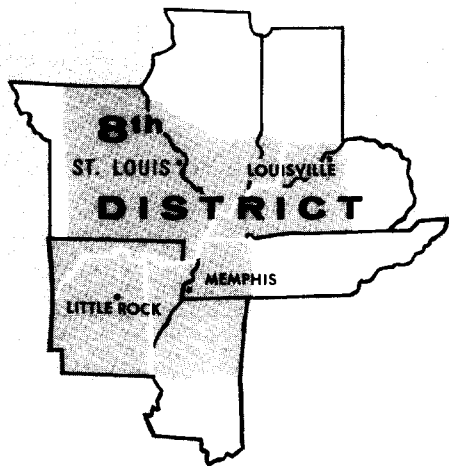


**MONTHLY**



# Review

**FEDERAL RESERVE BANK  
OF ST. LOUIS • P. O. BOX 442 • ST. LOUIS 66, MO.**

|   | Page |
|---|------|
| Rising Demand Supports Output Growth . . . . .      | 2    |
| Interest Rates Virtually Unchanged in Recent Months | 3    |
| Magnitude of the Federal Debt . . . . .             | 6    |
| Inflation and Interest Rates . . . . .              | 9    |

*This issue released on January 16.*

**VOL. 41 • No. 1 • JAN. '59**

# RISING DEMAND SUPPORTS OUTPUT GROWTH

AS 1958 ENDED, consumer spending was providing firm support for growth in the nation's production of goods and services. In December, department store sales apparently rose more than seasonally, and sales of new automobiles rose sharply as dealers' supplies increased. Total retail sales after seasonal adjustment were about 3 per cent higher in December than in October and November and exceeded the record rate reached during the summer of 1957. The October-December growth in sales occurred at both durable and nondurable goods stores.

During the recession, between the third quarter of 1957 and the second quarter of 1958, consumption expenditures for nondurable goods and for services increased by \$4.8 billion at the seasonally adjusted annual rate, or 2 per cent. Spending for durable goods, however, fell by \$4.8 billion, or nearly 12 per cent, with a drop in purchases of automobiles accounting for most of the decline. In the third quarter of the past year (July-August-September), consumer expenditures for nondurables and services continued to rise and an increase in spending for furniture and household equipment halted the year-long decline in sales of consumer durables. In the final quarter of 1958 a rise in automobile sales was added to the continuing growth of sales of household appliances and furniture. However, work stoppages at auto plants during much of the quarter held down production of the 1959 models so that consumer acceptance of the new models had not yet been thoroughly tested at year end.

Consumers, as buyers of new housing, provided most of the strength in private construction in 1958. Between May and December the seasonally adjusted annual rate of expenditures for private residential construction increased by \$4.4 billion, or 27 per cent. In terms of units, new private housing starts increased from a seasonally adjusted annual rate of 915,000 in February to 1.33 million in November.

Government expenditures for goods and services also continued to expand in the final quarter of 1958. Price-support operations of the Commodity Credit Corporation and the requirements of national defense programs brought about some increase in expenditures of the Federal Government. State and local government outlays were increased in part by growth in construction of public works. Expenditures for

new public construction (Federal as well as state and local) rose about 20 per cent on a seasonally adjusted basis between May and December.

Business expenditures for plant and equipment appear to have been slightly larger in the fourth quarter than in the third, according to the most recent United States Department of Commerce-Securities and Exchange Commission estimates. This suggests that the decline in business fixed investment from the peak reached in the third quarter of 1957 may have ended. Estimated expenditures for 1958 as a whole amount to about \$30.5 billion, as compared with expenditures of \$37.0 billion in 1957 and \$35.1 billion in 1956.

In the recession, total output of goods and services in physical terms fell much more than did final demand, or the actual purchases of goods and services for final use by consumers, government, and businesses. The difference between the rates at which goods and services were being purchased for final use and the rates at which they were being produced was made good by drawing down business inventories. Manufacturers, for example, sold to some extent from the stocks of their finished goods without refilling their shelves, or they used up stocks of materials on hand without replacing all of the materials used. Between the third quarter of 1957 and the second quarter of 1958 total gross national product estimated in 1957 dollars declined 5 per cent while final purchases in 1957 dollars declined but 3 per cent.<sup>1</sup> In the recovery since then total real output and final demand have been becoming more nearly equal, and in the final quarter of the year inventory liquidation probably ceased. If final demand continues to grow in the new year, total output may grow at an even greater rate for a time as some businesses find it necessary to add to their stocks of materials and goods in process in order to meet larger demands for their products.

The rising pace of production has improved employment conditions and raised personal income. In November and again in December manufacturing employment rose, in part because of settlement of work stoppages. At 50.7 million, total seasonally adjusted nonagricultural employment was 650,000 higher

<sup>1</sup> The United States Department of Commerce, National Income Division, has recently provided a valuable new tool in the form of quarterly estimates of real gross national product and its broad components. See the *Survey of Current Business*, December, 1958.

in December than at the recession low but still was nearly 2 million smaller than in mid-1957. Unemployment increased seasonally to 4.1 million between November and December. Personal income reached a seasonally adjusted annual rate of \$360 billion in November, with increases in wages and salaries accounting for most of the rise from the October rate. December personal income was undoubtedly higher also.

Prices have continued to be stable on the average, although prices of industrial materials, some manufactured items, and some services rose in November and December. Between October and early December price increases have been announced or put into effect for automobiles and some other consumer durables and some types of machinery. Wholesale prices of farm products and foods continued to decline in November and December, roughly offsetting the increases in prices of industrial commodities.

### *District Industrial Production Increases*

Industrial production in the Eighth District began 1959 on an upswing, according to early indicators, after allowing for seasonal influences. Automobile assembly plants, following strike and holiday interruptions, were operating on a relatively full schedule in order to stock dealers. The district's largest aircraft producer began working on several new contracts that appeared to assure a high rate of operation for many

months to come. Steel ingot output in early January at St. Louis was running at 93 per cent of rated capacity even after allowing for a 10 per cent increase of capacity during 1958. Shoe producers have experienced some increase in orders for 1959 shipments and anticipate a favorable spring season. Recent strengthening of demand was encouraging to producers of nonferrous metals, of which aluminum, lead, and zinc are particularly important to this district. Food and chemical industry spokesmen have issued optimistic reports for 1959.

Both Southern pine and hardwood lumber production in the district were greater in December than the latest three-year average for the same period, although they declined seasonally. Crude oil output reached the highest level of the year, reflecting the influence of a recently developed highly productive shallow field in Green County, Kentucky. And coal output in the district was running 10 per cent ahead of last year as the unusually cold weather in November caught dealers with low stocks and brought a rush of orders to mines.

Employment had increased slightly in three of the five major district metropolitan areas at mid-November, with manufacturing employment declining at only one center. Unemployment had risen slightly in four of the five areas, a seasonal pattern largely because of the slowdown in construction and other out-of-door activities during the cold weather.

## *Interest Rates Virtually Unchanged in Recent Months*

**A**LTHOUGH BUSINESS ACTIVITY and the demand for funds have been rising during the last three months, net changes in interest rates have been small. Discount rates, which did not rise as rapidly as yields on most marketable securities in the third quarter of 1958, have continued below their historic relationship with other interest rates. The increased demand for credit in recent months was partially matched by a more than seasonal growth in the money supply. Deposits in commercial banks and currency expanded more than seasonally during October and November, and according to preliminary indications rose again in December. The increase in the money supply has been caused largely by bank credit expansion.

### *Banking*

During the five weeks ending January 7, reserve balances of member banks rose nearly \$600 million. In the corresponding period a year earlier reserve balances rose less than \$500 million. The gain in reserves came primarily from an increase in the volume of borrowings from Reserve Banks. Member banks also received funds from currency movements, a sizable return flow into banks after Christmas more than offsetting an outflow in the three weeks before the holiday.

Demand for bank credit was relatively strong during December. Total loans at weekly reporting banks rose more than \$1 billion (2 per cent) in the five

weeks ended December 31. Normally, loans rise about 1.3 per cent at this time. Real estate credit, which characteristically declines during December, increased about 1 per cent. Advances for purchasing and carrying securities were up substantially, and business and "other" loans rose somewhat more than usual for this season.

The bank loan expansion was partially offset by net sales of securities. During the five weeks ending December 31, reporting banks sold \$460 million of securities on balance. Thus, total credit of these banks expanded \$560 million. The bulk of the sales were of short-term Government securities, a large portion of which were probably tax-anticipation bills purchased in November. Reporting banks increased their holdings of municipal and corporate obligations.

### Money Supply

Apparently, currency and coin outside banks plus commercial bank demand deposits (less interbank and U. S. Government and cash items in process of collection) rose more than seasonally in December. For the fourth quarter of 1958, it is estimated that the money supply may have risen at an annual rate of about 6 per cent on a seasonally adjusted basis. A major factor causing the money supply to grow was an expansion in bank credit.

Reflecting the growth in the money supply and a relatively high rate of turnover of money, total spending has been rising. Debits to demand deposits accounts (except interbank and U. S. Government) at banks in reporting centers outside New York city totaled \$376 billion in the three months ending with November 1958, compared with \$363 billion in the corresponding three months a year earlier. Information based on Eighth District banks indicates that total spending continued heavy during December.

### Interest Rates

Despite a more than seasonal demand for funds, interest rates in early January were generally close to levels reached three months earlier. Average yields on three-month Treasury bills in the week ended January 10 were 2.73 per cent compared with 2.75 per cent during the week ended October 4. Average yields on long-term Government securities went from 3.83 per cent in the week ended October 4 to 3.84 per cent in the week ended January 10. Over the same period yields on highest-grade corporate bonds declined from 4.13 per cent to 4.09 per cent.

### Discount Rates

In recent months discount rates have been low compared with the general structure of interest rates. In the past when discount rates have been relatively low the volume of member bank borrowing from the Reserve Banks has generally been higher than under the reverse conditions.

During the past fourteen months discount rates, interest rates charged by Reserve Banks on loans to the member banks, have been changed six times. From November 1957 through April 1958 discount rates were marked down from 3½ per cent to a level of 1¾ per cent in four steps. In the last half of 1958 discount rates were raised in two steps to 2½ per cent.

The following table gives the dates of change in discount rates from November 1957 through January 4, 1959.

#### RECENT CHANGES IN DISCOUNT RATES

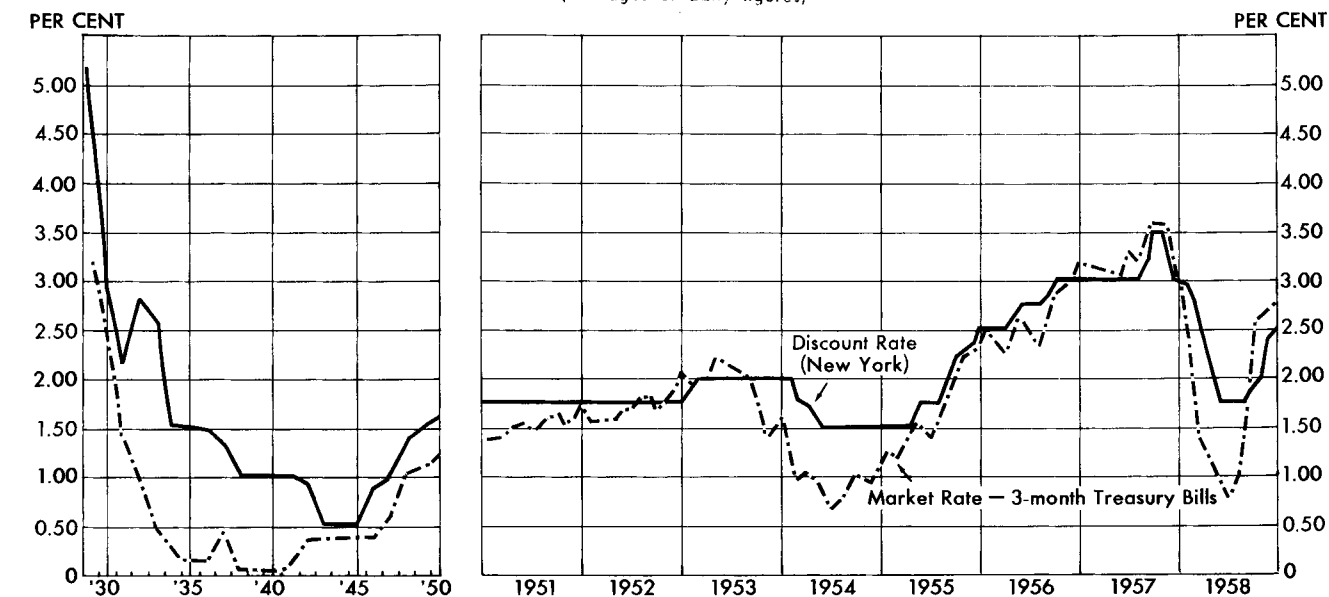
Federal Reserve Bank of St. Louis

|           | <u>Date Effective</u> | <u>Change</u> |           |
|-----------|-----------------------|---------------|-----------|
|           |                       | <u>From</u>   | <u>To</u> |
| November  | 15, 1957.....         | 3½ %          | 3 %       |
| January   | 24, 1958.....         | 3             | 2¾        |
| March     | 14, 1958.....         | 2¾            | 2¼        |
| April     | 18, 1958.....         | 2¼            | 1¾        |
| September | 12, 1958.....         | 1¾            | 2         |
| October   | 24, 1958.....         | 2             | 2½        |

Historically, the discount rates have been above yields on highest-grade short-term market paper most of the time. The accompanying chart shows the relationship between the discount rate and the market rate on three-month Treasury bills from 1929 through 1958. Using daily average figures, in each of the 22 years from 1929 through 1950 the discount rate at the New York Bank was higher than the Treasury bill rate. In 70 per cent of the 97 months since December 1950, the average discount rate was above the average bill rate.

Even though discount rates have been raised twice for a total of ¾ of 1 percentage point since last August, these rates have fallen substantially behind yields on high-grade securities. In both September and October average yields on Treasury bills were more than ½ of 1 percentage point above the discount rates. These were the only two months in

Discount Rate Compared to the Treasury Bill Rate  
(Averages of daily figures)



\*Source: National Bureau of Economic Research.

Note: 1929-50 plotted on annual averages. 1951-58 plotted on monthly averages.

**RELATIONSHIP OF DISCOUNT RATE TO  
TREASURY BILL RATE**

Averages of daily figures

|  | Years<br>1929-1950 | Months<br>Dec. 1950 through<br>Dec. 1958 |
|--|--------------------|--|
| <b>Discount rate above bill rate by:</b> |                    |  |
| More than 1 percentage point.....        | 6                  | 2  |
| .51 to 1.00 percentage point.....        | 8                  | 12                                       |
| .26 to .50 percentage point.....         | 5                  | 15                                       |
| .25 percentage point or less.....        | 3                  | 35                                       |
| <b>Discount rate below bill rate by:</b> |                    |  |
| .25 percentage point or less.....        | 0                  | 23                                       |
| .26 to .50 percentage point.....         | 0                  | 4  |
| .51 to 1.00 percentage point.....        | 0                  | 2  |
| More than 1.00 percentage point...       | 0                  | 0  |

recent years that the discount rates were so far below average Treasury bill rates. In both November and December discount rates were between  $\frac{1}{4}$  and  $\frac{1}{2}$  of 1 percentage point below the average bill rate. In only two other months in recent years (December 1952 and June 1957) has the Treasury bill-discount rate relationship fallen within this range.

In considering a change in discount rates the Reserve Banks are concerned with the magnitude of change as well as with direction and timing. In four of the six changes over the past fourteen months the discount rates were moved by  $\frac{1}{2}$  of 1 percentage point. Over the entire history of the Federal Reserve System the  $\frac{1}{2}$  of 1 percentage point change has been

used most often. From 1914 through 1958, the discount rate of the Federal Reserve Bank of New York was changed 68 times. About two-thirds of the adjustments were  $\frac{1}{2}$  of 1 percentage point, one-fifth were  $\frac{1}{4}$  of 1 percentage point and nearly one-seventh were  $\frac{3}{4}$  of 1 percentage point or greater. All changes in the discount rates of  $\frac{3}{4}$  of 1 per cent or more were made before 1934 and most of these large movements were used to make an upward adjustment in rates.

**NUMBER OF CHANGES IN DISCOUNT RATE**

Federal Reserve Bank of New York

| Amount of<br>Change                      | Raised | Lowered | Total |
|--|--------|---------|-------|
| $\frac{1}{4}$ of 1 percentage point..... | 11     | 3       | 14    |
| $\frac{1}{2}$ of 1 percentage point..... | 12     | 33      | 45    |
| $\frac{3}{4}$ of 1 percentage point..... | 1      | 0       | 1     |
| 1 percentage point.....                  | 5      | 2       | 7     |
| $1\frac{1}{4}$ percentage points.....    | 1      | 0       | 1     |
| Total.....                               | 30     | 38      | 68    |

Member banks use the discount facilities to meet unexpected deposit declines or temporary credit needs greater than can reasonably be met by use of the bank's own resources. Generally, banks do not borrow funds from the Reserve Banks to increase their holdings of securities even when the discount rate is below the yields available on high-grade obligations. Traditionally, bankers are reluctant to remain in debt for extended periods.

*Continued on page 11*

# MAGNITUDE OF THE FEDERAL DEBT

*The current Federal deficit raises questions about the size of the debt.*

**C**ASH EXPENDITURES of the Federal Government are now exceeding cash receipts at a rate of over \$10 billion per annum. Preliminary data for November and December indicate that outlays of the Federal Government exceeded income by roughly \$2.6 billion. Expenditures are customarily greater than receipts by about \$900 million in the two months. Hence, adjusted for seasonal influences, the Treasury operated at a \$1.7 billion deficit in November and December or at an annual rate of \$10.2 billion. This rate was still below the official forecast made in August which placed the cash deficit for the fiscal year ending June 30, 1959 at \$13.7 billion.

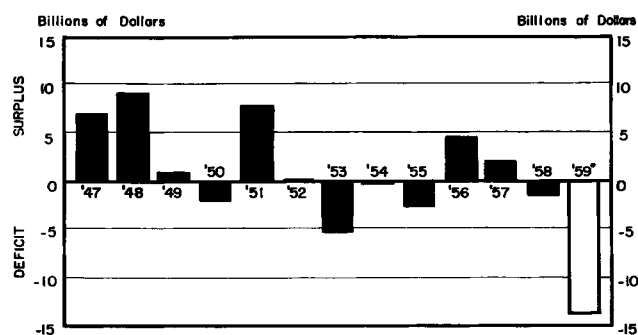
The stimulative effects of a large cash deficit were welcomed last spring and summer when there was a wide margin of idle capacity. Now, with business activity more nearly back to "normal", inflationary aspects of the deficit provide more reason for concern.

Some are worried about the burden of the Federal debt, which grows when the Government spends more than its income. In view of the deficit, the current growth in the national debt, and the public concern about the magnitude of the debt, it seems appropriate to review briefly Federal budget experience during the postwar period. A few comparisons will be made to put the national debt into better perspective.

## *Publicly held debt fell slightly from mid-1946 to mid-1958.*

In the table and chart adjoining, the net cash surplus or deficit of the Federal Government is given for each of the twelve fiscal years from July 1, 1946 to June 30, 1958. Over the entire period, the Government operated at a moderate cash surplus (nearly \$19 billion), rather than at a deficit as many people believe. Budgetary expenditures did exceed net budgetary receipts by about \$12.6 billion in the twelve years, but this was more than offset by surpluses in other Governmental activities, primarily trust funds operated by the Government.

Federal Cash Surplus or Deficit



FEDERAL GOVERNMENT CASH RECEIPTS AND EXPENDITURES (In billions of dollars)

| Fiscal Year Ended June 30 | Receipts | Expenditures | Surplus (+)<br>Deficit (-) |
|---------------------------|----------|--------------|----------------------------|
| 1947                      | 43.6     | 36.9         | + 6.7                      |
| 1948                      | 45.4     | 36.5         | + 8.9                      |
| 1949                      | 41.6     | 40.6         | + 1.0                      |
| 1950                      | 40.9     | 43.1         | - 2.2                      |
| 1951                      | 53.4     | 45.8         | + 7.6                      |
| 1952                      | 68.0     | 68.0         | - 0-                       |
| 1953                      | 71.5     | 76.8         | - 5.3                      |
| 1954                      | 71.6     | 71.9         | - 0.3                      |
| 1955                      | 67.8     | 70.5         | - 2.7                      |
| 1956                      | 77.1     | 72.6         | + 4.5                      |
| 1957                      | 82.1     | 80.0         | + 2.1                      |
| 1958                      | 81.8     | 83.3         | - 1.5                      |
| 1959E                     | 80.4     | 94.1         | -13.7                      |

Source: *Treasury Bulletin*  
E—Estimated

Reflecting the net cash surplus, plus a reduction in Treasury cash balances, the Federal debt in the hands of the public declined nearly \$21 billion (9 per cent) in the twelve years ended June 30, 1958. At mid-1946 there were about \$241 billion of Federal securities outside United States Government investment accounts; by June 30, 1958 there were just over \$220 billion. Total securities issued or guaranteed by the United States Government rose from \$270 billion to \$276 billion in the twelve years, but Government investment accounts increased their holdings from \$29 billion to \$56 billion.

*Relative to the real and dollar size of the economy, the debt declined significantly.*

While the national debt in the hands of the public has contracted about 9 per cent over the past 12 years, the real wealth, production, and income of the country have increased greatly. Personal income has risen by about a third in real terms, and dollar income has virtually doubled. Over the 1946-58 period, the gross national product of the country adjusted for price changes rose 44 per cent. Thus, over a 12-year span when the real product of the country was rising at an average rate of over 3 per cent per annum, the Federal debt (outside Government investment accounts) was declining at an average rate of about  $\frac{2}{3}$  of 1 per cent per year.

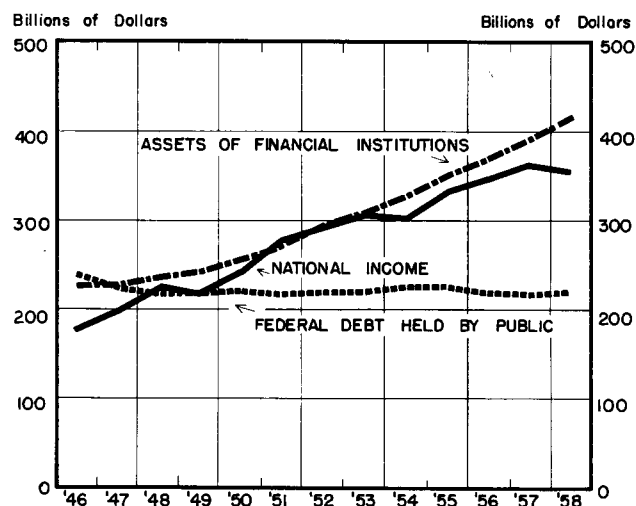
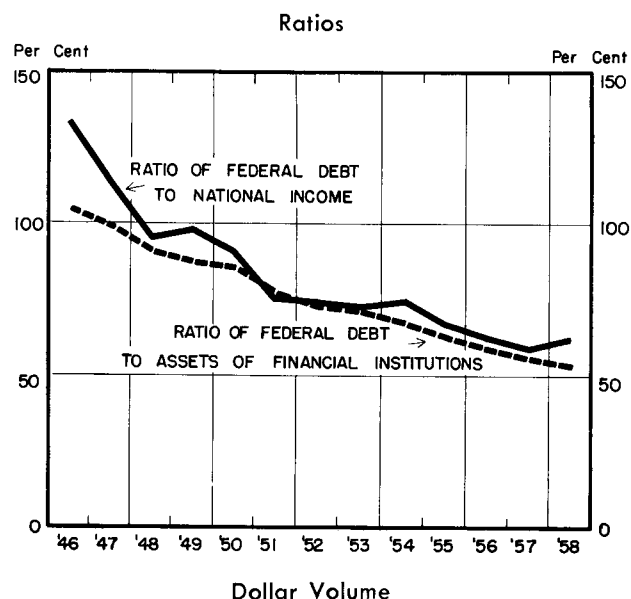
At mid-1946 the Federal debt in the hands of the public equaled 114 per cent of the national production for the year. By June 30, 1958 this debt was but half as large as the estimated gross national product for 1958.

The country's financial assets have also increased greatly over the postwar period. For example, resources of the country's leading financial institutions have risen 85 per cent. On June 30, 1946 the assets of commercial banks, savings banks, savings and loan associations, and life insurance companies combined amounted to \$227 billion. By mid-1958 their combined assets were \$419 billion. In 1958 United States Government securities in the hands of the public were equal to 53 per cent of the total assets of these institutions compared with 106 per cent in 1946.

The national debt has also declined in relation to cash receipts of the Federal Government. In 1946 the debt (outside Government investment accounts) was 5½ times as large as the Government cash receipts for the year, and in 1958 it was 2¾ times as large. Despite an increase in the cost of borrowing money since the end of World War II, interest payments on the debt held outside the Government declined from 2.7 per cent of national income in 1946 to less than 1.7 per cent in 1958. Servicing of the debt absorbed 11.0 per cent of Government cash receipts in 1946, but only 7.1 per cent in 1958.

Concern has frequently been expressed over the fact that a larger portion of the Federal debt is in the form of short-term obligations. On June 30, 1946 marketable Government securities due or callable within one year held by the public (other than U. S.

Publicly Held Federal Debt, National Income, and Assets of Financial Institutions



Sources: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, United States Department of Commerce, *Survey of Current Business*, Treasury Department, *Treasury Bulletin*. Some data interpolated and some estimated by Federal Reserve Bank of St. Louis.

Government investment accounts and Federal Reserve Banks) amounted to \$39 billion, accounting for 16 per cent of the total national debt held by the public. By mid-1958, the amount of these short-term obligations had risen to \$49 billion or 22 per cent of the total. According to preliminary indications, the rates rose to about 24 per cent by the end of 1958.

One fear of an increasing volume of short-term securities outstanding is that, since these issues are generally attractive to commercial banks, there is more likelihood that the debt will be financed by credit creation (monetized) rather than financed out of savings. However, from mid-1946 to mid-1958

short-term Government security portfolios of commercial banks fell from nearly \$24 billion to \$16 billion despite the larger volume of these securities available.

Although large short-term debt adds to problems of monetary management, it should be noted that the rise in the dollar amount of short-term Federal debt outstanding in the twelve-year period (26 per cent) was less than the increase in personal incomes in real terms (34 per cent) or in dollar terms (98 per cent). A larger volume of short-term Federal debt has probably filled a need in our growing economy. It has provided states and local governments, nonfinancial corporations, and other investors with high-grade liquid instruments for investment of temporarily idle funds.

*The debt is an established part  
of our financial structure.*

Although ownership of the Government debt shifts from time to time in response to changing conditions, the debt appears to be imbedded in our financial structure. Government securities are a major asset of most financial institutions and many other organizations. Such obligations are universally considered to be of highest grade and very liquid. Prices of Government securities, of course, fluctuate as aggregate demands and supplies of investment funds change, but buyers for a large volume of Government securities usually can be found without depressing prices greatly by the offering.

As the Federal debt matures, the Treasury is faced with refinancing problems, such as determining the proper rates and other terms on its offering in light of current market conditions. The Treasury, at times, has also been restricted in the interest rates it could offer on these issues, complicating its task. However, if the Government stands ready to pay the rates called for by the demand and supply conditions of the money market, there is little doubt but that any re-funding will be a success.

The existence of an outstanding Federal debt of \$220 billion in the hands of the public is not in itself conducive to inflation. So long as it is financed at

interest rates appropriate to the current supply and demand for credit and is not permitted to implement an undue credit expansion of the commercial banks, it is a neutral factor. At times of financial stress some monetization of the debt might be unavoidable, but with determined effort and a willingness to pay going interest rates for savings, the existing debt should not be inflationary.

*Net increases of debt carry dangers of inflation.*

A net increase in the Government debt is usually more of an inflationary threat than the refinancing of the existing stock of debt. When the debt of the Government is increasing, the rest of the economy must be saving on balance, either intentionally or by being forced to consume less via higher prices. To avoid inflationary pressures when business activity is near capacity, the current increase in the debt must be financed at such rates, and with such other terms, that it attracts a like amount of savings or postponement of other investment. Inflationary pressures will result if the deficits are covered by attracting otherwise idle funds, speeding up the velocity of the existing money supply, or by bank credit expansion increasing the size of the money supply. If the current increase of the debt plus other investment demands for funds are financed at such interest rates that they do not exceed people's willingness to save, it will not cause inflation.

*Sound financing of any unavoidable deficit  
can restrain inflation.*

It has become part of the folklore of the country that we have a tremendous Federal debt and that it has been continuously growing. The facts are that it has not grown on balance for over a decade, that relative to the growth in the rest of our financial structure the national debt has declined to only half the size reached at the end of World War II, and that it is at its most manageable size in nearly two decades. If future increases in the Federal debt are limited to reasonable proportions, and if they are financed sensibly in the light of prevailing financial conditions, the debt should be manageable and need not necessitate or create a presumption of inflation.





# INFLATION AND INTEREST RATES

**A**N ECONOMIC SYSTEM can produce only so much with a given volume of resources and an existing state of technology. Demands for goods and services beyond this point cannot be satisfied. If aggregate demand exceeds the supply of available goods, rationing is accomplished by rising prices (inflation) until enough of the requests are squeezed out so that demand and supply are equated. Inflationary pressures frequently arise even before the economy reaches the limits of physical and technological capacity because of immobility of resources, focusing of demand on items whose supply cannot be increased readily, and administered factor and product prices.

## The Nature of Inflation

The insidious nature of inflation has been widely publicized and needs little elaboration. Since prices do not rise evenly, inequities are created. Fixed income receivers, pensioners and holders of savings deposits, bonds, and insurance policies find their purchasing power reduced. Rising sales flowing from a hyperactive demand encourage marginal enterprises and unsound expansions. Incentives to increase efficiency are dulled. For a while businessmen have a pleasant sensation since consumers have an apparently insatiable appetite. Inflationary pressures, at times, stimulate business sales, but they take a heavy toll in reduced purchasing power and in development of inequities and instability. Continuous inflation leads to inefficiencies, maladjustments, social unrest, and if carried far enough the collapse of the financial structure. History has shown us the ruinous course of inflations within the memory of the present generation—the German, Austrian, and French inflations of the early twenties—the South American and other inflations which are wreaking their toll today before our eyes.

A secular trend of inflation can be avoided if total demand is limited by fiscal and monetary policy to that which is compatible with existing resources, technology, and business structure and if the prices of

resources and products are not monopolistically raised. Both consumer and wholesale prices moved within a narrow range over most of 1958, but inflation is still a threat.

Despite a margin of idle capacity and large productivity gains, some analysts have been anticipating that during 1959 upward pressures on prices will again develop. Consumers are expected to spend more, and businessmen with improved inventory-sales ratios and a high degree of optimism may increase investment outlays. In addition, the Federal Government will probably be operating at a sizable cash deficit.

A Federal deficit may be appropriate as a stimulative measure when business output and sales are relatively low or declining, but is generally inappropriate when activity is near capacity and rising. With an increase in business and personal incomes Treasury tax receipts will automatically rise, and certain Governmental expenditures (such as unemployment compensation payments) will probably decline. It is unlikely, however, that these developments alone will balance the budget in the near future.

If the nation cannot see its way clear to tax as much as it spends, or better still, under high employment conditions, to operate at a budgetary surplus, the next best alternative when inflationary pressures strike is to finance the deficit in a noninflationary way. A big step would be to borrow the funds from those who refrain from spending their entire incomes, that is, savers or those institutions that lend savings of others. Total demands for goods and services can be brought into line with available supplies if Government deficit plus private investment intentions do not exceed the amount people are willing to save.

## Financing of the Deficit

During the summer of 1958 a disturbance developed in financial markets, partially as a result of anticipations of a renewal of inflationary pressures cultivated by the turnaround in business conditions and the expected budgetary deficit. The attractiveness of fixed-

value securities (bonds) declined rapidly, and there was a marked increase in popularity of equities (common stocks and houses). By mid-September, the pressure to sell bonds had virtually ceased, and interest rates stabilized at levels considerably above those which prevailed during the early summer. Prices of common stocks, however, continued to rise throughout the remainder of the year.

One development in the early October period, which was favorable for economic stabilization, was the marketing by the Treasury of about \$4 billion of securities at interest rates sufficient to attract savings, that is,  $3\frac{1}{4}$  per cent for 7-month special bills and  $3\frac{1}{2}$  per cent for 15-month notes.<sup>1</sup> Although initially about \$2.2 billion of the \$2.7 billion bills and nearly \$0.7 billion of the \$1.2 billion Treasury notes were acquired by commercial banks, the bulk of these securities quickly moved out of the banking system into the hands of investment institutions and nonfinancial corporations. By following a debt-management policy of competing for the nation's savings, the Treasury was successful in obtaining a major portion of its cash requirements without a corresponding expansion in the money supply. The successful financing of the October cash offering may be attributed in large part to the attractive interest rates.

Following announcement of the October cash offering the structure of interest rates rose. But after the offerings had been digested rates again fell about the middle of October and remained at about late September levels through November. Nine-month Treasury certificates which were yielding roughly 3 per cent during the first half of October brought about 2.75 per cent in the last half of the month and during

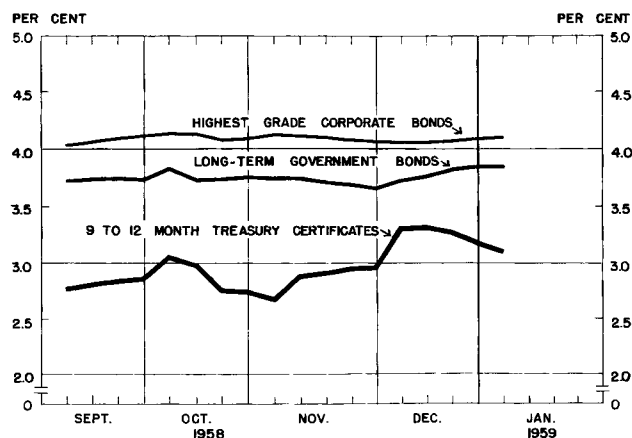
November. Rates on longer term Government securities and corporate issues worked slightly lower also (see chart). Dealers marked down rates on prime 4-to-6-month commercial paper in two steps, October 28 and November 10, from  $3\frac{1}{4}$  per cent to a level of 3 per cent. The easing reflected many things, including investor confidence in the existing rate structure and a moderate bank credit expansion.

Partly as a result of the mild easing in the money market, the Treasury obtained new funds in November at a lower rate of interest than it paid in early October. The cash offering of about \$3 billion of 7-month tax anticipation bills was announced on November 10. Subscription books were open until November 14, and payment was made on November 20. Average rate on accepted bids was virtually 3 per cent, and initially the bulk of these securities were purchased by commercial banks.

Following the November financing, some short-term interest rates increased slightly. Interest rates on Treasury bills averaged about 2.73 per cent in the week ended January 10, up from 2.50 per cent in late October and early November, and dealers marked up rates on prime 4-to-6-month commercial paper from 3 to  $3\frac{1}{4}$  per cent between November 19 and January 10. Interest rates on most longer term market issues continued to drift lower during most of November but rose during December.

On January 8, the Treasury announced a cash offering of \$750 million of 4 per cent 21-year bonds. The bonds were issued at a price of 99 per cent of face value, to yield about 4.07 per cent. Subscription books were open on January 12 and 13, and the securities are to be dated January 23. To encourage subscriptions from savings-type investors, savings institutions were permitted to pay for the bonds allotted to them in installments up to April 23. In addition, the Treasury offered \$2½ billion of 16-month Treasury notes bearing interest at the rate of  $3\frac{1}{4}$  per cent, and to be issued at a price of 99½ per cent of face value, to yield about 3.45 per cent. The books were open only on January 12 for receipt of subscriptions, and the notes will be dated January 21.

Selected Interest Rates



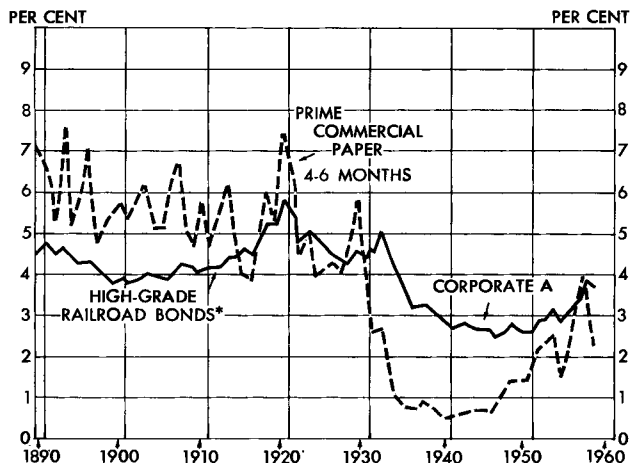
<sup>1</sup> The Treasury announced the offering on September 25, with subscription books open until September 29; payment dates were October 8 for the bills and October 10 for the notes.

### The Interest Rate Prospect

In view of the great current and growing demand for investment, some may feel that interest rates necessary to limit total demand for funds to the amount people are willing to save will be higher within the next year or two than the levels reached in recent years. For about three decades the country

has been accustomed to interest rates which by precedent of a longer history are very low (see chart). They

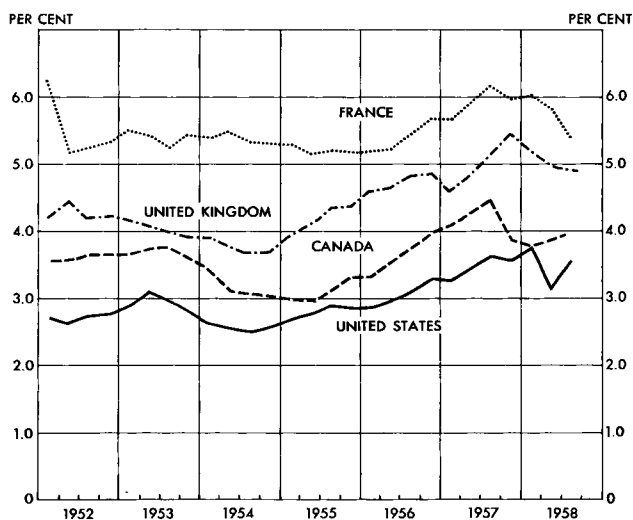
Long- and Short-Term Interest Rates



Source: Board of Governors of the Federal Reserve System.

are also below current rates in most other parts of the world (see chart). With productivity of capital so great as at present, an efficient operation of the

Yield on Long-Term Government Bonds 1952-58, By Quarters



Sources: Board of Governors of the Federal Reserve System and the International Monetary Fund.

economy may require an upward adjustment in interest rates over the next few months. Also, it is possible that as market rates adjust to changing conditions short-term interest rates may again be higher relative to long-term rates. The historical precedent may be of interest here (see chart).

In summary, if the nation seriously thinks that inflation is a danger, and if there is a will to avoid this danger, the means are at hand, and the means are compatible with free markets. A major condition is that interest rates shall prevail which limit total demand for funds to the proportion of income which the public chooses to save.

## Interest Rates Unchanged

Continued from page 5

Nevertheless, during the times when the discount rates have been low relative to market rates of interest, member bank borrowing from Reserve Banks has usually been heavy. Some member bank borrowing probably reflected the larger demands for

### DAILY AVERAGE BORROWINGS OF MEMBER BANKS FROM FEDERAL RESERVE BANKS

December 1950 through December 1958

| During Months when:                         | Number of Months | Average Borrowing (In Million Dollars) |
|---|------------------|--|
| Discount rate was above Treasury Bill Rate: |                  |  |
| More than ½ percentage point.....           | 18               | 177                                    |
| ¼ to ½ percentage point.....                | 15               | 349                                    |
| ¼ percentage point or less.....             | 35               | 611                                    |
| Discount rate was below Treasury Bill Rate: |                  |  |
| Total.....                                  | 97               | 565                                    |

credit prevailing during the periods in which discount rates have fallen behind other yields, but some borrowing probably resulted from bankers electing to use this mechanism in preference to some other method of getting temporary cash balances. In choosing between alternative ways of adjusting reserve positions, member banks can be expected to consider relative costs in their decisions.



### Notice Concerning Tables Formerly on Back Page

**M**ANY of the tables formerly printed on the back page of the Monthly Review are available for distribution by first class mail in mimeographed form. A list of those available will be sent upon request.

Please address inquiry to:

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Federal Reserve Bank of St. Louis  
Box 442  
St. Louis 66, Missouri

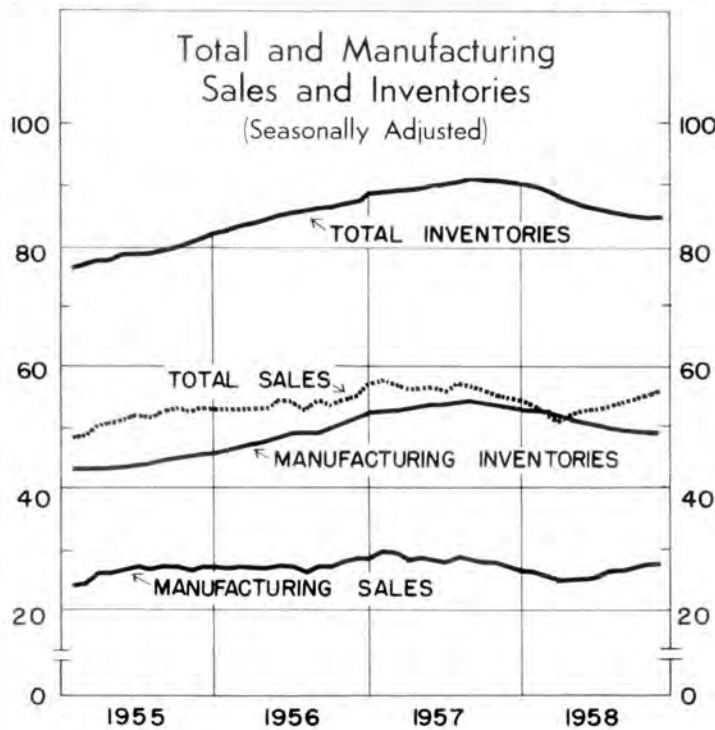
# Selected Current Business Indicators

Billions of Dollars

Billions of Dollars

Billions of Dollars

Billions of Dollars



Sources: Sales and Inventories—Department of Commerce; Housing Starts—Department of Labor; Index into Production—Board of Governors of the Federal Reserve System.

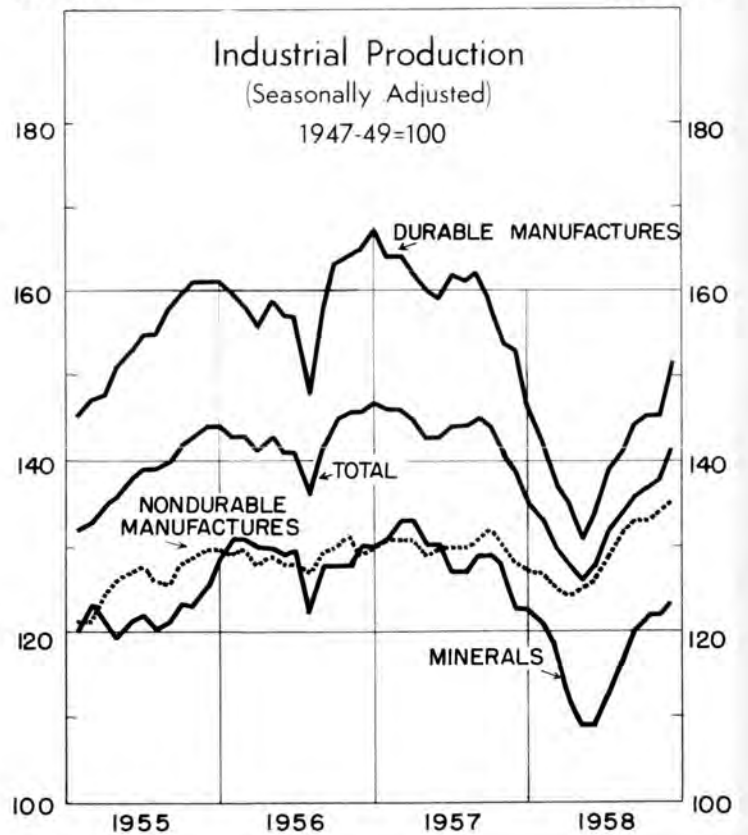
Millions of Units

Millions of Units



Per Cent

Per Cent



Latest Figures Plotted: November

The year 1958 ended on a business upswing. These graphs show that total sales (manufacturing, retail, trade and wholesale trade) seasonally adjusted increased. Inventory accumulation seasonally adjusted began to replace inventory depletion, though the upturn was of very small magnitude. Private nonfarm housing starts (seasonally adjusted) and industrial production (seasonally adjusted) continued to rise.