FEDERAL RESERVE BANK OF RICHMOND

MONTHLY REVIEW

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JULY 1967

A Retrospect on Tight Money

In the financial community, the big story in 1966 was, of course, tight money. For virtually the entire year, the subject of tight money dominated commentaries on the financial picture and was a key factor determining expectations patterns in financial markets. Yet despite the extensiveness of the contemporaneous discussion, there are important features of the 1966 financial experience that appear to have escaped popular notice. In particular, data on credit flows for the year suggest that the term "tight money" can be misleading indeed if it is taken to imply a diminution in the volume of loan funds being employed in the economy.

Interest Rates in 1966 Perhaps to most market observers the test of whether or not money is tight is found in the behavior of interest rates. By this test money in 1966 was tight indeed, especially in the first nine months of the year.

The year's interest rate experience began in the wake of the December 1965 hike in the Federal Reserve's discount rate. This move raised the discount rate from 4% to 4½%, the highest level since 1930. Rates in credit markets across the board adjusted swiftly to the new discount rate. Yields on 90-day Treasury bills moved up from a level of about 4.12% in early December 1965 to over 4.60 in mid-January 1966. Within the same time span, rates on 90-day bankers' acceptances and on four- to six-month commercial paper were marked up from 4⅜% to 4⅞%. The so-called prime rate at large commercial banks, which had been 4½% since August 1960, was raised to 5% in early December and to 5½% in March.

In the long end of the market, yields rose somewhat more slowly for most maturities, although most U. S. Government notes and bonds of under five-year maturity were up a full 50 basis points by mid-February. Yields on Governments of 10 years or more rose 35 basis points between early December and the end of February. For the same period, Moody's series showed a rise of 20 to 25 basis points for seasoned Aaa corporates and Aaa municipals.

Except for yields on Treasury bills, which drifted downward in late May and throughout June, the steady, across-the-board advance of rates continued through early September. Treasury bills rejoined the parade after July 1 and by early September the 90-day bill had passed 5%, on its way to a peak above 5½% later in the month. Peak yields in the longer end of the market came in late August and early September. At their peaks, U. S. Government bonds of maturities of 10 years or under yielded well above 5½%. Moody's series showed yields on seasoned Aaa corporates above 5½%, with Baa corporates moving well above 6%. New high-grade corporates yielded close to 6% and several Federal

SELECTED YIELDS ON SELECTED DATES, 1965-66

	1965	1966				
	Dec. 3	Mar. 25	June 24	Sept. 30	Aug.-Sept. Peak	Dec. 30
	%	%	%	%	%	%
90-day Bills	4.12	4.53	4.38	5.34	5.51 (Sept. 23)	4.81
U. S. Notes and Bonds						
0-3 years	4.23	4.69	4.61	5.31	5.66 (Aug. 26)	4.67
3-5 years	4.28	4.72	4.81	5.26	5.74 (Aug. 26)	4.66
5-10 years	4.43	4.87	4.81	5.06	5.66 (Aug. 26)	4.59
Over 10 years	4.36	4.59	4.60	4.71	4.92 (Aug. 26)	4.46
Corporates						
Moody's Aaa	4.60	4.98	5.08	5.45	5.52 (Sept. 9)	5.39
Baa	4.98	5.39	5.61	6.06	6.11 (Sept. 9, 23)	6.18
Municipals						
Moody's Aaa	3.37	3.51	3.58	3.88	4.04 (Aug. 26)	3.74

Source: Compiled from Federal Reserve sources and Moody's Bond Survey.

Agency financings involved yields well above this level. As was widely noted at the time, these yields were the highest since the 1920's. In most sectors of the bond market the total rise in yields between early December 1965 and early September 1966 was well over 100 basis points. The prime rate at large commercial banks, at 6% after mid-August, was the highest since that concept was introduced in the 1930's.

Bank Credit and the Money Stock Popular discussion of tight money in the first half of 1966 focused heavily on the sharp increases in interest rates and on the harsh impact of these rate movements in mortgage markets and in the construction industry. Relatively little attention was given to the overall size and pattern of the flow of loan funds in the economy as a whole, or to the question of how rapidly new credit was being created by the commercial banking system. Yet a closer look at the total credit picture through the tight money experience would probably have yielded some surprises to borrowers who felt that funds were scarce in some absolute sense. This is especially true of the first half of the year.

For example, while references to funds scarcities multiplied rapidly in the first half, data compiled at the St. Louis Federal Reserve Bank show that the commercial banking system was generating new credit in that six-month period at a rate well in excess of that obtaining in the 1960-64 period, when money was considered quite easy. Total loans and investments of commercial banks for the six months ending with June 1966 increased at an annual rate of more than 9½%. This compares with an average annual rate of increase of under 8% in 1960-64 and with a rate of 10% in 1965, when credit expansion was widely held to be proceeding too rapidly.

Banking statistics for the period show total bank loans rising at an annual rate of 14.5%, compared with an average annual rate of 9.3% in 1960-64 and 14.3% in 1965. The dollar increase in bank loans in the first half of 1966 came to about $13 billion. The data show that bank lending in this period moved toward a distinctly heavier concentration in loans to businesses, which grew at the very rapid rate of 19.7% per year.

The large increase in bank loans in the first half was financed only in small part through liquidation of bank investments. Overall, commercial banks increased their investment portfolios in this period at an annual rate of only 1.0% or, in absolute amounts, by some $0.5 billion. Liquidation centered entirely in holdings of U. S. Governments, which declined at an annual rate of 8.5%. Holdings of other securities, mainly municipals, increased at an annual rate of 13.9%.

Data on the money supply tell much the same story as that revealed in the bank credit figures. Complaints of tight money notwithstanding, the money supply in the first half of 1966 recorded a substantial increase. Indeed, the narrowly defined money stock (demand deposits adjusted plus currency outside commercial banks) grew at an annual rate of 4.7%. This was slightly higher than the rate for 1965 and compares with a 2.6% rate for the 1960-64 period. Defined to include time deposits the money supply grew at an annual rate of 6.9%, which

GROWTH IN BANK CREDIT AND MONEY, 1960-66

	All Commercial Banks					
	Total Loans & Investments	Total Loans	Business Loans	Total Investments	"Other" Securities	Money Supply
ANNUAL RATES OF GROWTH, PER CENT						
1960-64	7.9	9.3	7.4	5.9	16.1	2.6
1964-65	10.0	14.3	17.9	3.1	15.2	4.0
Dec. 1964—June 1965	10.9	17.4	22.8	0.5	16.7	2.6
June 1965—Dec. 1965	9.0	11.9	15.0	3.9	13.9	6.8
Dec. 1965—June 1966	9.7	14.5	19.7	1.0	13.9	4.7
June 1966—Dec. 1966	2.6	5.6	10.6	−3.3	− 0.8	−0.9
CHANGES IN BILLIONS OF DOLLARS						
1960-61	13.6	5.2	1.5	8.5	2.2	2.3
1961-62	16.6	10.3	3.0	6.3	4.6	3.0
1962-63	18.6	14.8	3.9	3.8	5.6	4.4
1963-64	18.7	17.2	5.3	1.5	4.1	5.8
1964-65	25.7	22.7	9.8	3.0	5.6	6.2
Dec. 1964—June 1965	14.1	13.8	6.2	0.2	3.1	2.1
June 1965—Dec. 1965	12.3	10.4	4.6	1.9	2.8	5.4
Dec. 1965—June 1966	13.8	13.3	6.4	0.5	3.0	3.9
June 1966—Dec. 1966	3.9	5.6	3.9	−1.7	− 0.2	−0.8

Source: Federal Reserve Bank of St. Louis.

was only slightly below the 7.1% average annual rate for the 1960-64 period although substantially below the 8.9% rate for 1965.

In summary, while references to tight money were legion in the spring and early summer of 1966, the banking and monetary data for the period indicate that the overall flow of money and bank credit in the economy continued to expand at rates that compare favorably with those in easy money periods.

Turnaround in Second Half The data for the second half, however, tell a quite different story. While bank credit continued to expand, its rate of growth slowed to a 2.6% annual rate. Total loans at all commercial banks grew at a rate of 5.6%, or less than half the rate of growth in the first half. Total loan expansion at commercial banks in the last six months of the year amounted to $5.6 billion, compared with a growth of $13.3 billion in the preceding six months. The rate of growth of bank loans to businesses was slowed in about the same proportion as the deceleration in total loan growth.

Liquidation of investments by commercial banks accelerated significantly in the second half, as banks reduced their total investments at an annual rate of 3.3%. As in the first half, liquidation was heaviest in Governments, which declined at an annual rate of about 5½%. But in contrast with their first half investment activities, banks also reduced their holdings of other securities (mainly municipals) in the second half. Holdings of other securities in the last six months of the year declined at an annual rate of just under 1.0%, with most of the reduction occurring in August and September.

The reduced pace of growth of financial flows in the economy in the second half is also reflected in the money supply data. By contrast with its relatively rapid rate of growth in the first half, the narrowly defined money supply declined at an annual rate of about 1.0% in the second half. The money supply plus time deposits at commercial banks continued to expand, but the rate of increase fell off to 2.2% or less than a third the rate in the first half.

Most of the slowdown in money and credit growth in the second half came after September 1 and represented, at least in part, a response by the commercial banking system to Federal Reserve policy moves. Over most of the first half, the Federal Reserve created new bank reserves at a relatively rapid pace. For the first six months of 1966 total reserves of member banks grew at an annual rate of 4.4%, compared with rates of 5.2% in 1965 and only 3.8% per year in 1960-64. But this policy of generous provision of reserves halted in late summer, and over the last six months of 1966 member bank reserves declined at an annual rate of 2.2%. In addition the Federal Reserve's refusal to raise ceiling rates on bank time and savings deposits, coupled with action to dampen the competition for thrift deposits, placed serious limitations on this important source of bank funds. Finally, the Federal Reserve's letter of September 1 to all member banks instituted a temporary change in the administration of the discount window with a view to encouraging banks to reduce the rate of growth of their loans and to refrain from large-scale liquidations of securities.

Flow of Funds Data The general picture that emerges from a study of bank credit and money supply data is corroborated by data shown in the Federal Reserve's flow of funds accounts, which afford a more comprehensive perspective on credit flows through the economy. Briefly, the flow-of-funds accounts provide a statistical framework for measuring financial flows in the economy by grouping all economic units into specific sectors and recording, for each sector, purchases and sales of goods and services, credit and capital outflows and inflows, and changes in monetary balances.

As in the case of the bank credit and money supply data, the flow-of-funds accounts show an acceleration of funds flows in the first half of 1966 and a sharp reduction in these flows in the second half. As estimated in these accounts, total funds raised in credit markets in the first half amounted, at a seasonally adjusted annual rate, to $83.5 billion. The comparable figure for the first half of 1965 was $74.3 billion and for the second half of 1965, $70.0 billion. In last year's second half, however, the figure fell sharply to $58.6 billion.

Net borrowing in credit markets by households and businesses as shown in the flow-of-funds accounts came to $65.6 billion, at a seasonally adjusted annual rate, in the first half. This compared with a figure of approximately $58 billion in each half of 1965. In the second half of 1966 net borrowing was reduced to $47.0 billion. The changes that took place in 1966, however, were not evenly distributed as between households and businesses nor as among types of businesses. For example, net borrowing by corporations in the first half was $29.5 billion, up from $19.3 billion in the second half of 1965. In the second half, 1966, however, net borrowings by corporate business fell off to $17.0 billion. Net borrowing by nonfarm noncorporate businesses rose to $8.0 billion in last year's first half, compared with $6.8 billion in the last half of 1965. It then fell to $4.4 billion for the final six months of 1966. Net borrowing by farms declined slightly in last year's first half, falling from \$3.6 billion in the second half of 1965 to \$3.2 billion, but rose to \$4.0 billion in last year's second half. Households' net borrowings fell in both halves last year, dropping from \$28.9 billion in the final half of 1965 to \$24.8 billion in last year's first half and to \$21.6 billion in the last half. The cutback in borrowings by households reflects principally reductions in home mortgage credit and in consumer installment credit.

The "Tight Money" Paradox It is clear from the data presented in the foregoing paragraphs that the overall volume of loan funds being made available to the economy continued to grow at a relatively rapid pace through the first half of last year. Not until the second half was there a significant cutback in financial flows. Yet during the first half, the continuing rapid expansion of credit was paralleled by steady and substantial increases in interest rates and by a growing crescendo of discussion of tight money. Early in the second half, however, interest rates began to stabilize and after mid-October actually drifted downward. This occurred in spite of sharp cutbacks in the overall rate of credit flows. As the general comment had it, money remained tight. It was tight in the last half because the flows had diminished. But it was also tight in the first half, when the flows were expanding rapidly.

There is, of course, no paradox here but rather an ambiguity in the popular usage of the term "tight money." Quite obviously, in the vernacular the term is used to denote either a situation of rising interest rates, irrespective of the volume of credit flows, or a situation of diminished credit supply, irrespective of the movement of interest rates. In the terms of the supply-demand apparatus of the professional economist, money can be "tight" because, with a given demand, credit supply has been reduced; or it can be tight even in the face of large increases in supply so long as demand is rising faster than supply. Depending on the level of employment, these two rather distinct "tight money" situations can have different implications for prospective business performance and might require different approaches of the economic policy-maker.

Some Changes in the Pattern of Credit Flows Even when overall credit flows are growing rapidly, it is possible that particular financial markets can experience a net reduction in funds availability. When rates rise more rapidly in some markets than in others, funds are likely to be diverted from the lower-rate markets and money will tend to become locally tight in these markets. This is all the more likely to occur in financial systems characterized by institutionally fixed rates in some sectors. In the United States such institutionally fixed rates are especially characteristic of the mortgage market. Usury laws in many states limit rates on conventional residential mortgages and FHA and VA mortgages are also subject to statutory limitations. Moreover, institutional investors that account for a large fraction of mortgage lending are limited by law in the rates they can offer depositors and hence in their ability to channel funds into mortgage markets.

High and rising yields in markets not subject to institutional rate limitations produced such shifts in credit flows in the first half last year. For the most part the incidence of these shifts bore most heavily on mutual savings banks and savings and loan associations, which specialize heavily in mortgage lending. They were subjected first to increased competition for thrift deposits from commercial banks. But as rates on market instruments rose above those offered on thrift deposits, savers diverted funds to market instruments, and commercial banks as well as nonbank institutions found their savings inflows sharply curtailed.

The extent to which savings institutions were affected by this diversion of funds is indicated in the flow-of-funds accounts estimates of savings inflows at major institutions. Inflows at savings and loan associations ran between \$8½ billion and \$11 billion a year between 1963 and 1965. In the first half of 1966 they fell to a \$4.2 billion annual rate, then slipped further to a \$3.1 billion rate in the second half. At mutual savings banks the rate fell from \$3.6 billion in 1965 to a \$1.9 billion annual rate in the first half of 1966 but then rose in the second half to \$3.3 billion. Time and savings inflows at commercial banks fell from a rate of \$20 billion in 1965 to a \$17.9 billion annual rate in the first half of 1966 and only \$8.5 billion annual rate in the second half.

Paralleling these declines in savings inflows came large reductions in the rate of increase in mortgage investments of each of these institutional types. Annual increases in nonfarm residential mortgage debt held by the three combined fell from nearly \$16.0 billion in 1964 and 1965 to \$8.7 billion in 1966. Over \$5 billion of this decline came in the first half. At the same time, life insurance companies found it necessary to divert large amounts of funds to policy loans and they too curtailed their mortgage activity.

Thus, while from the standpoint of the overall credit picture funds flows were increasing in the first half, the mortgage market and specialized mortgage lending institutions were experiencing both rising rates and a diminished flow of funds.

FIFTH DISTRICT FISHING

■ Fishing is one sport which can be enjoyed by every member of the family—women as well as men, children as well as adults. Each year anglers spend millions of dollars and travel billions of miles to enjoy sport fishing. In 1963 the nation's fishermen spent $96,532,000 on fishing tackle and equipment—a 27.4% increase over the $75,759,000 spent in 1958—ample evidence of the growing popularity of this sport. ■ With miles of ocean beaches, innumerable mountain streams, and a large number of wide rivers, the Fifth District offers a variety of choices for the fisherman. Anglers can enjoy deep sea fishing and surf casting along the coast, relax while they wait for a bite beside a slow moving river, and even thrill to the strike of a trout in a scenic mountain stream. ■ Each year the number of fishing licenses increases. In 1964, 1,268,773 fishing licenses were sold within the District and brought in revenue amounting to $3,805,895.47. The majority of this revenue is used by the states to finance fisheries research, land acquisition, conservation, and development of new sport fishing areas. North Carolina leads the other District states with a total of 345,222 licenses sold in 1964—representing 27.2% of the total sold within the District.

FIFTH DISTRICT FISHING LICENSES—1964

	No. of paid Fishing License Holders[1]	State % of Fifth District Total	Gross Cost to Fishermen ($)	State % of Fifth District Total
Maryland	106,274	8.4	340,642.50	9.0
North Carolina	345,222	27.2	1,114,983.62	29.3
South Carolina	292,456	23.1	656,228.35	17.2
Virginia	331,117	26.1	939,623.00	24.7
West Virginia	193,704	15.3	754,418.00	19.8
Fifth District Total	1,268,773		3,805,895.47	

[1] A paid license holder is one individual regardless of the number of licenses purchased.

Source: U. S. Department of the Interior, Bureau of Sport Fisheries and Wildlife.

Photo Credits: North Carolina Department of Conservation and Development, Travel Information Division, Virginia Commission of Game and Inland Fisheries.

Another epic battle is about to be concluded successfully in a moment or two—if the net man doesn't fall overboard in the excitement.

Deep sea fishing off Hatteras, North Carolina is another type of fishing which is extremely popular throughout the District and one which brings tourists from all parts of the United States.

This waterfall provides ct backdrop for a trout fisherman. Popular reas are numerous throughout the District sta are found in most of the state and national as.

Huge lakes created by power dams offer excellent fishing in all of the Fifth District states.

Cape Hatteras Lighthouse, tallest in America, overlooks famed surfcasting beaches in the Cape Hatteras National Seashore on North Carolina's Outer Banks. Over 30 different species of salt water gamefish are taken from surf, deep sea, and inlet waters along the coasts of Maryland, Virginia, North Carolina and South Carolina.

Therg quite like spending a lazy afternoon fishing in your stream—a pastime enjoyed by all regardless of age.

Mortgage Rates Under Pressure

With the nation's postwar babies now getting married, the mortgage market occupies an increasingly significant place in our economy. Growth in employment and income, as well as in new families, has increased the demand for housing and hence for funds to finance these needs.

During 1966 the mortgage market came under severe pressure. Funds normally directed into mortgages were diverted to other investments whose yields rose even more sharply than mortgage rates. This article will discuss briefly the mortgage market in the recent prolonged expansion, the effect of restrictive monetary policy on the market, the results of such policy in 1966, and the situation so far in 1967.

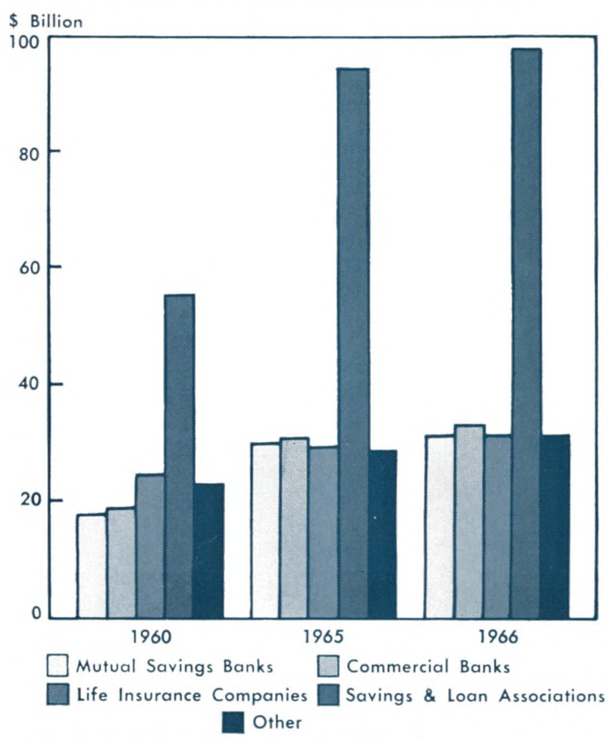
The Expansion of the Sixties The expansion in the nation's overall business activity during the first half of this decade was generally matched by growth in the mortgage market. Mortgage loans outstanding on 1- to 4-family nonfarm homes, shown in the first chart and representing about 65% of total nonfarm mortgages, rose at an average annual rate of 8.6% from 1960 to 1965. New housing starts increased steadily through 1963 with slight declines in 1964 and 1965, but the value of new construction increased at an average annual rate of 5.9% through the period.

Growing demands for mortgage funds during the period were comfortably met at fairly stable interest rates. The Federal Reserve System followed a relatively easy monetary policy and commercial banks substantially increased their participation in mortgage lending. As shown in the second chart, commercial banks were the leaders in increasing their annual savings flows from 1960 to 1965. Savings and loan associations, the dominant mortgage lender, and mutual savings banks experienced reduced deposits in 1965 but nevertheless had substantial gains in their annual inflows for the five-year period. The annual increase in funds available for lending by life insurance companies also followed an upward pattern through 1965. Together, these four institutions account for over 75% of all mortgage debt outstanding.

The Effect of Monetary Policy Restrictive monetary policy generally diverts money away from the mortgage market. As interest rates on bonds rise and their prices decline, they become increasingly attractive alternatives to mortgages from the standpoint of both high income and potential capital gains. For example the third chart shows that, during periods of business expansion when monetary policy becomes restrictive, the flow of funds into corporate securities tends to increase while the flow into mortgages tends to decline. Saving funds flowing to the large mortgage lenders tend to be diverted to these market instruments and mortgage lenders themselves will seek higher-yielding investments.

Although rates paid on mortgages are higher than on the other securities pictured in the fourth chart, changes in mortgage rates tend to lag behind the market in timing and degree of change. In particular, FHA-insured and VA-guaranteed loans have Government-set ceilings on their interest rates. In addition, usury laws limit the rate of interest paid on mortgages in certain states. In times of rising rates the spread in yields between mortgage instruments and other securities tends to narrow and alert investors turn away from the mortgage market. The same chart shows that in 1966 the rate of return on

ESTIMATED MORTGAGE LOANS OUTSTANDING ON 1-TO 4-FAMILY NONFARM HOMES

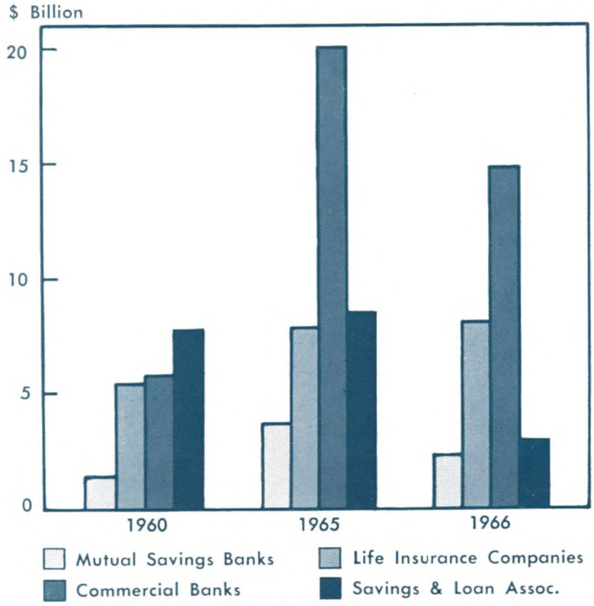


Source: Federal Home Loan Bank Board.

alternative investments to mortgages generally rose more sharply than mortgage rates. Of course, discounting of mortgages will increase their yield but large discounts discourage borrowing and detract from the lenders' good image.

A restrictive monetary policy also affects the mortgage market by diverting savings flows away from mortgage-lending institutions and into market securities. Institutions specializing in mortgages, such as savings and loan associations and mutual savings banks, are especially affected in this manner. These institutions have over 80% of their loans and investments in mortgages, which are basically long-term, fixed-rate investments. Thus, in the short run they are relatively inflexible in the rates they can pay depositors since the average yield on their assets can rise only slowly as the old, lower-yielding assets are gradually replaced by higher-yielding ones. Consequently, in periods of high interest rates, these mortgage lenders experience reduced flows of savings.

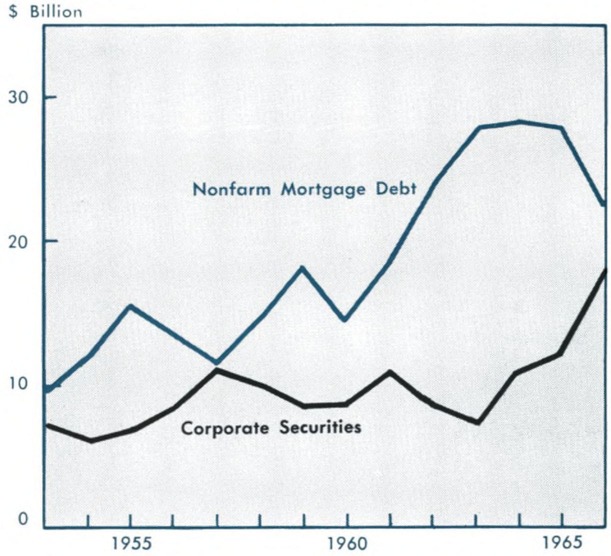
NET INCREASE IN SAVINGS



Note: 1966 Figures Estimated.
Source: Federal Home Loan Bank Board.

Commercial banks are restricted in the interest rates they can pay on time and savings deposits by Federal Reserve regulations. Within these limitations, however, a greater diversification of assets, including only 15% in mortgages, permits greater flexibility in the rates they can pay. As the second chart shows, commercial banks have been aggressive competitors for savings in recent years. Life insurance companies seem to be least affected by a restrictive monetary policy, being the only mortgage-lending institution on the chart to experience an increase in flow of funds in 1966.

ANNUAL NET CHANGE IN CORPORATE SECURITIES AND NONFARM MORTGAGE DEBT OUTSTANDING



Source: Board of Governors of the Federal Reserve System.

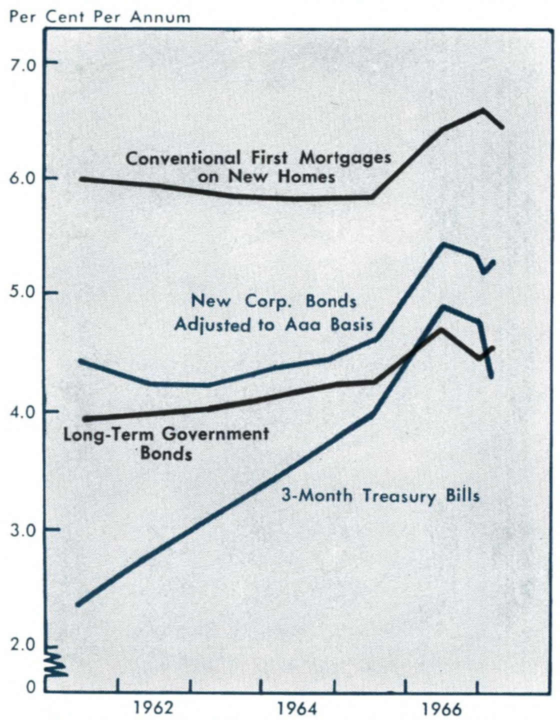
The 1966 Mortgage Market Increased Government spending in the Vietnamese War and continued large capital expenditures by business created large demands for funds and inflationary pressures in the economy in 1966. In the absence of stronger fiscal policy, monetary policy acted forcefully to curb the inflationary pressures. The combination of restrictive monetary policy and the large credit demands pushing up interest rates put severe pressure on the mortgage market.

As monetary policy firmed early in the summer credit conditions became increasingly tight. Rates paid to depositors were increasing but the inflow of savings declined. Government securities, offering record high yields, were the chief recipient of funds diverted from the mortgage market, but corporate and municipal securities also attracted mortgage money. The growth rate of mortgage loans outstanding on 1- to 4-family homes dropped from an annual average of 8.6% in the previous five years to 5.5% in 1966. This figure would have been smaller if the average size of mortgages had not risen. For the year, total new housing starts declined 18.9% after ranging from —3% to +10% during the preceding five years. The period of sharp decline lasted from March through October.

Reductions in mortgages extended by savings and loan associations and mutual savings banks accounted for about 85% of last year's estimated $7.6 billion decline in the growth of nonfarm residential mortgages held by the four major mortgage institutions. Savings and loan associations alone accounted for $5.0 billion of the decline. The scarcity of funds responsible for this reduced growth rate was in great part due to competition from high-yielding securities and the continued aggressiveness of commercial banks in attracting savings. Thrift institutions, however, also experienced declines in cash flows coming from mortgage prepayments and retirements. Householders reduced their prepayments on outstanding mortgages and more buyers of existing houses assumed the mortgages already outstanding on those houses. In addition, during much of 1966 savings and loan associations were restricted from raising rates paid on savings by Federal Home Loan Bank regulations, and in April the Federal Home Loan Banks, faced with tight money themselves, discontinued advances to savings and loan associations made for the purpose of expanding mortgage credit.

The growth in total savings of commercial banks fell sharply in 1966 but was still substantial and, as seen in the second chart, far larger than the growth of savings at the other three institutions. Despite the rising rates on market securities, commercial banks competed fairly sucessfully for savings through the first half of the year by offering instruments, such as savings certificates, with higher yields than regular

RATE OF RETURN ON SELECTED INVESTMENTS



Source: Board of Governors of the Federal Reserve System and the Bond Buyer.

savings accounts. As rates continued to rise, however, the Federal Reserve acted in July to reduce competition for funds among the principal mortgage lenders by lowering the Regulation Q ceiling rate payable on time deposits. Banks subsequently realized reduced success in attracting funds. During 1966 total mortgage loans held by commercial banks increased by $4.7 billion, about $1 billion below the record 1965 increase.

Life insurance companies in 1966 encountered unusually large demand for policy loans which together with the slowdown in mortgage prepayments tended to reduce their mortgage lending. In fact, however, a substantial decline in residential mortgage acquisitions was roughly offset by an increase in purchases of higher-yielding nonresidential mortgages.

The pressures created by the decline in the acquisition of new mortgages in 1966 by the four major mortgage institutions was at least in part alleviated by record purchases of mortgages by the Federal National Mortgage Association. This agency, commonly known as Fannie Mae, operates in the secondary market for VA-guaranteed and FHA-insured mortgages. During times of tight money the agency stands ready to buy eligible mortgages and thereby inject funds into the market. Conversely, it will sell mortgages in periods of money ease. In 1966 Fannie Mae purchased over $2 billion of residential mortgages, nearly double the previous record set in 1957. More striking is the mere $73,000 total of mortgages sold, down from about $46 million in 1965.

The Recovery As seen in the fourth chart, interest rates retreated from 1966 peaks during the first quarter of 1967. This decline in rates together with large increases in savings flows to thrift institutions raised expectations for a turnaround in the housing market. Total time and savings deposits at the three deposit-type institutions increased by $11.3 billion through the first four months of 1967. This equals, so far this year, the record pace of 1965 and far exceeds the $6.9 billion increase through April 1966. New policy loans by life insurance companies were also greatly reduced from the last half of 1966. More recently, however, rising long-term rates during April and May have dampened the optimism. Interest rates on home mortgages declined through April but apparently rose slightly in May. Other long-term rates turned up during April. The result has been that yield spreads have switched from favoring mortgages early in the year to currently favoring bonds.

THE FIFTH DISTRICT

Times Change "Expansion" was the word used to describe Fifth District business conditions in these columns a year ago. The discussion then centered on strong current construction activity, an acute labor shortage in textiles, furniture, and a host of service industries, and the extraordinary order backlogs that were very much in evidence early in 1966.

By contrast, this year finds the District economy in a somewhat different position. Growth has continued, but there has been ample evidence that a readjustment has been taking place. Expanding inventories and declining order backlogs were matters of considerable concern to many District industries during early months of this year, and, while some corrections have been made, inventories in particular are still being watched closely.

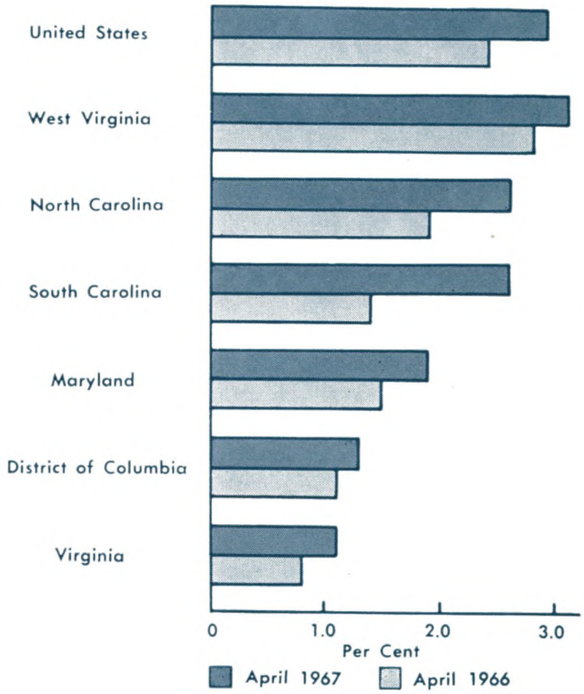
Unemployment Remains Low The insured unemployment rate was perceptibly higher in April than it was a year earlier, both in the District and in the nation as a whole. Despite this rise the level was well below that of any April in the 1961-65 period. Nevertheless, many people are now concerned with finding enough jobs for students and others entering the labor force. This contrasts with the search for warm bodies to fill the many vacancies which existed early last year. Employers, remembering the extremely tight labor situation of last year, and apparently expecting improvements soon, have been quite reluctant to lay off trained workers, even in the face of reduced orders and the rise in inventories that occurred in late 1966 and early 1967. Understandably, there are indications that most of the rise in unemployment is concentrated in the unskilled levels. This also helps to account for the concern with finding adequate jobs for new entrants into the labor market.

Virginia continues to report the lowest rate of insured unemployment in the District, a position it has maintained for much of the past five years. All District states except West Virginia report lower rates than the nation as a whole. Total unemployment remains below 4% in most of the states, although there are scattered localities where it has crept higher.

Man-Hours Also Edge Downward A further measure of year-to-year changes is the number of man-hours worked in manufacturing industries. The series peaked this January and has shown month-to-month declines each month through April, the latest month for which data are available. This reflects the elimination of overtime, which was dominant in 1966, and movement to short work-weeks in some cases as industries have moved to keep inventories in line with sales.

The impact of the change from what many have described as the overly exuberant economy of last year to the more nearly normal situation of the present has, of course, been uneven. Some industries, especially textiles, furniture, and lumber and wood, which were operating at extremely high levels a year ago, suddenly found their order backlogs declining sharply and inventories building up and hence have reduced man-hours. The food and tobacco industries, on the other hand, have recorded gains.

INSURED UNEMPLOYMENT
WEEKLY RATES
APRIL AVERAGE 1966 AND 1967



Source: U. S. Department of Labor.

Last year strong demands were placed on the textile industry by the Defense Department as the Vietnam conflict escalated sharply and necessitated the equipping of many new soldiers as well as replenishing reserve supplies. Private domestic demand was also high. Imports increased considerably during the year, however, and order backlogs declined sharply. Total national textile employment in May had dropped 2.5% below the level of a year earlier and weekly textile man-hours dropped 4.0%.

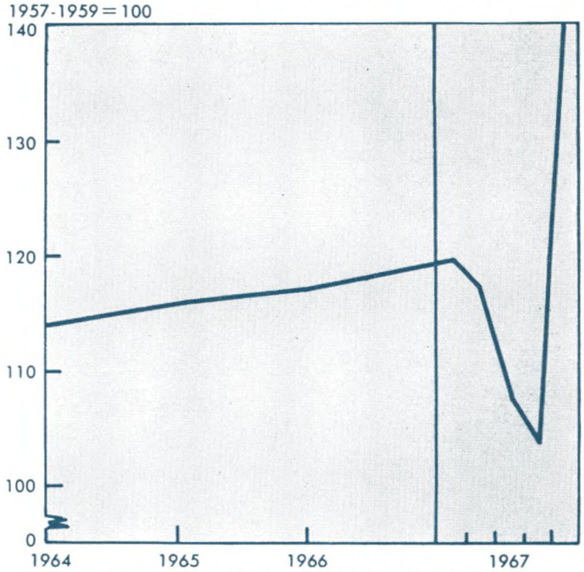
The changed situation in the lumber and wood industry, and to some extent in furniture, too, can be traced to the sharp declines in residential construction which dominated the last half of last year. There has been some improvement in the new housing picture this year, but residential construction remains somewhat short of the levels which were common during the period between 1963 and early 1966. Non-residential construction contracts for the first four months of this year were only slightly below those of a year ago. Total residential and nonresidential contract award values in the District in the first four months were down 14% from last year, and there was a national drop of 11%. Building permits, however, trended upward during the January-May period and in April and May were higher than at any time since March 1966.

Employment Above Last Year District nonagricultural employment increased throughout the year in 1966, but there was a very slight decline (less than 0.5%) during the January-May period this year. Even so, regional employment has been about 4% ahead of the same 1966 period. Manufacturing payrolls have eased gradually downward so far, but nonmanufacturing employment has gained slightly, particularly in the areas of government, finance, and services. Jobs with government—federal, state and local—had increased 2.2% this year through May and recorded the largest numerical gain of any of the major categories. Government employment averaged about 7.4% above year earlier levels during the first five months. Agricultural employment continued its long-term decline.

FIFTH DISTRICT MAN-HOURS
SEASONALLY ADJUSTED
(thousands)

	5th District April	% change from year ago 5th District	% change from year ago United States
Total Manufacturing	69,771	−1.3	−0.8
Durable Goods	26,075	−1.8	−1.5
Primary Metal	3,056	−6.8	−5.9
Lumber and Wood	2,670	−4.6	−5.4
Furniture and Fixtures	3,565	−4.1	−4.3
Electrical Machinery	3,703	−0.1	0.0
Nondurable Goods	43,696	−1.0	0.0
Food and Kindred Products	5,738	+3.8	+0.6
Tobacco Manufacturing	1,787	+4.2	0.0
Textile Mill Products	18,065	−3.1	−4.5
Paper	2,028	−0.7	+1.4
Chemicals	5,181	−0.3	+3.0

CIGARETTE PRODUCTION INDEX
SEASONALLY ADJUSTED-MONTHLY AVERAGE



Note: March, April, May 1967 Figures Estimated.
Source: U. S. Treasury Department, Internal Revenue Service.

Personal Income Up Personal income in the District, as in the nation, rose significantly in the first four months compared with early last year. Several factors help to account for the rise. Among them were: a larger employed labor force, higher wage and salary rates, and larger transfer payments including Social Security, Medicare, and various welfare programs.

Cigarette Production Up After climbing to a high level in January, cigarette production dropped for three successive months and then climbed very sharply in May, according to tax statistics maintained by the Internal Revenue Service. Despite further publicity on smoking hazards, cigarette consumption has continued to grow. Early in June major companies raised cigarette prices, particularly on their new extra-length brands.

District Economy Healthy In summary, although there have been some soft spots in the region's economy this year and despite some easing of the extreme expansiveness of last year, many indicators point to continued growth. The unemployment rate remains low in comparison with earlier periods and personal income and total employment have continued to expand.