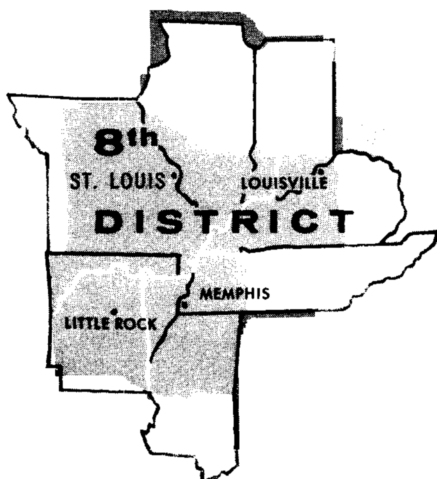
MONTHLY



Review

FEDERAL RESERVE BANK
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Business Activity in the Nation and the District

RECENT ECONOMIC DATA indicate that overall activity in the nation during the third quarter of this year was markedly below the second-quarter level, and that renewed expansion in the final quarter of 1959 may fall short of establishing new records in total output of goods and services. Superficially, such data might be interpreted as reflecting a deterioration in the economy's strength which in time might lead to a general downturn in activity. However, aggregate measures are frequently inadequate in providing a true indication of the basic strength and weaknesses underlying the economy. Such appears to have been the case since mid-summer of this year when the steel strike and its consequences have dominated the overall economic picture. The temporary decline in activity and the failure of the economy to expand rapidly to new highs following the court injunction should, therefore, not be attributed to a leveling-off of total demand for goods and services, but rather to the inability of total supply to meet this demand. Dwindling inventories of steel consumers and producers, resulting from the strike, have forced a number of industries to curtail production. Moreover, shortages and bottlenecks in steel-consuming industries and transportation appear in many instances to preclude the regaining of pre-strike production levels for some time. The unexpectedly rapid expansion of steel production since the injunction in early November and the continued strength in many other sectors of the economy indicate, however, a possible early return to pre-strike levels of overall activity.

The Eighth Federal Reserve District has weathered the latest economic disturbance favorably when compared with the nation. District steel production, concentrated in the St. Louis area, was not interrupted by the strike, and shipments of foreign steel into the District continued to rise. Consequently, District steel users have experienced better-than-average inventory conditions, fewer and smaller-than-average curtailments in production, and few layoffs. Moreover, coal, petroleum, and lumber production in the District states have been running above year-earlier levels. District farm income is expected to be higher than last year's and total unemployment has declined markedly from year-ago levels in all District metropolitan areas.

Industrial Production Edged Upward

Total industrial production in the nation in November, as measured by the Federal Reserve Board's Index, edged upward slightly from the October level to 148 per cent of the 1947-49 average. Steel mills, which operated at only 14 per cent of capacity in October, were at 60 per cent in November, and at 96 per cent by mid-December. Total industrial output, however, was still about 5 per cent lower in November than in the peak month of June. Although steel ingot production was up sharply, shipments of finished steel products had not increased enough by mid-November to avert further curtailment of production by some steel-using industries, including the auto industry. The index will probably show a substantial increase for December, since production in the steel and auto industries has been at a high rate during this month.

Consumer Income and Spending Moderate Decline in Total Activity

Income and expenditure data indicate that, despite hardships suffered by those directly affected by the strike, consumers as a whole have experienced little change in their standards of living. Personal income, which showed a sudden drop in August, has since then been rising again, causing the July-October average to equal that of the second quarter of this year. Consumer spending during the third quarter was even slightly above the second-quarter level, thus helping to prevent a more serious decline in total economic activity.

Increases in spending have occurred mainly on services such as medical care, rents, and transportation, while consumer outlays on both durable and nondurable items have generally maintained their mid-summer levels. Advanced estimates indicate, however, that retail sales of durable commodities increased from September to October. In November, sales of new automobiles were reduced by shortages of supply caused by the steel strike.

Manufacturers' Orders Remain High

The level of manufacturers' new orders, one of the main indicators of business confidence in the future,

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has remained high since mid-year. Machine tool orders in October amounted to more than $67 million, 14 per cent higher than in the previous month and 3 per cent above the previous high set in June of this year. Two of the main reasons for this sharp rise in machine tool orders appeared to have been a marked upswing in European orders and a large replacement program initiated by one of the domestic automobile producers.

Sales of manufacturers and wholesalers have declined slightly from their second-quarter level, and were on a seasonally adjusted basis about 6 per cent lower in October than in June. This decline, besides reflecting a readjustment to a more normal level after the extraordinary volume of sales preceding the steel strike, can be partly attributed to deteriorating supply conditions resulting from the strike.

Total manufacturers' inventories have declined relatively little since June, despite the heavy drain upon steel and steel products. Inventories of non-steel commodities appear to have been building up in recent months, especially in those industries which have experienced bottlenecks resulting from steel shortages.

Construction Activity Continues to Decline

One of the contrasting elements in the overall economic picture is the construction industry which has experienced a decline since mid-summer of this year. Seasonally adjusted expenditures on total new construction, including both public and private outlays, were almost 10 per cent lower in October than in June. Public expenditures showed a drop of about 19 per cent over the same four-month period, while residential construction outlays were down approximately 7 per cent from the June level. However, compared with expenditures a year ago, October outlays were relatively favorable, with only public expenditures being lower this year.

Construction contract awards not seasonally adjusted show that October contracts were 5 per cent below the October 1958 total, although at the end of ten months the value of total awards was about 5 per cent ahead of the value accumulated during the comparable period of last year. Residential contracts in October were also 5 per cent below those of October 1958, while contracts in the heavy engineering sector were down about 19 per cent.

The declining activity in the construction field appears to be the result of several factors. Tightness in the mortgage markets, expressing itself in increased cost of borrowing and greater selectivity in the type of mortgages by investors, reportedly have been a major cause of the reduction in residential outlays. Contraction in industrial construction activity may indicate a desire on the part of businessmen to delay new fixed investments until a final settlement of the labor-management negotiations in the steel industry and actual steel shortages accounted for some of the decline. The increased stress of the Federal Government upon a balanced budget appears to be one of the major reasons behind the current decline in public construction expenditures.

Recent Slowdown in Steel Caused Unemployment to Rise

As could be expected, the recent steel strike proved to have an unfavorable effect upon the employment situation. Mid-October unemployment, seasonally adjusted, amounted to 6 per cent of the labor force as compared with 4.9 per cent in June. Since workers on strike are not classified as unemployed, the actual number of persons idle by mid-October was considerably larger than indicated by the percentage figure.

Seasonally adjusted unemployment declined to 5.6 per cent by mid-November. However, secondary layoffs resulting from the steel strike doubled between mid-October and mid-November. Total unemployment had risen to more than 3.5 million by mid-November, the second largest unemployment total for that month since World War II.

The length of the average workweek declined by 0.4 hours between October and November, reflecting cutbacks in the automotive industry. On the other hand, average hourly earnings in industry rose by 2 cents to $2.23, following return to work at most steel plants.

District Activity Shows Few Effects from the Strike

From the limited number of data available it appears that the Eighth Federal Reserve District has not recently been subjected to serious economic disturbances. In the first place, agriculture plays a more important role in the economy of the District than in that of the nation, and secondly, District steel production has not been interrupted by the recent national strike.

(Continued on page 139)

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Treasury Debt-Management in the Last Quarter of 1959

LAST SEPTEMBER it appeared that the Treasury was facing an almost insurmountable financing problem in the final quarter of the year. The Treasury had to raise about $6.5 billion of funds to meet seasonal needs and refund about $9 billion of maturing debt (not counting the roughly $1.6 billion short-term Treasury bills coming due each week). Interest rates, the cost of borrowed funds, had been rising for over a year and were at postwar peak levels. The Treasury was narrowly circumscribed in its financing effort by the 4¼ per cent interest ceiling on new bond issues which effectively prevented it from obtaining long-term funds (over 5 years).[1] For over a year commercial banks had been large net sellers of short-term Government securities as they sought funds to satisfy the loan demands of customers.

Despite the obstacles the Treasury has been overwhelmingly successful. Sufficient funds have been received to meet seasonal needs and to pay off maturing obligations that were tendered for payment. The Government bond market, far from being unsettled by the operations, probably developed its best tone in about a year and a half. The number of investors holding marketable Government securities may well have reached a new high. The amount of debt in highly liquid, very short-term securities remained about the same despite restrictions on long-term financing. Hence, one inflationary threat was avoided. In addition, the Treasury anticipated some financing problems of 1960 by advance refundings.

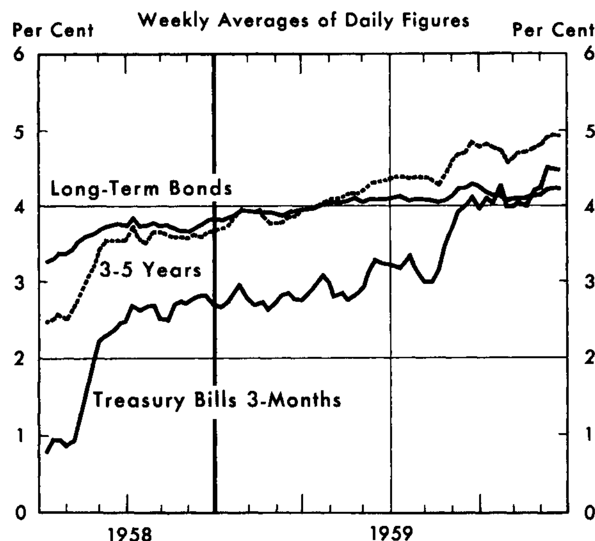
Interest Rates on Treasury Securities

The fourth quarter of 1959 followed an extended period of credit tightening which caused some analysts to question whether the Treasury could accomplish its financing without an inflationary expansion in bank credit. Reflecting a sharp increase in the demands for funds by individuals and businesses as well as by the Government, interest rates rose markedly from June 1958 to September 1959. Rates on most marketable securities were pushed up beyond the peak levels reached in 1957 to new postwar highs (see chart). Yields on three-month Treasury bills rose from below 1.00 per cent in June 1958 to an average of 4.04 per cent in September 1959. The former postwar high was 3.58 per cent in October 1957 .

Other interest rates had shown a similar pattern. Yields on 3- to 5-year Governments fell from 4.00 per cent in October 1957 to 2.25 per cent in June 1958 but rose to 4.78 per cent by September 1959. Over the same periods, interest rates on long-term Government securities fell from 3.63 per cent to 3.19 per cent and then rose to 4.26 per cent.

During October there was a slight easing of pressure in the money markets partially reflecting a moderation in the demand for credit accompanying the steel strike, and interest rates generally receded in the month. In November and early December, however, most rates worked higher. By mid-December most interest rates were at or slightly above their September levels. Thus, despite the large volume of financing by the Treasury, interest rates were not forced substantially higher, and no severe pressures developed in the money markets.

Yields on U. S. Government Securities



Latest data plotted: Week Ending Dec. 18, preliminary
Source: Board of Governors of the Federal Reserve System.

Treasury Offerings

A study of the individual Treasury offerings made during the last three months of 1959 points up the skill used by the Treasury in tailoring its issues to the

[1] See "Interest Rate Ceiling on the Federal Debt" in the *Monthly Review* of the Federal Reserve Bank of St. Louis for October.

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market. It offered competitive rates and terms to attract savings. Maturities were set about as far into the future as legally possible on some offerings to avoid an undue increase in highly liquid short-term debt outstanding. Market response to the announcements exceeded many expectations.

"Magic Fives"

One of the Treasury's most successful offerings was its October cash financing, announced October 1. The Treasury sold $2.3 billion of four-year ten-month 5 per cent notes—called the "magic fives" by the press. Subscriptions were received through October 6, and the securities were dated October 15. The offering evoked such enthusiastic response on the part of the public that subscriptions totaled over $11 billion from 130,000 separate subscribers.

Particularly significant was the great appeal which this offering had for the individual investor. The yield plus the widespread publicity given to the "magic fives" attracted a large number of individuals who had never before purchased a marketable Government security. Subscriptions of $25,000 or less totaled $941 million and were allotted in full under the terms of the offering.

In addition to raising the funds needed and stimulating interest in the Government security market, the "magic fives" made a contribution to economic stability. To the extent that the public was induced to divert funds which would otherwise have gone into consumption outlays, the Treasury's offering had non-inflationary effects. It appears, however, that the bulk of the funds used to buy the notes came from balances in savings institutions or other accumulated savings. By attracting these funds, the Treasury was competing directly for the savings of the country to finance the Government rather than resorting to an inflationary expansion in bank credit. Also, since intermediate-term Treasury securities are subject to price fluctuations as interest rates change, a shift of funds from savings balances into these securities may be said to have reduced the liquidity of the holders somewhat.

Tax-anticipation Bills

Since a large portion of the need for funds in the fall was for seasonal purposes, the Treasury borrowed in the October financing some funds to be paid off next June when receipts are expected to exceed expenditures. About $2 billion was borrowed on 245-day tax-anticipation bills which were dated October 21 and will mature June 22, 1960. The competitive bidding was held on October 14, and the average rate on accepted bids was 4.78 per cent.

November Refunding

The Treasury followed up its earlier success with a large refunding operation, announced on October 29, that also proved gratifying. Coming due on November 15 were nearly $9 billion of certificates and notes. In exchange for these the Treasury offered 4¾ per cent certificates due in one year (November 15, 1960) and 4⅞ per cent notes due in four years (November 15, 1963). Subscription books were open through November 4 for the exchange.

Federal Reserve Banks and U. S. Government investment accounts held a total of $5.1 billion of the maturing obligations. These holdings were exchanged in full, virtually all into certificates. Of the remaining $3.8 billion, holders of over $1.3 billion asked for the notes, about $2.0 billion went into certificates, and $528 million were turned in for cash. The 14 per cent attrition on the publicly held securities was considered low in comparison with some recent refundings.

The Treasury further broadened its exchange offer by permitting holders of the outstanding 4 per cent notes due August 15, 1962 to exchange them for the new four-year securities. When the 4 per cent notes were issued in September 1957, buyers were given the option of holding them to maturity or redeeming them on February 15, 1960, on three months' notice. A major purpose of this advance refunding was to reduce the volume of financing that would otherwise be necessary next February. Of the $2 billion of 4 per cent notes outstanding, holders of nearly $1.7 billion accepted the exchange offer. Hence, in the aggregate about $3.0 billion of new 4⅞ per cent notes were issued.

November Cash Offering

On November 19, the Treasury announced a $2 billion cash offering of 320-day Treasury bills to be dated December 2, 1959 and to mature October 17, 1960. The auction was held on November 24, and the average rate on accepted bids was 4.86 per cent. This was the fourth and final step in the Treasury's program for the establishment of a pattern of one-year maturities on quarterly dates in January, April, July, and October, which was initiated on April 1, 1959.

Savings Bonds

Also on November 19 the Treasury announced that Series F and G Savings Bonds issued in 1948, and maturing in 1960 ($1.6 billion outstanding) may be exchanged for a limited time period for 4¾ per cent Treasury Notes maturing May 15, 1964 to be issued at 99¾ per cent and accrued interest to December 15,

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1959. Early reports indicate that about half of the eligible bonds were exchanged for the notes.

The Treasury also made a preliminary announcement on November 19 that holders of Series E Savings Bonds, and unmatured Series F and J Savings Bonds could exchange them effective January 1, 1960 and thereafter, for Series H Savings Bonds, subject to deferral of gain on the exchange for Federal Income Tax purposes. This action permits persons who hold bonds on which the interest earnings are reflected in the increase in redemption value to exchange them for bonds on which interest is payable each six months by check issued to the bond owner.

In Conclusion

Attempts by the Treasury during the final quarter of 1959 to design its security offerings to compete for the savings of the community were highly gratifying. The notable success of the "magic fives", as well as the following issues, helped to improve market psychology. Analysts were favorably impressed by what they regarded as the determination of the Treasury to seek savings and to lengthen the maturity of the debt to the extent possible under existing legislation, and the willingness of the Treasury to pay the going market rate to do so.

These financing operations may have a further significance in that they may indicate a shift of public attitude with respect to the kind of securities which small investors will buy. For many years it has been said that marketable bonds, because they fluctuate in price, are suitable only for institutions and the more experienced investors. Smaller and less experienced investors would, according to this view, buy only savings bonds which do not fluctuate in price. This philosophy was an important principle of the entire savings bond program. However, in recent years the savings-type investors have apparently been purchasing fewer savings bonds than they have redeemed and thus aggravating the Treasury's financing problems. The "magic fives" and other attractively priced intermediate-term securities have demonstrated that relatively small investors will commit some of their funds to marketable issues.

The experience of recent months is one more example of the proposition that if future increases in the Federal debt are limited to reasonable proportions, and if they are financed sensibly in light of prevailing financial conditions, the debt should be manageable and need not create additional inflationary pressures. The Treasury's financing problems could be made less difficult by removal of the 4¼ per cent ceiling on bonds of five years or more, but meanwhile sound management of public debt is attainable.

VAULT CASH AS

ON NOVEMBER 30 the Board of Governors of the Federal Reserve System amended its Regulation D so that member banks having relatively large holdings of vault cash in relation to their deposits are permitted to count a part of this cash in meeting their reserve requirements.

Effective December 1, 1959, so called "country" banks (that is, banks not classified as reserve city or central reserve city banks) having vault cash in excess of 4 per cent of their net demand deposits are permitted to count the excess as part of their required reserves. Also, effective December 3, banks classified as reserve city and central reserve city banks are similarly permitted to count vault cash in excess of 2 per cent of their net demand deposits.

History of Vault Cash Requirements

The Federal Reserve Act of 1913 required member banks, after a 3-year transition period, to hold part of their required reserves with the Federal Reserve Banks and part in their own vaults, while the remainder could be held optionally in their own vaults or at the Reserve Banks. (See table, page 135). Prior to the passage of the Federal Reserve Act, national banks, under the National Bank Act, held their reserves in the form of balances with correspondent banks together with vault cash holdings.

During the 3-year interim, reserve city and country member banks were permitted to continue to carry part of their reserves in the form of balances at national banks located in central reserve and reserve cities. The act also provided that the transfer of required reserves of country and reserve city banks to the Reserve Banks could be made in specified installments covering a period of 2½ years after the Reserve Banks were established. An amendment, approved September 7, 1916, authorized the Federal Reserve Board to permit member banks to carry in the Federal Reserve Bank any portion of their reserves previously required to be held in their own vaults.

With the entry of the United States into the war and the prospect of large Government financing, there was increased pressure for centralizing the gold reserves of the country and for enlarging the potential lending powers of the Reserve Banks. These purposes were accomplished in the amendment to the Federal Reserve Act approved June 21, 1917, which made substantial reductions in the reserve percentages but provided that all required reserves must henceforth be

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held with the Reserve Banks, eliminating any requirement as to cash in vault. The new percentages against demand deposits established by this amendment were 13 per cent at central reserve city banks, 10 per cent at reserve city banks, and 7 per cent at country banks as compared with 18, 15, and 12 per cent under the original act. For time deposits the reserve requirements were lowered from 5 per cent to 3 per cent at all classes of banks.

For member banks as a whole the reduction in total reserve requirements at this time did not immediately release any considerable volume of reserves for the expansion of loans and investments. Although the banks were no longer permitted to count vault cash as legal reserves, they had to continue to keep on hand sufficient currency to meet the cash needs of their customers. The vault cash so held offset to a considerable extent the reduction in legal reserve requirements.

From 1917 to December 1, 1959, vault cash holdings of member banks have not been counted as funds satisfying legal reserve requirements.

Reserve Impact of Vault Cash Change

On the basis of bank currency and coin holdings over the past year it appears that roughly half of the 6,250 member banks are in a position to apply a part of their vault cash in meeting their reserve requirements. It is estimated that total member bank reserve balances were expanded about $230 million, or 1.2 per cent, of which $160 million was at the country banks, $70 million at reserve city banks. Total vault cash held by all member banks has averaged about $2.2 billion.

The 487 Eighth District member banks had held on the average about $90 million of currency and coin. It is estimated that the permission to apply cash in excess of the specified minimums increased total reserves of these banks over $5 million or about 1 per cent. Approximately 120 district banks were affected.

The action by the Board was taken under the terms of an Act of Congress in 1959 designed in part to remedy inequities that have arisen because many banks, particularly the small country banks, find it necessary for operating purposes to hold relatively larger amounts of vault cash than do other banks. The Act recognizes that since these vault cash holdings represent minimum amounts that banks feel obliged to keep for working purposes they have effects similar to the required reserves in limiting bank credit expansion.

The Board of Governors stated that the action did not indicate any change in its general monetary or credit policy. Early December is a logical time for such action inasmuch as the banking system needs additional reserves at this time to meet currency and other seasonal drains.

At the same time the Board of Governors adopted several amendments to technical provisions of Regulation D, including an amendment (effective December 31, 1959) whereby the reserve computation period for country banks will be bi-weekly, with weekly reporting, instead of semi-monthly.

Reserve Requirements for National Banks and Member Banks of the Federal Reserve System as Enacted by Congress
(Percent of deposits)

		FEDERAL RESERVE ACT		
		As approved Dec. 23, 1913		
Kind of Reserves	NATIONAL BANK ACT, as amended	Effective upon establishment	To be effective by November 1917	As amended 1917
AGAINST DEMAND DEPOSITS:				
Central Reserve City Banks				
Cash in vault[2]	25	6	6	....
Deposit with Reserve Banks	....	7	7	13
Optional	....	5	5	....
Total	**25[1]**	**18**	**18**	**13**
Reserve City Banks				
Cash in vault[2]	12½	6	5	....
Deposit with Reserve Banks	....	3	6	10
Optional	12½	6	4	....
Total	**25[1]**	**15**	**15**	**10**
Country Banks				
Cash in vault[2]	6	5	4	....
Deposit with Reserve Banks	....	2	5	7
Optional[3]	9	5	3	....
Total	**15[1]**	**12**	**12**	**7**
AGAINST TIME DEPOSITS:				
All Member Banks	[4]	**5[5]**	**5[5]**	**3[6]**

[1] Includes the fund deposited by national banks for the redemption of notes.

[2] Cash in vault eligible for reserves under National Bank Act excluded national banknotes and under Federal Reserve Act excluded national banknotes, Federal Reserve notes, and Federal Reserve banknotes.

[3] Includes amounts that could be held with national banks in central reserve or reserve cities. Under Federal Reserve Act all reserves had to be held in vault or in Federal Reserve Banks beginning 36 months after establishment of System; i.e. from November 1917.

[4] Same as demand.

[5] Distributed in the same ratio as the reserve against demand deposits.

[6] All reserves required to be on deposit with Federal Reserve Bank.

Source: Board of Governors of the Federal Reserve System, Hearings on S. 860 and S. 1120, March, 1959, p. 127.

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The Impact of Recent Cotton Marketing Changes on Bank Credit

CHANGES in the way the 1959 cotton crop is being marketed have had an important impact on bank credit at Eighth District banks in the larger marketing centers. Such changes include:

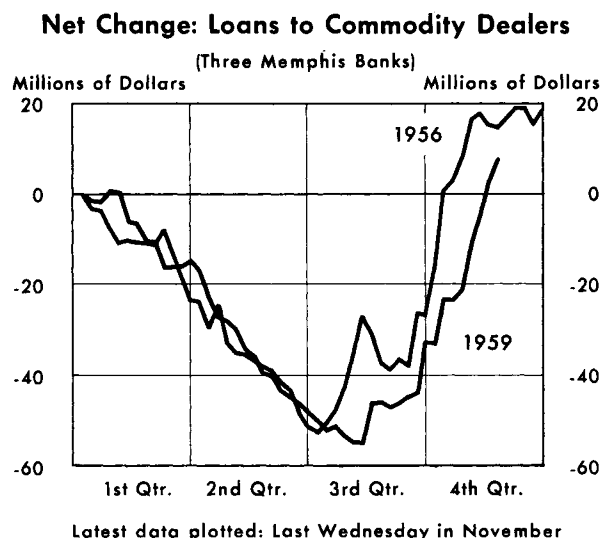
(1) This year cotton was purchased outright by the CCC (Commodity Credit Corporation) from most farmers who elected to avail themselves of the Government price support program. In previous years, cotton price supports were handled through a CCC loan program. The movement of cotton into the loan program involved bank credit whereas bank credit is not required in the movement of cotton into the CCC via the purchase program.

(2) Merchants are generally carrying smaller inventories of cotton this year than in earlier years.

These changes were effective in reducing the early demand for cotton marketing credit. In other comparable crop years such loans have increased substantially in September and often reached a peak in November. This year, however, loans on cotton did not increase appreciably until October despite an earlier than normal harvesting season. Furthermore, the volume of such loans continued to increase at a rapid rate after the time at which they usually begin to taper off. By late November totals at the three weekly reporting banks in Memphis reached the volume usually expected for a crop as large as the 14.7 million bales harvested this year.

Loans to commodity dealers by the Memphis banks increased about $34 million, or $3 million per week, in the eleven marketing weeks ending on October 28, or substantially less than expected. In 1956, for example, with production approximately the same as this year, loans at the Memphis banks rose $48 million in the same period, an increase of more than $4 million per week.

In late October and November, however, loans to commodity dealers expanded sharply this year, as a large volume of cotton began flowing to mills and to foreign countries via Memphis merchants. In the four weeks ending November 25, commodity loans at the Memphis banks increased $29 million or more than $7 million per week. In 1956 very little increase occurred during this period. Commodity dealer loans have tended to level off in the corresponding period in all the years since 1952.



Cotton Marketing in Prior Years

In prior years all cotton went either into a CCC loan program or was sold in commercial trade. Producers electing to place their cotton in the CCC loan program obtained loans from local authorized CCC lending agencies. The process was as follows: (1) Funds were advanced by local banks on non-recourse notes made by producers to the CCC. (2) Such notes with attached warehouse receipts were sent to correspondent banks where they were in turn forwarded with transmittal letters to the CCC in New Orleans. (3) Country banks were immediately given credit for such notes. (4) The correspondent bank had two options for converting the notes into other assets.

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They could write drafts directly on the Treasury when the notes and warehouse receipts were shipped to the CCC in New Orleans or they could ship the above documents to New Orleans and request payment in CCC certificates. (5) About six weeks from the mailing date the banks received CCC certificates of interest in payment for the notes. Such certificates are demand obligations of the United States carrying an interest rate generally comparable to the Treasury bill rate. In view of the attractiveness of the certificates banks in cotton-producing areas generally preferred them to immediate cash payment. City correspondent banks found them useful in meeting seasonal investment needs of country banks. This process involved the use of bank credit from the date funds were advanced producers until the certificates of interest were disposed of.

Cotton moving directly into commercial channels was generally sold to merchants either direct or through local ginners and buyers. Merchants often purchased substantial quantities to meet expected orders both from domestic mills and for export. Most cotton moving this route to consumers required bank credit through the various channels of trade.

Factors Underlying the Change

Farmers Given Two Choices of Acreage Controls and Price Supports

Part of the delay in growth of cotton marketing loans at the beginning of the current marketing season can be traced to changes in financing the movement of cotton into the Commodity Credit Corporation. Such changes stem from basic alterations in the acreage control and price support program.

This year for the first time cotton was produced under two acreage control plans, namely, "Choice A" and "Choice B". Under "Choice A" farmers planted their regular allotted acres and were eligible for a cotton support price of not less than 80 per cent of parity through a CCC purchase program. "Choice B" permitted increased allotments at reduced support prices. Approximately 84 per cent of the acreage was produced under "Choice A."

Bank Credit not Required for Moving Cotton into the CCC under "Choice A" Plan

The purchase program under "Choice A" reduced the early demand for cotton marketing credit. Instead of making loans on such cotton as in prior years, which in practice involved bank credit, the CCC is buying it outright.[1] Farmers as in other years have the option of selling cotton in commercial channels or taking advantage of the price support program.

Cotton marketing procedures under "Choice A" are as follows: (1) The farmer delivers cotton to the gin where it is ginned and sent to the warehouse. (2) The warehouse receipt and class card are taken to the CCC purchasing agent (often the ginner, the banker, or other local individual). (3) A draft is drawn either by the local banker on the U. S. Treasury covering the purchase price plus the purchasing agent's fee of $.75 or the documents are sent to the correspondent bank where the draft is drawn. (4) The producer is paid from the proceeds of the draft, less marketing charges. (5) The draft is sent in for collection through the banking system, and the warehouse receipt is retained by the custodian bank (a custodian bank agrees to hold such receipts for specific CCC sales agents; the sales agents for specific bales of cotton are designated by the purchasing agents and may be the same person). (6) Country banks are given immediate credit by the correspondent banks on the drafts. (7) The correspondent banks are in turn given immediate credit by the Federal Reserve Banks.

The support price on most "Choice A" cotton is above the spot price, and a large per cent of the cotton produced under this plan is being purchased by the CCC. However, the cotton is being resold at a minimum of "Choice B" support price plus 10 per cent—CCC purchasing and selling prices at Memphis in early November were 34.35 and 31.76 cents per pound, respectively. The operations were carried on at a loss of about 2.6 cents per pound. More recently, however, with the short supply and improved demand for lower grades, losses have been reduced and some cotton grading low middling and under has sold directly to merchants at prices above those of the "Choice A" support program.

Only Small Per Cent of Cotton Produced under "Choice B" Plan

"Choice B" permitted the producers to increase their regular allotments by 40 per cent. In exchange, the price support guaranteed was reduced to about 65 per cent of parity. (On October 15 the parity price was 37.80 cents per pound. The actual support price on "A" cotton was 34.35 cents per pound and the

[1] CCC purchasing agents, often the same individuals as the lending agents in earlier years, have been appointed throughout the Cotton Belt. The CCC pays $.75 per bale to the agents for purchasing.

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average spot price at 14 markets was 31.95, considerably more than 65 per cent of parity.)

Only 16 per cent of the cotton acreage was employed under "Choice B" as most farmers apparently preferred the combination of reduced acreages and higher support prices. "Choice B" cotton may be marketed through a CCC loan program in the same manner as cotton produced in earlier years or it may be sold to merchants. The loan rate is substantially below spot prices. Most "Choice B" cotton, therefore, moved directly into commercial channels, i.e., ginners or local buyers purchased from farmers and sold to merchants in the larger centers, who in turn sold to mills or exported to other nations.

Smaller Merchant Inventories Reduce Early Demand for Credit

Another factor tending to reduce the credit demand for cotton marketing this year is that merchants are carrying smaller cotton inventories. With the CCC purchase price above the spot market price for most grades, a large portion of "Choice A" cotton has been purchased by the CCC whereas in prior years greater quantities of cotton were purchased by merchants directly from farmers, with bank credit. The CCC has in turn, through sales agents, resold much of the cotton at a loss. As the marketing season progresses, the announced minimum CCC selling price moves up .15 cents per pound, or considerably less than the carrying charges to merchants of .25 to .30 cents per pound. Thus, merchants find it more profitable to purchase most of their cotton from CCC sales agents than to carry inventories as mill and export orders are filled.

Other Impacts of Recent Changes in Cotton Marketing

Diminished Importance of the Exchanges

The recent cotton marketing changes also have an impact on cotton futures markets. The greater proportion of cotton is sold by the CCC directly to merchants for immediate transfer to mills or for export. All CCC-owned 1959 crop cotton is offered weekly or bi-weekly at a previously announced minimum price. This minimum price tends to set the spot price as most supplies are held by the CCC, and supplies of most grades are generally considered excessive even at reduced resale prices. The CCC-announced minimum prices for future dates thus tend to become the spot prices, limiting the need for trading on the futures exchange or in the futures market. On the other hand, a small amount of exchange trading may be necessary for merchants to obtain the precise grade of cotton purchased from the CCC. Small inventories do not contribute to a high level of hedging activity on the exchanges. Furthermore, with the price of cotton on any specific future date assured within narrow limits by the announced minimum CCC sales price, substantial hedging activities are not essential.

Impact of Changes on Market Concentration

A feature of the price support program which may in future years affect the volume of cotton transactions in the major marketing centers if this type of program is continued is that the functions of all three agencies —CCC purchasing agent, CCC sales agent, and independent merchant—are often vested in the same person. The purchasing agent is usually the same person as the lending agent of prior years and the lending agent for 1959 "Choice B" cotton.

Many of the purchasing agents other than commercial banks have also been approved by the CCC as sales agents. Such agents may designate themselves as sales agent for specific cotton. Sales agents also designate custodians to hold warehouse receipts for CCC-owned cotton. In some instances the purchasing agent may also be a limited sales agent and a cotton merchant. In this case the sales agent, also acting in the capacity as cotton merchant, is permitted to bid on the cotton that he offers for sale for the CCC.

Many firms operate outside the major marketing centers in all three capacities, as CCC purchasing agent, CCC sales agent, and as cotton merchant. Because of the handling of a multiplicity of functions by the same firm in the smaller marketing centers, an unexpectedly large number of cotton warehouse receipts have remained in such centers rather than moving as usual to the major markets.

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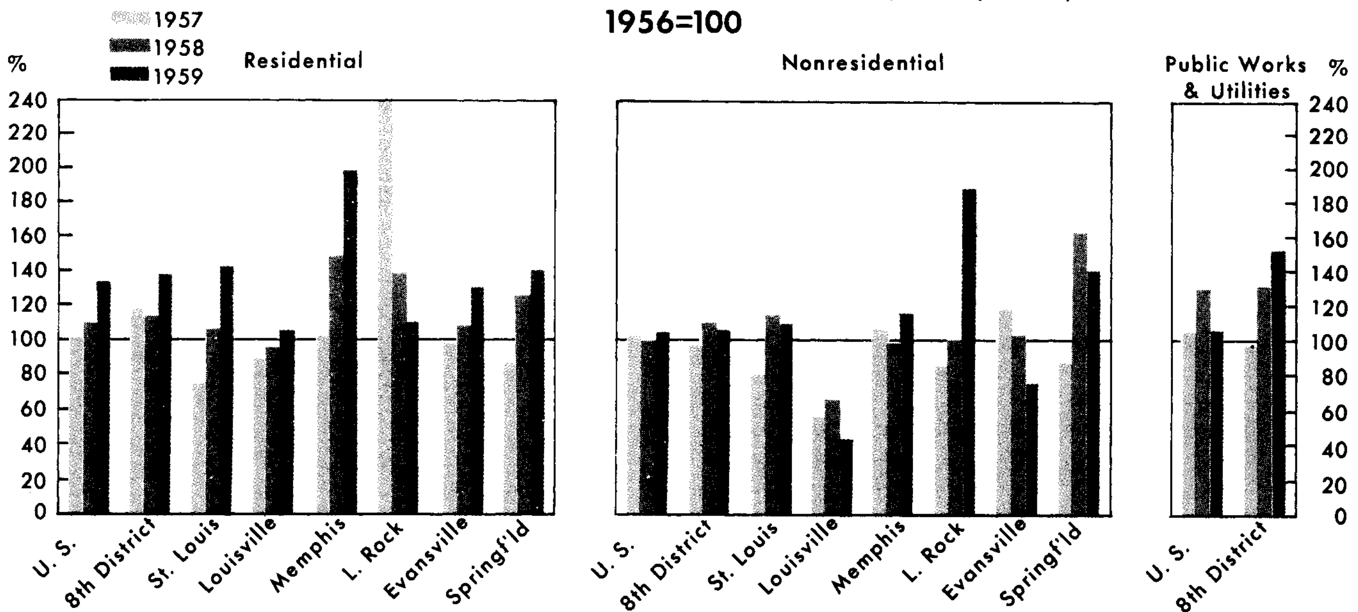
District steel production has been averaging well over 90 per cent of capacity since June, thus alleviating shortages for many District consumers. Inventories appear to have been at a somewhat higher level than in the nation as a whole, especially in the southern part of the District which has recently been experiencing sizable imports through the Gulf ports. Serious shortages which did occur have been limited to products such as heavy structural steel which is not produced in the St. Louis area, and also among large consumers who saw their supplies "rationed" by producers. The majority of smaller consumers as well as most warehouses have reportedly been able to maintain a fairly satisfactory level of inventories.

Among the primary producing industries, lumber and paper have scored almost continuous gains in output. Production of pine and hardwoods has expanded both in volume and capacity, reflecting the still high level of construction activity and of business activity in general. Coal production has expanded since the spring of this year, with output at higher levels than in the comparable months of 1958.

Agricultural production of major crops in the Eighth District states shows a pattern roughly similar to that of the nation. Corn production in Missouri is estimated to be about 30 per cent above 1958 output, while production of burley tobacco in Kentucky is expected to exceed 1958 output by about 5 per cent. Cotton production in the delta states is estimated to be as much as 60 per cent above that of last year. Although declining farm prices caused cash receipts from farm commodities to be slightly below 1958 levels during the first eight months of this year, returns from the cotton crop indicate that District farm income for entire 1959 will in all probability exceed that of last year.

A comparison of construction contract awards for the first ten months of this year and of 1957 and 1958 in the District with those for the nation shows a picture generally favorable to the District (see chart below). In all sectors, the District gained relatively more in dollar value of awards than the nation, comparing the ten-month periods of 1958 and 1959. Among the District cities shown, for the most recent period, three of the six had larger relative gains in residential construction awards than the nation, and five of the six cities had relatively larger nonresidential award gains.

District employment has been rising in all major metropolitan areas during the last year except Evansville where in mid-October nonagricultural employment was 6 per cent below last year's October level. Memphis currently enjoys the largest nonmanufacturing labor force in its history, while total employment in the Louisville area is at the highest level since the end of 1957. Little Rock has experienced especially significant increases in the trade and service fields. Unemployment has declined markedly in all district metropolitan areas from year-ago levels, although both St. Louis and Memphis have recently experienced some layoffs indirectly attributed to the steel strike.



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