 32.5% above June 1958.

Reports from Charlotte indicate that many carded yarn mills there are sold up for third quarter and inventories are at one of the lowest levels in history. The Carded Yarn Association in Charlotte reports that on July 4 its members had backlogs of orders equal to 8.31 times stocks on hand. Last year at this time backlogs were only 3.99 times stocks on hand.

Most knitting mills—except full-fashioned hosiery mills—had good to exceptionally large backlogs of orders as they began last month the seasonal upturn for knitted merchandise. Production of seamless hosiery continues to increase. In the first five months of 1959 total production of women's hosiery was up 7.2% over the first five months of 1958. Seamless hosiery production showed a 27.6% gain for the same period, while full-fashioned hosiery production was down 5.1%.

POSSIBLE RECORD The department store sales index for June held even with the May level on a seasonally adjusted basis and was 8% above a year ago. Activity during the second quarter was about even with the record average for any three-month period achieved this past December, January and February. Early reports for July indicate that sales during the month reached a new peak and probably exceeded the high of August 1958 by several points.

PHOTO CREDITS

4. Lynn Pontiac Inc. 5. Farmington 8. Chamber of Commerce, Charleston, S. C. 9. Atlantic Yacht Basin, Inc. - Cavalier Yacht Club - Photo by Abbie Rowe, courtesy National Park Service and C. A. Chaney and Associates.

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