MONTHLY Review

FEDERAL RESERVE BANK

OF ST. LOUIS • P. O. BOX 442 • ST. LOUIS 66, MO.

This issue released on October 30

VOL. 41 • No. 10 • OCTOBER '59

Current Business

Forces of Expansion in the Economy

As THE EFFECTS OF THE STEEL STRIKE spread like an out-of-season cold wave, they dominate most discussions of current economic conditions. At the same time they make appraisal of the situation exceptionally difficult by distorting the usual measures of activity, such as industrial production, railroad freight carloadings, manufacturers' sales and orders, and the like. Of necessity then, discussion turns to speculation about underlying sources of demand and the forces which make for the recurring expansions and contractions of activity that have long characterized the American economy. It therefore seems timely to review the recovery from the most recent recession, in order to discern expansionary forces which might be expected to persist or to subside.

The recovery from the spring of 1958 through June of this year brought an increase of $53 billion in the seasonally adjusted annual rate of gross national product, or 12 per cent. Since the price level was relatively stable over the period the gain in physical output was about as great as the gain in output measured in dollar terms. Industrial production rose 23 per cent in the 14 months ending in June, reaching a level about 7 per cent above the prerecession peak. In the third quarter gross national product is estimated to have slipped back $4-5 billion or so in annual rate from the peak of $484.5 billion reached in the second quarter. The industrial production index declined from 155 per cent of the 1947-49 average in June to 148 in September despite increases in output of some industries not affected by the strikes in the steel and copper industries.

The general outlines of the forces for recovery from the recession are now obvious in retrospect; a large increase in consumer spending, a rise in residential construction, a shift from liquidating business inventories to building up inventories, and growth in government expenditures. These were joined several months after the recovery began by an upturn in business spending for plant and equipment. Questions to ask now are: Have any of these major types of demand stopped growing? Will they be as strong after the strike as before it?

Consumer Demand

Although total spending of consumers declined very little during the recession, purchases of durable goods, particularly automobiles, contracted sharply. Between the third quarter of 1957 and the second quarter of 1958 consumer purchases of durable goods declined by $4.2 billion in seasonally adjusted annual rate, or about 10 per cent. Purchases of automobiles and parts accounted for $3.7 billion of the drop in total durables purchases, falling more than 20 per cent. The volume of outstanding consumer instalment credit contracted during most of 1958, reflecting the reduction in financing of automobiles.

This year, consumer spending for durable goods has risen again, with autos accounting for a considerable part of the increase. Sales of domestically produced autos reached a seasonally adjusted annual rate of 5.6 million in the third quarter, as compared to total sales of 4.3 million in 1958. Total auto sales, including imports, reached an annual rate of 6.2 million units. In 1955, when imports were a negligible factor, total auto sales reached a peak annual rate of 7.4 million.

A rise in consumer instalment credit has accompanied the increase in consumer buying of durable goods. The total increased in July and August at a seasonally adjusted annual rate of about $6 billion, approximately the same rate as in the third quarter of 1955. Although the rate of repayments on instalment credit rose about 7 per cent from the second quarter of 1958 to August 1959, it remained at about 13 per cent of disposable income, a ratio which has been roughly the same since 1956.

It is interesting to note, however, that automobile credit has accounted for a smaller part of the growth of instalment credit thus far this year than it did in the comparable period of 1955. Through August of this year about 45 per cent of the increase in instalment credit was in auto loans as compared with nearly 70 per cent in the same period of 1955.

In the great expansion of consumer credit in 1955 a major development was a lengthening of maturities. There has recently been some increase in the proportion of 36-month contracts on new cars and 30-month contracts on used cars but this change is not as significant as the lengthening in 1955.

Consumer spending has been noticeably resistant to decline in the postwar recessions and has grown rapidly in each of the recoveries. Currently, the strength of consumer demand is being put to another test. The strike and its associated layoffs are affecting consumer income much as a recession does. There are, of course, important differences; the steel workers and the other people laid off still have jobs and presumably expect a period of high output after returning to work. Nevertheless, the income loss has been considerable.

Between June and September wages and salary income declined by $3.5 billion in seasonally adjusted annual rate, or 1.3 per cent. Since September, growing shortages of steel have probably reduced wage and salary income further. In St. Louis alone, for example, the number of men laid off because of steel shortages is estimated to have reached about 10,000 in late October from less than a thousand in September.

The maximum decline in wage and salary income during the past recession was $7.9 billion in seasonally adjusted annual rate, or 3.3 per cent, and occurred between August 1957 and April 1958. This year's strike-related decline in wages and salaries was by September more than one-third as great as the decline resulting from the recession. During the recession a large part of the $7.9 billion decline in wages and salaries was offset by an increase of $2 billion in the net income of farm proprietors and a $4.7 billion increase in transfer payments, including unemployment compensation, social security benefits, and veterans' benefits. These offsets cannot be expected to be nearly so effective this year. Net farm income in fact has been declining this year; part of the increase in transfer payments last year was the result of changes in scale and coverage of social security benefits; and unemployment compensation payments are limited to nonstrikers.

The influence of such a decline in consumer income upon spending is extremely difficult to weigh. Consumer spending has generally declined less than income in each of the recessions. Furthermore, the length of time in which incomes are reduced is obviously an important factor; if people believe a drop in current income is a temporary matter they are more apt to attempt to maintain customary rates of spending than they would if the drop was believed to be permanent. They may draw upon savings or borrow to tide themselves over a period of reduced income. While the strike is expected to be a temporary interruption, it may be significant that its income effects are concentrated upon the same classes of people who were most affected by the recession little more than a year earlier, production workers in durable goods manufacturing, miners, and railroad employees. Some of these people probably have not had time to rebuild financial resources depleted by the recession.

For whatever reasons, growth of retail sales came to a halt in the third quarter after rising at an average rate of more than 2.5 per cent per quarter, or 10 per cent per year, since the third quarter of last year. Retail sales declined 1 per cent in August and 2 per cent in September after reaching a record level in July. Most types of retail stores had declines in sales in September. Sales in the automotive group were down 5 per cent and sales at other durable goods stores were also off, causing sales of the durables stores as a group to be off 4 per cent. Sales in nondurables lines were down 1 per cent.

Despite the decline in retail sales total consumer expenditures as estimated in the national income and product accounts may well show a small increase from the second quarter to the third, largely because of a continuing increase in expenditures for services which are not included in the retail store series. The expenditures for services are heavily weighted by rent payments and imputed rent on owner-occupied houses so are considerably less volatile than expenditures for goods. Furthermore, changes in tastes and living standards have been conducive to steady growth of expenditures for personal services, such as medical care and travel, for the whole postwar period.

Construction

Expenditures for new construction rose sharply from the spring of 1958 until March of this year; held steady for two more months; and then began to decline again. Private homebuilding accounted for more than three-fourths of the increase in construction spending as the seasonally adjusted annual rate

Construction Contracts Awarded

(Millions of dollars)

United States	June, July, August 1959	1958	Per Cent Change	First Eight Months 1959	1958	Per Cent Change
Public works and utilities	$ 2,189.2	$ 3,389.9	—35.4	$ 5,617.2	$ 6,674.1	—15.8
Residential	5,002.7	4,372.3	+14.4	12,120.8	9,500.0	+27.6
Nonresidential	3,207.4	3,131.0	+ 2.4	7,857.0	7,624.3	+ 3.1
Total	$10,399.2	$10,893.2	— 4.5	$25,595.0	$23,798.5	+ 7.5
Eighth District						
Public works and utilities	$ 126.8	$ 162.0	—21.7	$ 384.1	$ 333.5	+15.2
Residential	200.1	162.7	+23.0	495.3	389.0	+27.3
Nonresidential	152.2	137.4	+10.8	363.5	390.1	— 6.8
Total	$ 479.2	$ 462.1	+ 3.7	$ 1,242.9	$ 1,112.6	+11.7

Source: F. W. Dodge Corporation.

of housing starts rose from less than one million in March 1958 to a peak of 1.43 million in April of this year. Part of the early rise in home-building was spurred on by special Federal programs to provide financing assistance for low-cost housing as a counter-recession measure. The low interest rates obtainable on government securities in the first half of 1958 also made mortgages, particularly those underwritten by the FHA and VA, relatively attractive to investors.

Residential mortgage markets have recently been under considerable pressure as demands for funds have increased on all sides. Despite the rise of interest rates and the competing demands for funds total mortgage debt increased by a record $5.5 billion in the second quarter of this year to $181 billion. Home mortgage debt rose by a record $4 billion with four-fifths of the rise in the form of conventional mortgages. The increasing costs of financing and declining availability of credit have probably been factors in a gradual decline of new housing starts to a seasonally adjusted annual rate of 1.33 million in September. Applications for FHA mortgage insurance and requests for VA appraisals declined in September also, suggesting that home starts may continue to go down in the near future.

Recent legislation may tend to support demand for residential construction. The Housing Act of 1959 increased the FHA general mortgage insurance authorization by $8 billion and authorized a reduction in minimum statutory downpayments on FHA-insured home mortgage loans. The authority has not been used, however. It also permitted Federal savings and loan associations to make loans for acquisition and development of raw land under certain conditions. Several steps were taken in the Housing Act and other legislation to facilitate mortgage lending by banks also. The Housing Act excluded FHA-insured home mortgages held by national banks from Federal Reserve Act limitations on the amount of real estate loans that a national bank may hold in relation to its capital and surplus or its time and savings deposits. Other legislation expanded mortgage lending powers of national banks by increasing the maximum loan-to-value ratio on conventional mortgage loans to three-fourths from two-thirds.

The Eighth District as a whole appears to have fared a little better than the nation in volume of construction contracts let during the summer, according to reports of the F. W. Dodge Corporation. The total for June, July, and August, was up 3.7 per cent from the volume in the same period of 1958, as compared

Contracts for Residential Construction in Eighth District Metropolitan Areas

(Millions of dollars)

	First Eight Months 1959	1958	Per Cent Change
St. Louis	$128.9	$ 83.4	+54.6
Louisville	58.5	44.3	+32.1
Memphis	46.6	31.0	+50.3
Little Rock	10.6	11.3	— 6.2
Evansville	7.9	5.4	+47.3
Springfield (Mo.)	6.0	5.4	+11.1
Six-area total	$258.5	$180.8	+43.0

Source: F. W. Dodge Corporation.

to a decline of 4.5 per cent for the nation. Residential awards appear to account for the difference in behavior of the district and national contract volumes.

For the year through August the total volume of construction contracts awarded in the Eighth District was 11.7 per cent higher than the volume of awards in the same months of 1958. The corresponding gain for the nation was 7.5 per cent.

Business Investment

Business inventories probably changed little during the third quarter, after building up at a $10 billion annual rate in the second quarter. Users and distributors of steel drew on the stocks they had built up in preparation for the strike. By October steel stocks were down to such low levels that production of many items had to be curtailed.

Business expenditures for new plant and equipment had been rising at the time the strike began, and surveys of business plans indicated that the rise would continue for a time. Currently there are some indications that fixed investment programs may be delayed by difficulties in obtaining steel. Another factor that may revise the timetable is the impact of the strike upon business revenues. The loss of income experienced by some companies may reduce their internal resources for financing capital spending, at least for a while.

Agricultural Conditions

Total output from the nation's farms this year is expected to exceed the record level of 1958, according to the United States Department of Agriculture. Production of livestock and livestock products may exceed 1958 production by about 2 per cent and production of crops is expected to equal last year's level.

Pork production estimated at 11.7 billion pounds may exceed last year's output by 10 per cent but will be less than the previous record of 13.6 billion pounds in 1943. Milk, beef, and poultry production is expected to approach record levels.

Corn production estimated at 4.4 billion bushels is 17 per cent more than the previous record of last year and 36 per cent more than the 1948-1957 average. Soybeans output is estimated at about 8 per cent less than last year but 62 per cent more than the 1948-57 average. Oats and wheat each are expected to be down about 24 per cent.

A feed grain crop of 167 million tons is expected, topping the 1958-59 record by 6 per cent and almost 30 per cent greater than the 1953-57 average. Carryover from former crops is estimated at 68 million tons, 9 million more than a year earlier and a further increase in carryover is expected in 1960.

Cash receipts from farm marketings were down 2 per cent in the first 8 months of this year compared to the same months last year. Increased marketings this year have nearly offset lower prices. Gross income has declined somewhat more. Government payments to farmers this year have been lower with the end of the Acreage Reserve portion of the Soil Bank Program. Net income to farmers has also declined as expenses in the first half of the year were up about 3 per cent from year-earlier levels.

Prices received by farmers on September 15 averaged about 6.3 per cent below levels of a year ago. The greatest reductions occurred in prices received for hogs, sheep, and poultry. Prices of beef cattle and most crops have held near 1958 levels. Most crop prices were near support levels in both periods.

Farm conditions in the Eighth District generally parallel those of the nation. Crops are good to excellent throughout the district and with the exception of some recent rains (which were needed for fall seeded crops) harvesting conditions have also been good. The corn crop is expected to exceed the production last year by about one-third in Missouri, 17 per cent in Kentucky, and 16 per cent in Illinois. Output of oats and soybeans is down somewhat from 1958 levels in most district states.

Burley tobacco production in Kentucky is estimated at 6 per cent above that of last year. Increased burley production is also estimated in other district states.

(Continued on Page 114)

The Interest Rate Ceiling on the Federal Debt

THE ENTHUSIASTIC PUBLIC RESPONSE to the issue of the Treasury "Fives" has introduced in the money market a note of optimism in marked contrast to the "all is now lost" feeling generated initially by Congress' refusal to raise the interest ceiling on marketable Government bonds (issues of five years or more). What this recent Treasury success means for debt management and the related problems of monetary policy is a question that will be debated for some time to come.

This article attempts to put the problem of the interest rate ceiling in perspective. First, it explains the reasoning of those who regard the interest ceiling as extremely dangerous under present market conditions. Secondly, it examines the conditions under which the interest ceiling problems might be minimized. It concludes that, despite the problems created by the statutory limit on interest rates, the present lack of balance in the maturity of the debt need not increase substantially the immediate pressures of inflation during the next several months.

Dangers Inherent in the Interest Ceiling

The alarm occasioned by the unsuccessful attempt of the Treasury to have the interest ceiling raised or removed is based on the conviction that the concentration of Treasury securities in the short end of the market not only poses difficult problems of debt management, but more importantly, introduces a new inflation potential in that the purchase of such securities may lead to the creation of new bank credit and an increase in the money supply. The inflationary force may also become apparent if the growing supply of short-term instruments of high liquidity leads to a further increase in velocity of circulation of deposits and currency.

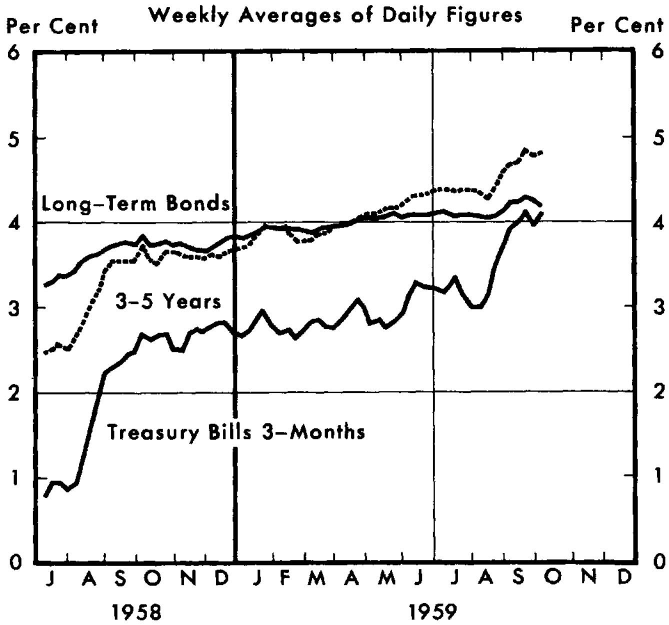
Debt Management Becomes More Difficult

The magnitude of Treasury financing and the requirements of sound debt management make it desirable that all sectors of the credit market be accessible to the Treasury. Treasury needs, even within the framework of a balanced budget, involve financing to cover both seasonal and refunding operations. Sound financing would dictate a variety of maturities —short-, intermediate-, and long-term—to reflect the variety of Treasury needs and to appeal to the variety of investment needs of the lenders.

Because of the higher structure of interest rates (see chart) and the 4¼ per cent ceiling on Government

Yields on U. S. Government Securities

Weekly Averages of Daily Figures



Latest data plotted: Week Ending October 2 bonds (issues over five years) the Treasury is now forced to do all its financing in relatively short-term securities. Under present conditions when the demands for credit by businesses, real estate owners, consumers, municipalities, and others are heavy, most investors have more attractive places to utilize their limited funds than to purchase long-term Government securities at yields of 4¼ per cent or less.

Forced to rely solely on shorter term securities, the Treasury will find that the funds of the "savings type" investor are more difficult to obtain. Many savers and savings institutions prefer to invest substantial portions of their funds in longer term obligations. To the extent that these investors do not face relatively large needs for cash within a brief period, they can place a large share of the funds in longer term securities. Most of the time since the early thirties the long-term securities had given investors a higher yield than short-term securities of similar qualities. Even under present interest rate structures marked by relatively high yields on short-term issues, savings institutions may prefer the longer term issues, if they feel that the general level of interest rates is comparatively high, because the yields can be received over the longer period of time.

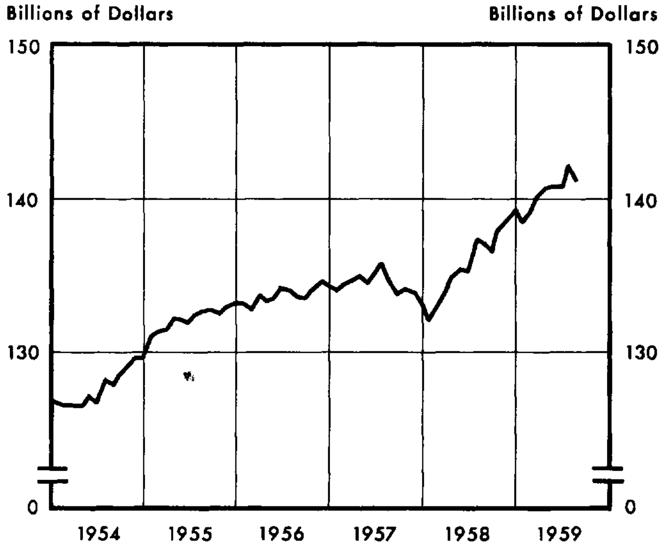
Because the Treasury is now unable to secure its financing from long-term credit markets, it faces a prospect of making more frequent trips to the short-term markets. On June 30, the Treasury had $73 billion of marketable securities maturing within one year, $57 billion in 1-5 years and $19 billion in 5-10 years. As the most important borrower of short-term funds, the Treasury may subject this market to disruptive credit tensions evidenced by sharply rising interest rates influenced in part by the uncertainty in the market as it awaits the terms and conditions surrounding each new Treasury issue. Short-term maturities also increase the frequency of the debt management problems of the Treasury as it attempts to design each issue to insure the best possible market reception.

Monetization of Debt May Be Difficult to Avoid

An increasing concentration of Government debt in shorter maturity obligations may increase inflationary pressures through several avenues. On the one hand, since shorter term securities have greater appeal to those interested in holding assets in "near-money" form, there is great danger that such securities might find their way into commercial bank portfolios. If banks buy the new short-term securities, payment will be made by expanding bank credit and deposits (i.e., money).

Banks can increase their credit only if they have reserves, but it is argued that the central bank may feel more impelled to provide reserves if the demands for bank credit increase sharply, causing short-term interest rates to rise and credit availability to decline. A rapid increase in the money supply induced by the requirements of Treasury financing

Money Supply



Demand Deposits adjusted and Currency outside banks seasonally adjusted for last Wednesday of month.
Latest data plotted: August

would prove to be a serious setback in the battle against inflation, in view of the fact that the money supply rose so very rapidly in the early stages of this expansion. From the end of April 1958 to the end of August 1959, demand deposits adjusted and currency outside banks, seasonally adjusted, rose 4.7 per cent. In the corresponding 16 months of the 1954-55 revival the money supply rose 4.1 per cent.

Growth of Liquid Assets May Accelerate Velocity and Total Spending

On the other hand, even if Government securities are not bought by commercial banks, it may be that the individuals and businesses that buy the short-term debt assume a more liquid position than they would have if they had bought longer term issues. The securities which holders consider close alternatives to cash are those with less than one, or maybe two, years left until they mature. Interest rate fluctuations have a relatively minor effect on the prices of these issues, so they can be converted to cash at almost anytime with less significant losses. Then, too, these securities will become cash within a relatively short period. As a result, holders of Government securities with maturities less than one year usually feel that they are close substitutes for cash.

In the current cyclical expansion the volume of short-term Government securities in the hands of the public (that is, outside the Federal Reserve and U. S. Government agencies and trust funds) has already increased substantially. Those securities within one year of maturity increased from $49 billion in April 1958 to about $56 billion at the end of July this year. In the corresponding 15 months of the 1954-55 business upturn public holdings of Government securities within one year of maturity decreased $3.5 billion to a level of about $42 billion. Public holdings of the somewhat less liquid Government securities in the one- to five-year maturity range rose from $42 billion to $51 billion in the 15 months ending with July of this year as against an increase from $21 billion to $34 billion in the comparable period in the previous cyclical expansion.

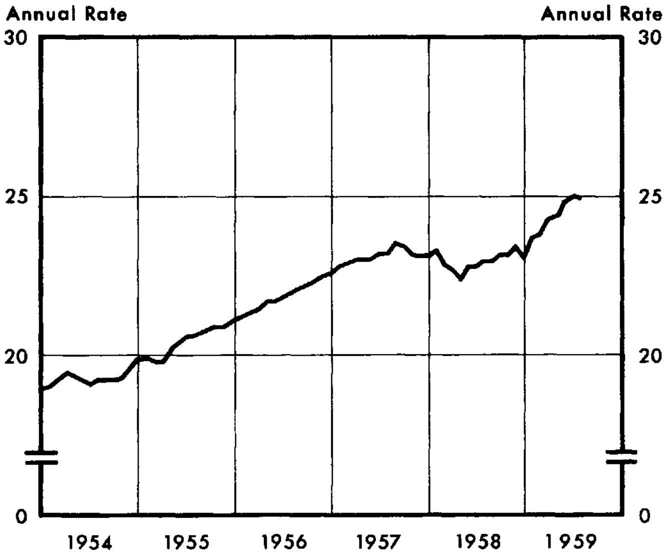
Other holdings of liquid assets of varying degrees of "moniness" in the form of time deposits in commercial banks, shares in savings and loan associations, accounts in mutual savings banks, and holdings of savings bonds rose to an estimated $202 billion by the end of August this year. By comparison, these assets aggregated $188 billion in April 1958, the bottom of the recent recession. This rise of 7.4 per cent during the current upswing in business activity has roughly paralleled that in the like 16 months' period of the previous business recovery when such savings rose 7.1 per cent to a level of $167 billion.

The significance of this growing volume of liquid assets and the possibility of further growth with additional short-term Treasury financing is that the growth of money substitutes, by permitting an economizing of cash balances, is one of several factors underlying the increase in the activity of the money supply.[1]

The turnover of money has been rising rapidly and is currently at a postwar peak (see chart). During June, July, and August demand deposits (excluding interbank and U.S. Government) at reporting centers outside the seven large financial centers were turning over at the seasonally adjusted rate of 24.9 times per year. By comparison, turnover of demand deposits reached a recession low rate of 22.4 times per year in the three months ended with May 1958 and a previous postwar peak rate of 23.5 times during the third quarter of 1957. In 1950 deposits at these banks turned over 17.2 times, and in 1945 they were used 13.5 times.

Turnover of Demand Deposits

Reporting Centers (outside seven large financial cities)



Three—month moving averages of seasonally adjusted data.
Latest data plotted: July, which includes August data.

From the recession low (March, April, and May of 1958) to the summer of 1959 deposit turnover has increased from 22.4 times to 24.9 times per year, a rise of 11 per cent. In the like period of the previous recovery the velocity of deposits rose 9 per cent to a level of 20.9 times per year.

Since individuals, businesses, and others have been accelerating the use of their money, and since the growth in the money supply has been greater, total outlays have been rising more rapidly during the current improvement in business activity than during the previous boom. In the early stages of the recovery, the increased pace of spending was welcomed as a stimulant to business activity. More spending at that time was predominantly reflected in a larger physical volume of sales, more production, greater employment, and higher incomes. As business activity in many lines approaches capacity, however, an increase in spending may not necessarily be reflected primarily in a greater volume of output but in higher prices.

[1] It is generally believed that rising interest rates also tend to increase velocity, since at higher rates of interest the cost of holding idle cash balances rises. Growing optimism regarding the future may also prompt people to spend more rapidly. It may also be noted that in the long run changes in velocity may reflect structural or institutional changes in methods of payment, credit mechanisms, and so forth.

The reliance of the Treasury on short-term financing is likely to build up an even larger volume of liquid assets and an activation of otherwise idle balances. Such a development would contain a serious inflationary threat in an economy already showing signs of excessive money expenditures reflecting both increasing money supplies and a rising rate of turnover (velocity).

What Can Be Done under the Interest Rate Ceiling

While freedom to market long-term Treasury securities on realistic terms will sooner or later be necessary if we are to avoid inflation, appropriate procedures within the present limitation may avoid inflation during the next few months. The Federal debt cannot be monetized without additional bank reserves, and by extending maturities on the debt as far as legally possible the economy should not become unduly liquid.

Monetization of Debt Is Not Inevitable

The issuance of more short-term, rather than long-term Government securities, does not necessarily mean that the commercial banks will hold any more securities. As mentioned above, legal requirements prevent banks from expanding credit (which creates deposits) without obtaining the necessary reserves. Hence, if monetary actions of the Federal Reserve System are conducted so as not to provide the commercial banks with additional reserves to facilitate the short-term financing of the Treasury, the only way the banks can buy Government issues is to liquidate a like amount of loans or other securities.

If bank customers continue to seek loans in large volume and if the Treasury offers short-term securities, the demand for the limited volume of bank credit may be intense. Loan applications may be screened more carefully, and borrowers may have to pay higher interest rates. Nevertheless, without additional bank reserves there can be no net credit creation, and the money supply cannot be expanded.

It is unlikely, however, that banks will be large net buyers of Government securities in periods of booming economic conditions and restraint on their reserve positions. In fact, it is more likely that commercial banks in attempting to satisfy their customers' demands for loans will be net sellers of Government securities, as they have been over the past year. Holdings of Government securities by commercial banks declined from $57.5 billion in mid-1958 to $53.5 billion in mid-1959.

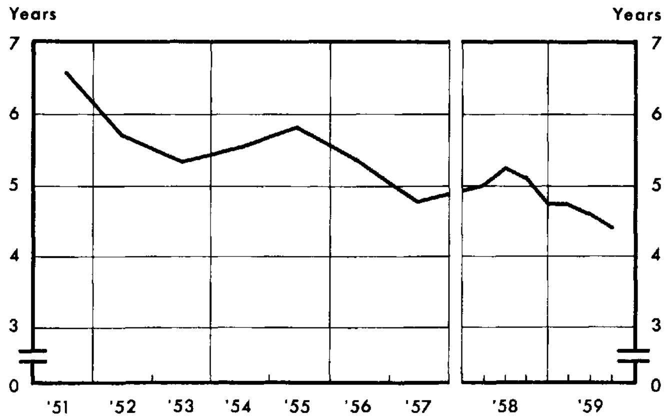
Liquidity of Federal Debt Can Be Limited

An interest rate ceiling which prevents the Treasury from offering bonds of over five years will probably cause the average length of the Federal debt to decline further, but this does not necessarily mean that the debt must be significantly more liquid. Although "liquidity" is a relative term and impossible to measure precisely, it is believed that a four- or five-year obligation is only slightly more liquid than a 20- or 30-year bond. Institutions holding four-year obligations realize that they are subject to price declines as interest rates rise, and as a result these securities are not considered as virtually the same as cash. Cash balances may not be kept quite as large as they would be if investments were in 20-year issues, but they should not be much less.

If savers and savings institutions are offered somewhat higher rates on four- or five-year issues, however, there is no reason to believe that they would not buy such obligations despite a preference for 20- or 30-year bonds. It should be noted that the institutional savings group was awarded over $670 million of the 4-year 10-month Treasury "Fives," about 45 per cent of the $1.3 billion for which this group subscribed.

In order to attract sufficient funds into the short-term obligations the Treasury may have to incur greater current interest expense than it otherwise would (defeating one purpose of the interest rate ceiling), since the ceiling effectively prevents the issuance of securities with maturities that many investors prefer. But, experience indicates that intermediate-term Treasury securities can be readily sold if priced attractively.

Average Maturity of Marketable Federal Debt



Latest data plotted: September 30, 1959, Preliminary

At the present time about one-third of the marketable Government debt held by the public is concentrated in the very short-term area of roughly one year or less to maturity. By extending the maturities on a portion of these obligations to five years as they come due, the liquidity of the economy could be reduced. In fact, vigorous actions to decrease the volume of debt in the under-one-year-to-maturity category might offset the increase in the liquidity of the debt which comes with the passage of time as obligations become progressively shorter term. As noted earlier, the Treasury took a big step in holding down the amount of very short-term debt by selling to investors about $2.3 billion of 5 per cent 4-year 10-month notes in its October financing. Subscriptions to this issue totaled $11.1 billion, indicating that there is large demand for intermediate-term securities if the interest rate is attractive.

The Federal debt might also be made less inflationary by placing more of it in savings bonds. Although Series E savings bonds can be readily cashed at fixed prices after the first two months, most holders do not usually consider them as close an alternative to cash as short-term marketable Government securities. Recent legislation raising maximum interest rates which the Treasury can pay on savings bonds to 4¼ per cent (from 3.26 per cent) permits the Treasury to be more competitive in seeking savings. Under this authority the Treasury has already marked up maximum interest rates from 3¼ per cent to 3¾ per cent by reducing maturities on new Series E issues from 8 years 11 months to 7 years 9 months which should make savings bonds more attractive to investors. Whether the 3¾ per cent rate will do more than prevent further deterioration in the savings bond program, however, is not clear.

Conclusion

The interest rate ceiling of 4¼ per cent on Treasury bonds of five years or more seems unwarranted from an economic point of view. It increases the inflationary potential by making it more difficult to avoid monetizing the Federal debt and to avoid an increase in the turnover of money because the volume of near monies is increased. Nevertheless, it does not appear that a serious inflation is a necessary immediate consequence of this limitation if proper monetary and debt-management actions are taken.

Under booming economic conditions bank reserves can be limited to the point that there is not an inflationary bank credit expansion. Then, too, the short-term securities can be priced so that they are attractive to savers and to those who invest the funds of savers, and a substantial share can be placed at the four- to five-year maturity range to avoid a large increase in the volume of close money substitutes. It seems likely that one of the chief effects of an interest ceiling is to prevent the Treasury from giving investors those maturities they wish. Accordingly, the ceiling is likely to increase the total interest payments which the Treasury must make.

*Agricultural Conditions**—Continued from Page 109*

Cotton production in the district this year may exceed that of last year by 50 per cent. Percentage increases over 1958 production estimated for the various states, partially in the district, are as follows: Tennessee 41 per cent, Mississippi 66 per cent, Missouri 64 per cent, and Arkansas 53 per cent. Cotton production estimates for most of these states are also well above the 10-year (1948-57) average.

Prices of major Eighth District farm commodities have trended downward most of this year. On October 16, district agricultural prices averaged about 8 per cent below the level on October 16 last year. Hog prices were down 33 per cent at St. Louis National Stock Yards. Cattle prices were down 3 per cent and eggs 30 per cent. Broilers were up 1 per cent. Prices of most crops were down some, but price supports generally held such declines to modest percentages.

Cash farm income in the district for the first 8 months of this year was down about 2 per cent from levels in the same months last year. As in the nation, increased production has offset reduced prices for most district farm commodities. Cash receipts in Arkansas and Kentucky were ahead of those in 1958 for the period. Other district states were down slightly. However, with the excellent cotton crop moving to market in Missouri, Arkansas, Tennessee, and Mississippi, Eighth District marketings may exceed 1958 levels for the entire year. Part of such increased marketings will be offset by increased expenses, but net farm income in the district may also be as great or greater than in 1958.

Is the Balance of Payments Improving?

THE RECENT IMPROVEMENT in the export volume of the United States has elicited from some observers a strong optimism with respect to our balance of payments in the future. Their cheerful predictions that our foreign payments deficit would be reduced sharply or eliminated are in marked contrast to the equally strong opinion that the deficit in the balance of payments has not only been persistent but that it is growing.

For many years until 1959, United States exports of goods and services exceeded imports. One of the great international problems in the early postwar period was how the rest of the world could secure the wherewithal to pay for the goods and services which they bought from us. The answer to this problem centered in the grants and loans provided by the United States. Since the early 1950's, however, the volume of dollars acquired by the rest of the world from public and private United States sources has generally exceeded the amounts needed to cover the export surplus, and thus foreign countries were able to add to their gold and dollar reserves.

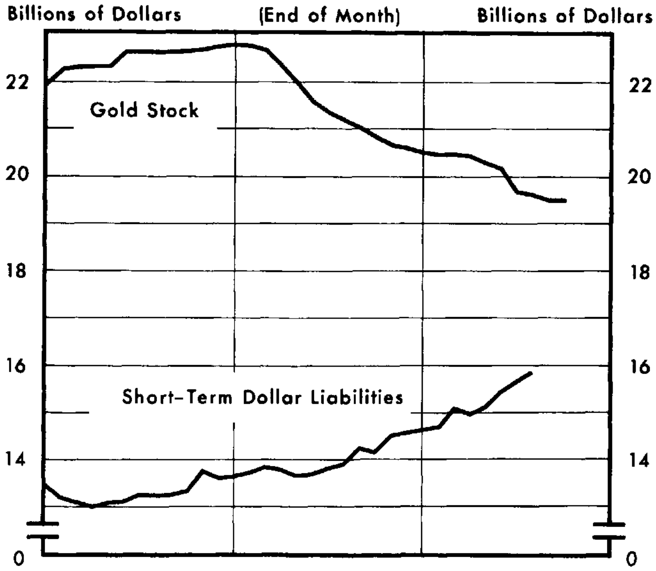
Since the beginning of 1958, U. S. exports declined substantially while imports have increased. The decline in U. S. exports is particularly noteworthy in view of the continued large volume of grants and loans by the U. S. Government and the substantial export of private capital. The United States export surplus of goods and services, excluding military exports financed by grants, was reduced from $5.8 billion in 1957 to $2.2 billion in 1958. The surplus became a deficit of about $200 million in the first half of this year.

Our Gold Has Declined and Our Short-Term Debts Have Increased

The excess of the supply of dollars over the demand for United States goods and services has taken two chief forms, a flow of gold from this country and building up of short-term dollar holdings in the form of deposits, Treasury bills and certificates, and other short-term debt instruments. Since the beginning of 1958 the gold stock of the United States has declined from $22.8 billion to $19.5 billion, or by about $3.3 billion. In 1958 the outflow amounted to $2.3 billion reflecting, among other factors, the relatively low interest rates in the United States during the first half of 1958 and uncertainty as to the strength of the dollar. In 1959, when the marked rise in United States interest rates made dollar holdings increasingly attractive, the gold outflow was reduced to a rate of $1.2 billion during the first nine months.

Short-term dollar holdings of foreign countries increased $1.0 billion in 1958, and in the first seven months of this year were growing at a rate of $1.4 billion per year. The rate of acquisition of short-term balances and the decline in the United States gold stock is shown by months in the accompanying chart.

U.S. Gold Stock and Short-Term Dollar Liabilities to Other Countries



Latest data plotted: Gold Stock-September
Dollar Liability-July

In the face of this record of the past year and three quarters, opinions differ regarding the significance of these developments, probable future developments, and appropriate public policy. There is probably agreement that some decline in the proportion of the world monetary gold stock held by the United States was desirable. In 1952 the United States held about two-thirds of the monetary gold of the free world compared with about one-half today. Likewise some building up of short-term dollar holdings of other countries from the $9 billion holdings of 1952 and $12.8 billion in 1957 (they are about $16 billion today) has probably been desirable for the freedom of trade and international payments which is so necessary for a free world.

It seems quite evident that the loss of gold and building up of dollar balances which has been proceeding at a rate of almost $4 billion per year in the first nine months of this year cannot continue indefinitely. This adverse balance must some time be reduced or eliminated either by natural forces or by public action. Consequently, interested analysts bend every effort to discern whether the forces promoting the adverse balances continue unabated or whether there are signs of a reversal of trend.

Two Contrasting Views

Some commentators have been urging that the deficit in the balance of payments has not only been persistent but that it is growing. On the other hand, it has been said that if the rate of recent improvements in our exports keep up, "with luck, exports next year could easily rise to the $20 billion level"[1] and that "at that level the United States payments deficit would probably be reduced markedly or possibly even eliminated."[2]

[1] *New York Times,* September 20, 1959, p. 19.
[2] *Ibid.*

Neither of those extreme views appears justified on the basis of developments to date. Preliminary estimates for the period July-September of this year suggest that the over-all balance-of-payments deficit for that period was still in the neighborhood of $4 billion. The previously rapid rise in merchandise imports leveled off this summer, while seasonally adjusted exports were at least $1 billion higher at an annual rate than earlier this year. This improvement in trade seems so far to have been offset by shifts in other items of the balance of payments.

Although the outflow of private loans and investments abroad has been held down markedly by relatively high interest rates in this country for more than a year, currently rising interest rates abroad and expanding investment opportunities are likely to result in an increased outflow of United States private capital. The trade accounts are only part of the whole balance of payments picture, and there is no firm evidence that export developments in the near future will reduce the over-all deficit to negligible proportions. It behooves us to concern ourselves with public policies which will help to alleviate further the balance of payments trend which was so adverse in 1958 and the first half of this year.

What Should Be Done?

Changes in policy which have been recently most prominently mentioned pertain more to the policies of other countries than to ours. It has been urged at the recent meeting of the International Monetary Fund and of the International Bank that there is need for elimination of discrimination against imports from the United States to countries now in sound financial condition. Further, it has been suggested that these countries can and should rapidly increase their role relative to the United States in the field of aid and capital exports to countries in need of such funds.