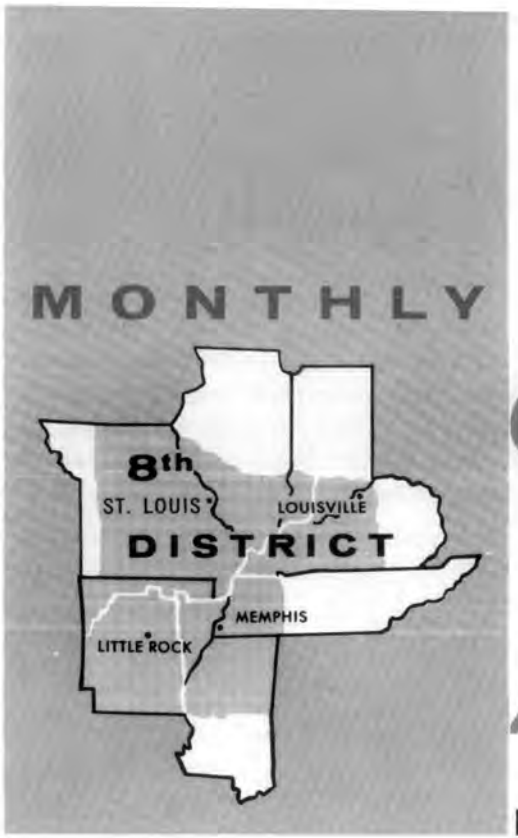


# Review

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



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# *Interest Rates in Perspective*

MOVEMENTS IN INTEREST RATES have caused considerable public comment in recent years. Last year when interest rates on marketable securities were rising to new postwar highs some alarm was expressed. More recently as interest rates have been declining there has been concern over the level and trend of yields. This article comments on interest rates, reviews recent changes in them, and attempts to put the changes into perspective.

## *Preliminary Observations*

Interest rates are prices, expressed as percentages rather than in dollars and cents, paid for the use of money. In our market system interest rates, like other prices, serve to allocate a limited supply of funds among competing demands. Movements in interest rates reflect changes in the relationship between the demand for and supply of funds. An increase in the supply or a weakening in the demand tends to lower rates. Conversely, a decrease in the supply or a strengthening in demand tends to raise them.

There is a wide array of interest rates, reflecting differences in credit risk, maturity, taxability, and marketability. Some rates are quite sensitive to changes in demands and supplies of funds, such as those on Federal funds, Treasury bills and most other money market instruments.[1] On the other hand, some administered rates are fairly rigid; for example, those on savings bonds. Generally, rates on long-term securities are more sluggish than those on short-term issues, but prices of long-term obligations usually fluctuate more than prices of short-term instruments as a result of a change in yields.

The supply of credit funds comes primarily from savings. If people save more, other things equal, more credit will be available; conversely, if the flow of saving is reduced the amount of new credit extended tends to contract. Saving can be supplemented by an expansion of bank credit (and thus the money supply), but year-to-year additions to total bank credit are usually small compared to the flow of saving. The total supply of new credit—saving plus bank credit—generally has not changed greatly within short periods. On the other hand, there have been wide fluctuations in the amount of credit demanded. Thus, most short-run movements in interest rates reflect changes in the demands for funds, but the amount of saving has an important impact on longer run interest rate levels.

Interest rate changes usually contribute automatically to economic stability. During a period of business contraction, the demands for credit usually decrease and interest rates decline. Lower interest costs and greater availability of credit tend to stimulate and to encourage economic recovery. On the other hand, sharply rising business levels are generally accompanied by greater demands for credit and rising yields. The higher rates tend to restrain exuberance.

Monetary policy, since 1951, has not attempted to prevent interest rates from adjusting with changes in the market demands and supplies of funds. The immediate objective of the central bank is to manage the quantity of member bank reserves with a view to influencing the money supply. Of course, the central bank buys and sells securities in order to affect bank reserves, and these operations influence interest rates. Also, a change in bank reserves tends to cause commercial banks to expand or contract credit which may further affect interest rates. Nevertheless, monetary actions are not taken to establish any particular pattern or level of rates.

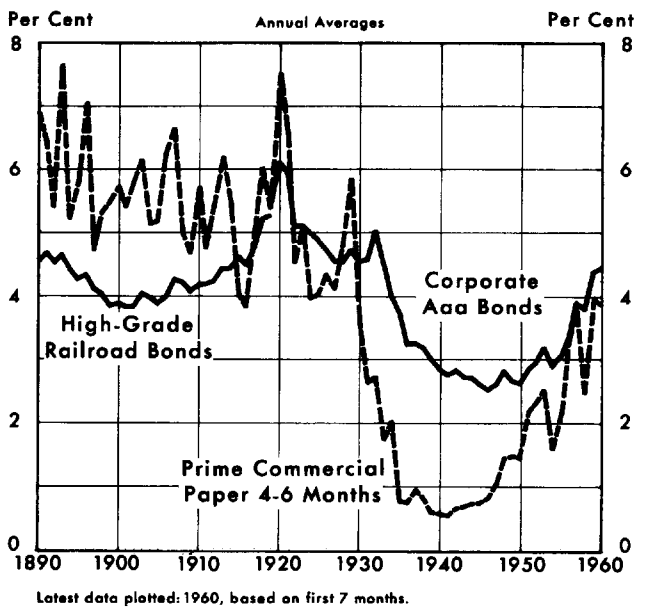
Changes in interest rates affect almost everyone. Exactly how they affect each person or business concern is a difficult question to answer. Lenders obviously benefit from higher rates, and borrowers gain from lower rates. But it is not always easy to know who is a net creditor and who is a net debtor. From the consumer viewpoint, higher interest rates mean greater costs on new mortgages and automobile financing, but they also bring increased income from savings accounts and many other investments. The net position becomes more blurred and confusing when changing yields are further analyzed as to effect on the social security program, pension plans and insurance premiums, capital gains or losses on existing assets, tax rates, and the cost of manufactured goods. In any case, the nation gains from a change in interest rates which contributes to economic stability as against an alternative of economic decline or price inflation.

[1] See articles on "The Federal Funds Market", and "Treasury Bills", in the April 1960 and July 1960 issues of this *Review*, respectively.

## *The Postwar Trend in Interest Rates*

Interest rates in the United States rose irregularly from the end of World War II through 1959 as business activity expanded and as inflationary fears grew. The average rate on long-term Government securities increased from 2.19 per cent in 1946 to 4.27 per cent in December 1959 (see chart). Average yields

**Long- and Short-Term Interest Rates**




Latest data plotted: 1960, based on first 7 months.

on three-month Treasury bills increased from 0.38 per cent to 4.49 per cent over the same period. The rise was irregular, however, with three major interruptions, in 1949, in 1953-54, and in 1957-58.

It is not enough to judge any interest rate *per se;* one must place rates in historic and geographic perspective and must look at the economic forces which have influenced yields, including the productivity of capital. Although interest rates in the United States were higher at the end of 1959 than at any time in several decades, they were not unusually high when compared with interest rates in other industrialized countries or in this country historically.

The average rate on highest grade corporate bonds in 1959 was 4.38 per cent; by comparison the average rate on highest grade corporate bonds from 1890 to 1930 was 4.45 per cent. Short-term rates were relatively lower; prime 4-to-6-month commercial paper yielded 3.97 per cent on the average in 1959 as against 5.42 per cent in the 1890-1930 period. Although the quality of the paper may have improved over this long period, reducing the significance of these comparisons, there is little doubt but that the cost of credit has been higher than in 1959.

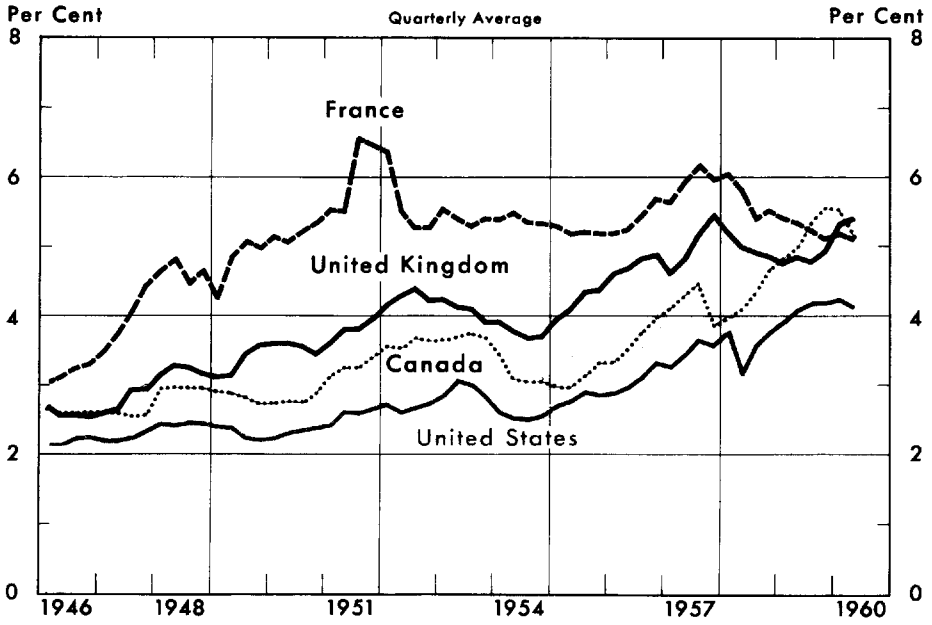
The postwar rise in interest rates in this country has been roughly paralleled by similar increases in other industrialized nations (see chart). Average interest rates on long-term Government bonds in the United States rose from 2.19 per cent in 1946 to 4.27 per cent in December 1959. By comparison over the same period similar rates in the United Kingdom went from 2.55 per cent to 4.99 per cent.

## *Recent Decline in Interest Rates*

Since the beginning of 1960 there has been a marked decline in interest rates. Yields on short-term Government securities have fallen sharply. Average yields on three-month Treasury bills fell from about 4.50 per cent last December to 2.14 per cent in early August. The decline in yields of other Government securities has been large but somewhat less pronounced. Intermediate-term issues fell from 4.95 per cent in December to 3.45 per cent in early August, and the rate on long-term bonds declined from 4.27 per cent to 3.73 per cent.

**Yields on Long-Term Government Bonds**

Selected Countries




Latest data plotted: 2nd Qtr. 1960

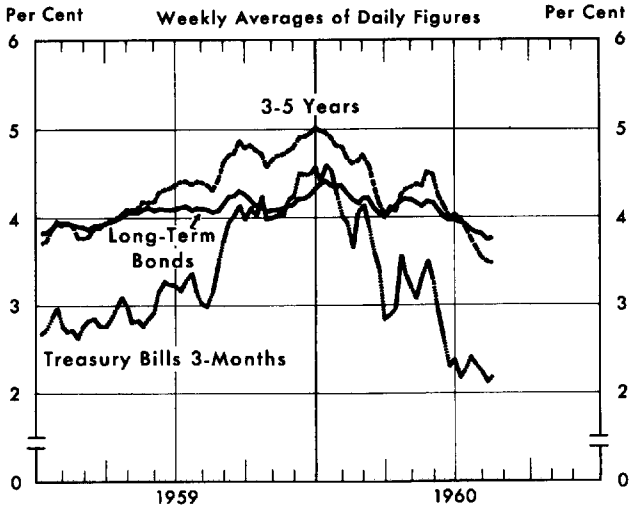
Declines in the yields of Government securities as great as the recent one have occurred only twice before since the end of World War II. These decreases occurred between May 1953 and June 1954 and again from November 1957 to July 1958. During both of these periods the decline in rates accompanied an economic recession. This is the first time since World War II that interest rates have declined so much and for so long a period while business activity continued at a relatively high level.

Despite the apparent severity of the recent decline in interest rates, rates are still relatively high compared with the other postwar years. In fact the current rate on long-term Government bonds, 3.73 per cent in early August, is higher than at any time from the end of World War II to the fall of 1958. This is also true of interest rates on many corporate and municipal securities and on many bank loans.

One feature which distinguishes the current interest rate decline from those which occurred during the recessions of 1953-1954 and 1957-1958 is the fact that the yields on corporate and municipal issues and on mortgages have declined only slightly. Previously, yields on these debt instruments moved about the same amount as yields on marketable Government bonds. On the other hand, most short-term money rates have reflected the current decline in the Treasury bill rates.

Examination of the factors of supply and demand for funds may reveal the causes of these developments in the rate level and structure. From the end of December to the end of July, the money supply contracted about 1 per cent, which, everything else equal, might be expected to cause rates to rise. The flow of saving apparently changed relatively little. It would appear, therefore, that the recent decline in rates primarily reflected a weakening in the demands for funds.

**Yields on U. S. Government Securities**




Latest data plotted: Week Ending August 12 preliminary

The Federal Government changed its position in the money markets substantially over the past year or two. The Government operated at an estimated cash surplus of about $4.5 billion in the first seven months of calendar year 1960, compared with a $4.7 billion cash deficit during the corresponding period of last year. The improved fiscal position changed the Government from a net borrower of funds to a net repayer of debt, and the shift has centered on relatively short-term securities. Rates on short-term Government obligations have fallen rapidly partly because of the sharp turnabout in the Government's activity in this market.

Most other short-term money rates declined also, probably reflecting the smaller total demand for short-term funds. Commercial paper rates on prime four-to-six-month paper declined from 4⅞ per cent in January to 3⅜ per cent in early August and over the same period rates on bankers' acceptances fell from 4½ per cent to 3⅛ per cent.

Partly because demands for funds by businesses and state and local governments have remained fairly strong, most interest rates on securities of these issuers have decreased much less than rates on Government securities. Total loans at commercial banks rose during the first seven months of 1960, and with deposits drifting lower, loan rates have not eased much. The rate charged prime business customers, 5 per cent, has not changed at all.

Mortgage debt continued to rise in the first seven months of 1960 but at a slower pace than during the like period a year earlier. The smaller demand for new funds was accompanied by a slight easing in the availability of mortgage funds. Interest rates on mortgages have not declined much from the peak levels reached early this year, but reportedly, credit can now be obtained in many areas with a smaller downpayment and for longer terms.

### *Conclusion*

Interest rates in our society are set primarily by the impersonal forces of the market place. They fluctuate chiefly in response to changes in demands for funds, although shifts in saving flows have an important influence on rate levels. Interest rates allocate the available funds among competing uses, and changes in rates contribute automatically to economic stability.

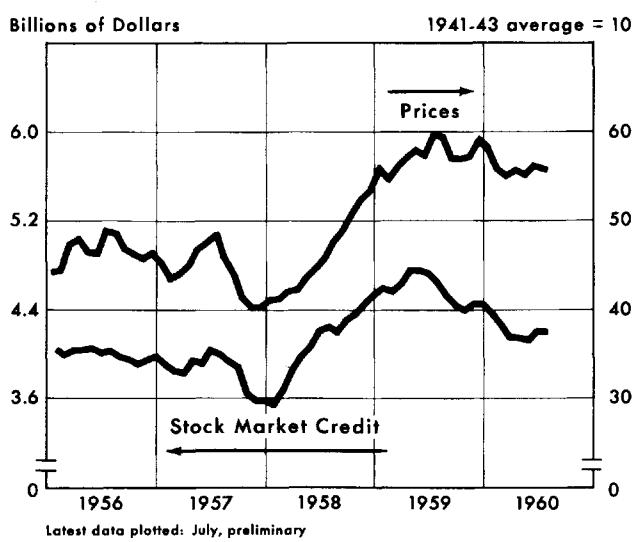
Experience indicates that for interest rates to serve their functions best they must continue to be unencumbered and free to move with changing economic conditions. Nevertheless, there is a tendency to rationalize that what has occurred in the recent past is normal and any variation is suspect. Thus, whenever rates change some people become alarmed.

The climb in interest rates from the end of World War II through 1959 caused concern. However, when these rates are put into perspective of other times and places when business activity was at an advanced level for a prolonged period and when the productivity of capital was high, they were not unusually high. More recently there has been a decline in interest rates, notably the rates on Treasury bills, but when placed in the perspective of the entire postwar period, the current interest rate structure does not appear unusually low.

# *Reduction of Margin Requirements on Stocks*

THE BOARD OF GOVERNORS of the Federal Reserve System on July 27 amended Regulations T and U, relating respectively to margin requirements of brokers and banks, by reducing margin requirements from 90 per cent to 70 per cent, effective July 28, 1960. The reduced requirements apply to both purchases and short sales.

**Stock Prices and Credit**



Latest data plotted: July, preliminary

### *History of Regulation*

Prior to 1934, the volume of credit flowing into the stock market was not subject to direct regulation. The imposition of controls resulted in part from the belief that excessive use of borrowed funds to purchase or carry stocks had contributed importantly to market collapse in 1929. Also, some felt that an excessive amount of credit tended to flow into the purchase of corporate stocks making borrowed funds for other purposes more difficult to obtain. The Securities Exchange Act of 1934 directed the Board of Governors of the Federal Reserve System to prescribe rules and regulations with respect to the amount of credit that may be extended and maintained on any security, with certain exceptions, registered on a national security exchange. In accordance with the Act the Board of Governors has issued Regulation T (dealing with the extensions of credit by brokers) and Regulation U (dealing with commercial banks).

### *Margin Requirements*

The margin requirements on stocks prescribed in these regulations fluctuated around 50 per cent in

*(Continued on page 11)*

# *Earnings of District Member Banks in the First Half of 1960*

EARNINGS from current operations of Eighth District Member Banks set a new record for the period from January through June. Though expenses of member banks also rose, the banks ended the first half-year with a greater profit margin than in the similar period of 1959. Banks were therefore able to increase cash dividends paid to stockholders and to make a substantial addition to capital accounts.

## *Earnings*

In the first six months of 1960 total income from current operations of member banks in the Eighth District was $142 million; this was 13 per cent higher than in the first half of 1959. The greatest source of increased earnings this year was interest received from borrowers, as district banks made more loans, at generally higher rates of interest, than in the first six months of last year. Between January and June of 1959, district member banks had an average of $2.8 billion in loans outstanding; during the corresponding months of 1960 their loans had increased to $3.1 billion. Meanwhile, average interest rates on loans rose from about 6.2 per cent in the first half of 1959 to around 6.3 per cent in the first half of this year.

Average yields on Government securities held by district member banks were also higher this year than last, but member banks sold a large volume of these investments during the first half of 1960. As a consequence, interest income from U. S. Government obligations rose only slightly this year above that received by banks during the first half of last year. Similarly returns from other investments and from service charges on deposit accounts were a little larger this year than last.

## *Expenses*

Current operating expenses of district member banks were 12 per cent greater in the first half of 1960 than in the first half of 1959. Banks paid out a larger sum as interest on time deposits during the January-June period than in the corresponding period of 1959: balances in time accounts were greater this year than last, and a number of banks increased the interest rate they paid to time deposit holders during 1959 as commercial banks competed with other financial institutions for the public's savings. Wages, salaries, and other costs of carrying on business also continued to rise in 1959 and 1960.

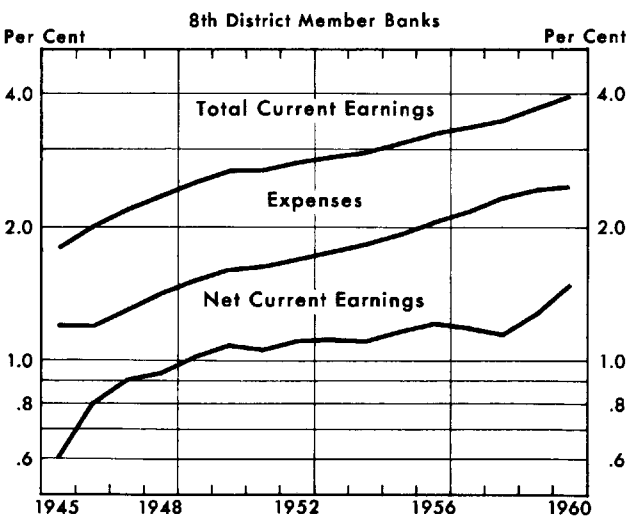
**EARNINGS AND DIVIDENDS**
**ALL EIGHTH DISTRICT MEMBER BANKS**
**FIRST SIX MONTHS OF 1959 AND 1960***

In Millions of Dollars

| | Jan. 1 thru June 30 1959 | 1960 | Dollar Changes | Percentage Changes |
|---|---|---|---|---|
| Interest on U. S. Government Obligations | $ 28.0 | $ 29.0 | + 1.0 | + 3.6 |
| Interest on Loans | 74.7 | 88.7 | +14.0 | +18.7 |
| Other Current Earnings | 23.0 | 24.5 | + 1.5 | + 6.5 |
| **Total Current Operating Earnings** | **125.7** | **142.2** | **+16.5** | **+13.1** |
| Total Current Operating Expenses | 76.3 | 85.3 | + 9.0 | +11.8 |
| **Net Current Operating Earnings** | **49.4** | **56.9** | **+ 7.5** | **+15.2** |
| Net Losses and Charge-offs | 9.7 | 3.8 | — 5.9 | —60.8 |
| **Net Profits before Taxes** | **39.7** | **53.1** | **+13.4** | **+33.8** |
| Taxes on Net Income | 16.0 | 23.8 | + 7.8 | +48.8 |
| **Net Profits after Taxes.** | **$ 23.7** | **$ 29.3** | **+ 5.6** | **+23.6** |
| Cash Dividends on Common Stock | $ 9.4 | $ 10.8 | + 1.4 | +14.9 |

* Preliminary

**Bank Earnings and Expenses as a Per Cent of Total Assets**




Plotted on Semi-Logarithmic scale.
Latest data plotted: 1960, based on first 6 months.

Since the war, operating expenses of district member banks have grown more rapidly year after year than their assets (see chart). Annual expenses of these banks rose from 1.2 per cent of total assets in 1945 to an annual rate of 2.5 per cent in the first half of 1960. In the first six months of 1960 banks' current expenditures totaled $85 million.

In spite of rising expenses, net current operating earnings of district member banks were nearly $57 million in the first half of 1960; this was about 15 per cent higher than in the comparable period a year earlier. Net losses and charge-offs were approximately $6 million less this year than in the first six months of 1959, when banks took losses amounting to nearly $10 million. Most of the losses in these two years were on sales of securities, and were taken intentionally to reduce tax liabilities or in order to obtain funds for lending.

### *Net Profits*

After deducting net losses taken in the first six months of this year, net profits of district member banks totaled about $53 million, and were more than $13 million greater than in the comparable period last year. Income taxes reduced net profits to around $29 million. About $11 million was paid as dividends to bank stockholders, and $19 million was retained to strengthen banks' capital structures.

## *Changes in Member Bank Reserve Requirements*

ON AUGUST 8 the Board of Governors of the Federal Reserve System amended its Regulation D, relating to bank reserves and reserve requirements, in three respects. The amendments are to become effective August 25 and September 1, 1960.

The changes, made in further implementation of an Act of Congress relating to vault cash and reserve requirements, will make available about $600 million of additional reserves for expanding bank credit as the economy enters the season of rising credit needs. The changes are as follows:

1. Effective August 25, 1960, member banks outside of central reserve and reserve cities ("Country banks") will be permitted to count, in meeting their reserve requirements, any vault cash that they hold in excess of 2½ per cent of their net demand deposits. At present they can only count any vault cash that they hold in excess of 4 per cent of net demand deposits.

2. Effective September 1, 1960, reserve city and central reserve city banks similarly will be permitted to count vault cash in excess of 1 per cent of their net demand deposits, instead of the present 2 per cent.

3. Effective September 1, 1960, the reserve requirement of central reserve city banks against their net demand deposits, now 18 per cent, will be reduced to 17½ per cent. This change is a first step toward compliance with a provision of the 1959 Act that the differential between the requirements of central reserve city and reserve city banks be eliminated by July 28, 1962. Since the requirement for banks in reserve cities is now 16½ per cent, the present action reduces the differential from 1½ percentage points to 1 point.

As a result of the first two changes, it is estimated that about four-fifths of the 6,200 member banks will be in a position to count a part of their vault cash in meeting their required reserves.

The amount of reserves made available by the Board's actions on vault cash will be around $480 million, of which somewhat more than half would be at country banks and almost all of the remainder at reserve city banks. The reduction in the requirement of central reserve city banks arising from the third change will release about $125 million of reserves.

# COMMERCIAL BANK LIQUIDITY

OVER THE PAST NINE YEARS, total loans held by commercial banks in the United States have grown steadily. As economic activity has expanded, businesses and individuals have sought more bank credit. During the same period, deposits in these banks have also increased, but at a less rapid rate. A sharp increase in the rate of deposit turnover in recent years has made possible a large increase in the volume of money payments with a less rapid growth of bank reserves and deposits. While commercial banks more than doubled the volume of their loans outstanding from the first half of 1951 to the first six months of this year, demand and time deposits increased by little more than one-third.

In order to expand their lending activity, commercial banks have reduced the proportion of their assets invested in U. S. Government securities. Banks now hold somewhat fewer short-term Treasury securities than in 1951 and, in relation to their deposits, a smaller amount of intermediate- and longer term Government obligations. Commercial banks have also reduced the proportion of their resources held as cash as they have increased their loans. Changes in the composition of bank assets have caused some observers to caution banks on maintaining a balance between liquid and illiquid assets.

## *The Risk of Being Illiquid*

The funds a bank obtains from its depositors and stockholders may be used in a number of ways: a bank may make various types of loans; it may purchase a range of securities maturing at different times; and it may hold cash. Within the limits of banking laws and regulations, the management of each bank decides what proportion of its funds will be used in each of these ways, trying to get the highest return and yet to risk as little loss as possible. There are several kinds of risk that a bank takes by holding earning assets. One is that the borrower will not be able to repay the borrowed sum. The bank tries to keep this credit risk at a minimum by acquiring only high-grade assets.

Another risk—the liquidity risk—is that the bank will have to sell an asset at a loss in order to obtain cash. The smaller the loss the bank might have to take by selling the asset, the more liquid the asset is considered to be. Cash, of course, *is* liquid; debt instruments are more liquid the more likely it is they will continue to have an immediate market value close to their ultimate promise of payment. Since the deposits of a bank may decline sharply within a short period of time, a bank will pay attention to the liquidity, as well as to the financial soundness, of the assets it holds.

## *Which Assets Are Liquid?*

There is often an inverse relationship between the yield of an asset and its liquidity. Interest on loans is usually the main source of a bank's income. On the other hand, many types of loans, even the most sound, can only be sold by the bank at a discount. They are, then, relatively illiquid. U. S. Government and other securities yield less income than most loans do, but a bank can more easily find a market for its securities. The prices of obligations fall when interest rates rise, however. The farther an obligation is from maturity, the more its price generally fluctuates with changes in interest rates. Intermediate- and long-term investments must, therefore, be considered relatively illiquid even though they may be sold at a profit when interest rates are low. Prices of very short-term investments seldom fluctuate widely; for this reason Treasury bills are considered almost the equivalent of cash.[1] Whether an asset is said to be more or less liquid, then, depends upon how much loss might have to be taken in exchanging it for cash.

A bank needs to keep a reserve of cash and relatively liquid assets so that it may more easily meet possible deposit withdrawals, and also to be able to take advantage of more favorable lending opportunities. How large this reserve should be depends on how large a deposit drain the bank might have to meet, and also upon the nature of its other assets.

Financial arrangements and banking practices change from year to year. Debt instruments which were once considered illiquid have been modified to make them more readily marketable. For instance, the Government now insures some types of loans, and secondary markets have developed for others. On the other hand, longer term Government obligations,

[1] See article on Treasury Bills, July issue of this *Review*, pp. 7-10.

which could be sold to the Federal Reserve at a relatively fixed price from 1942 until 1951, have since then lost some of their liquidity.

While loans are usually thought to be less liquid than securities, Federal funds—one-day loans to other banks—are probably the most liquid asset banks can hold next to cash. Commercial paper and bankers' acceptances are highly negotiable loans and, like Federal funds, have grown in importance in recent years. In addition, long-term bank loans, which are spoken of as relatively illiquid, are now frequently paid off in regular instalments; these payments provide banks with a fairly steady inflow of funds.

## *Some Attempts to Measure Liquidity*

A number of ratios have been used to measure commercial bank liquidity. Each has certain limitations; and none can be used to gauge the aggregate liquidity of the nation's banks. These ratios only give a rough indication of the *average* bank's ability to obtain cash when it needs to. The ratios also obscure the great differences within classes of bank assets. But several measures taken together can indicate trends, if not the exact state, of bank liquidity.

The most commonly used measure of bank liquidity is the ratio of commercial bank loans to total deposits. This ratio gives a rough guide to the proportion of assets which are not immediately available to meet deposit withdrawals, although we have seen that there are wide variations in the liquidity of loans and also of other assets. As commercial bank loans have increased more rapidly than deposits from the first half of 1951 to the first half of 1960, the ratio of loans to deposits has risen by nearly one-half (Chart I-A).

Another commonly used measure of bank liquidity, the ratio of loans to U. S. Government securities held by banks, illustrates changes in the composition of bank earning assets (Chart I-B). There has been a great increase in this ratio over the past nine years: commercial bank lending has more than doubled while Government securities held by banks have decreased slightly. But again, the ability of banks to obtain cash when they need it has changed much less dramatically during this period, as many of the new bank loans are in the form of relatively liquid short-term advances.

Shorter term securities fluctuate less widely in price when market interest rates rise or fall, and are therefore considered more liquid, than longer term securities. For this reason, a maturity breakdown of bank-held Government obligations, showing the proportion of funds invested in shorter and in longer term obligations, is sometimes used as an indicator of bank liquidity. In early 1960 banks held a smaller proportion of securities maturing within one year, than in the first half of 1951 (Chart I-C). As a result, there appears to have been a slight decline in the liquidity of bank investments. More important, in 1951, when prices of Government securities were pegged, obligations of all maturities were much more liquid than they have been since that time.

Attempts have been made to develop a more refined way of comparing bank liquid assets to their maximum potential needs for cash. One such measure is the "short-term liquid assets ratio" (see table, page 10). Since it is based on a more detailed examination of bank assets and liabilities, this ratio can be computed for all member banks in the country only four times each year, while deposits and liquid assets can change widely from day to day as banks receive and pay out funds. Even this ratio contains arbitrary classifications; for instance, Government securities maturing within one year are called liquid, while all those over one year (even thirteen months) from ma-

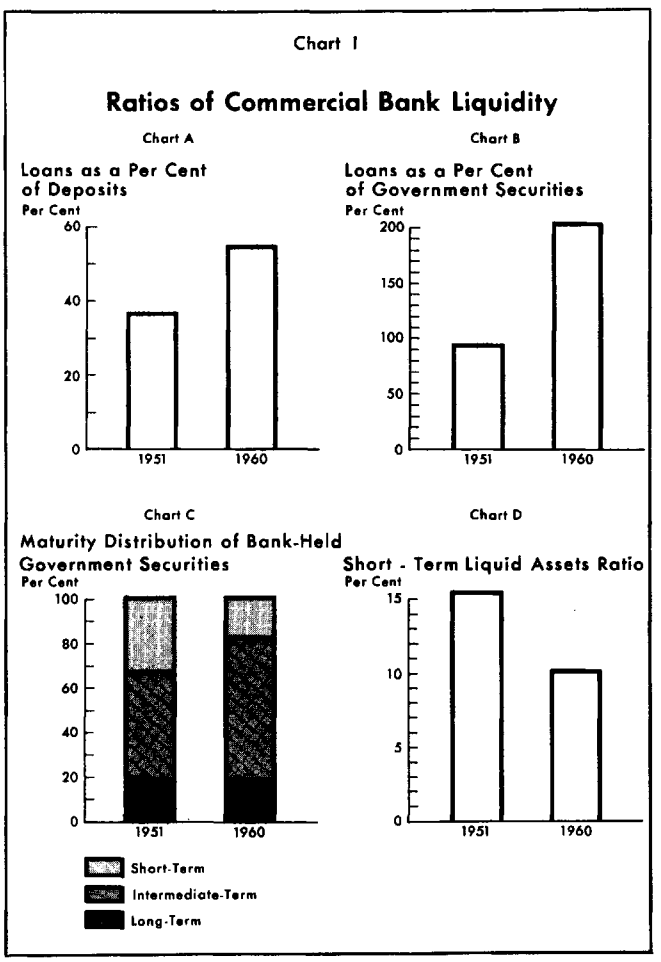


Table I

SHORT-TERM LIQUID ASSETS RATIO

All Weekly Reporting Member Banks in the United States

(Dollar Figures in Billions)

| Liquid Assets | Jan.-June, 1959 Average (Last Wednesday of Month) | Jan.-June, 1960 Average (Last Wednesday of Month) |
|---|---|---|
| Cash in Vault | $ .9 | $ 1.3 |
| Balances with other Commercial Banks | 2.2 | 2.8 |
| Excess Reserves | .1 | .1 |
| Loans to Other Banks | .4 | 2.2 |
| Loans to Securities Dealers | 1.4 | 1.7 |
| Treasury Bills | 1.9 | 1.5 |
| Treasury Certificates | .1 | .7 |
| Government Notes and Bonds maturing within 1 year | 3.5 e | 1.5 |
| Less Borrowings | .5 | 2.4 |
| Net Liquid Assets | 10.1 | 9.4 |
| **Short-Term Liabilities** | | |
| Total Deposits | $85.7 | $116.3 |
| Less | | |
| Cash Items in Process of Collection | 5.9 | 9.8 |
| Required Reserves | 13.9 | 12.9 |
| Net Short-Term Liabilities | 65.9 | 93.6 |
| Ratio of Net Liquid Assets to Net Short-Term Liabilities | 15.3% | 10.0% |

e—Estimated in part

turity are termed illiquid. Table I shows the averages of the selected assets and liabilities held by larger (weekly reporting) banks in the Federal Reserve System. The short-term liquid assets ratio has also shown a decline over the past nine years.

These ratios indicate that the liquidity of the *average* bank has decreased to a certain extent in the past nine years. It should be noted, however, that there is some evidence of a declining need for liquidity. Federal insurance of deposits lessens the possibility of severe deposit runs. And, in the last nine years, banks in this country have added to their capital accounts, so that many feel comfortable with a higher proportion of risk to total assets. Also, time deposits have risen faster than demand deposits over the past decade. Since time deposits are less volatile than demand accounts, the shift reduces liquidity needs.

## *The Ultimate Source of Bank Liquidity*

In the final analysis, though, the liquidity of the entire banking system is influenced by Federal Reserve monetary actions. Federal Reserve purchases of securities in the open market and loans to banks can convert less liquid assets into cash reserves. The central bank can supply the banking system with the credit-creating ability that will be consistent with growth and stability in the nation's economy.

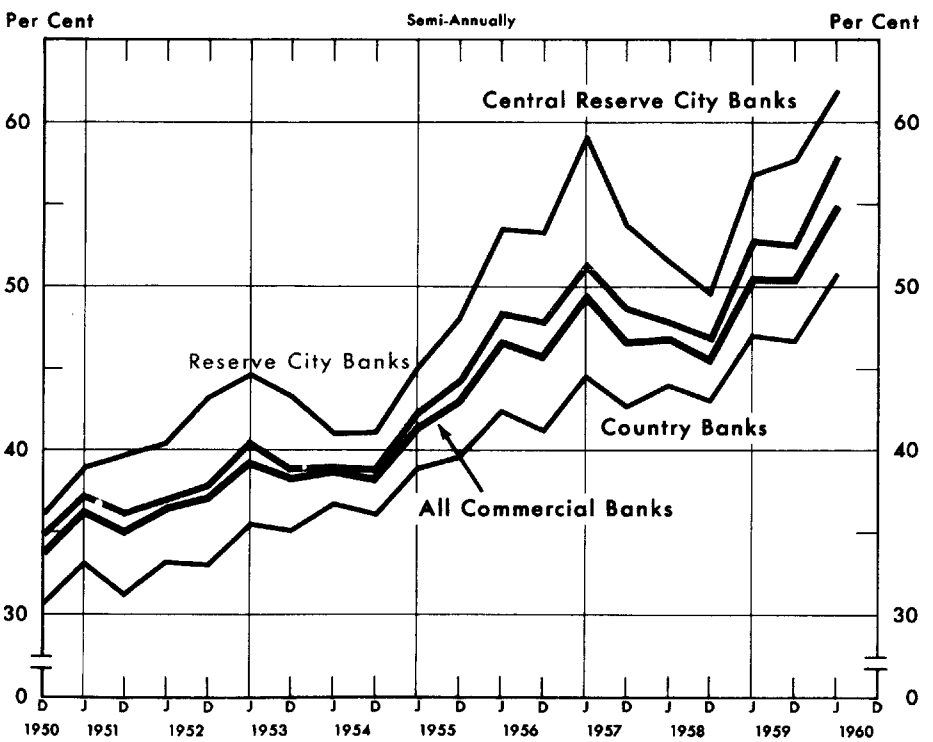
## *Variations Among Groups of Banks*

Any ratio which expresses the average liquidity of commercial banks in the nation obscures variations among banks of different sizes and in different locations. During the nine years from the first half of 1951 until now, the differences between the lending activities of banks have increased, as can be seen from Chart II. The larger banks in New York and Chicago, known as central reserve city banks, tend to hold a larger proportion of their resources in loans than banks in the rest of the country. Their lending activities have also responded more to cyclical changes in the demand for funds. By June of 1960, the loan-to-deposit ratio of central reserve city banks had risen to 62 per cent.

Chart II

**Ratio of Loans to Deposits**

All Commercial Banks in U. S.



Similarly, larger banks in other major cities of the United States have generally carried a greater volume of loans in relation to their deposits than most other banks. In June of 1960, loans made by reserve city banks were equal to 58 per cent of deposits.

But the majority of commercial banks in the nation —the country member banks and the nonmember banks—hold deposits about twice as great as their loans. Country banks in the Eighth Federal Reserve District, for instance, had a loan-to-deposit ratio of 46 per cent in June of this year.

Variations in the liquidity of banks may reflect differing management policies and objectives, as well as difference in customers' demands for credit and in rates of deposit growth. Variations may also arise as bigger banks are more able to compete in making large-scale loans to corporations throughout the nation.

## *Conclusion*

It is important for an individual commercial bank to be able to meet unexpected cash withdrawals without having to take great losses. It is therefore important for the individual bank to maintain an adequate cushion of highly liquid assets. But there is no "best" structure of assets for every bank. An asset distribution which provides sufficient liquidity at one time may be inadequate at another time, under different conditions.

Over-all measures of bank liquidity have many shortcomings, but they indicate that there has been a modest decrease in liquidity over the past decade. The management of each bank must continually review the portfolio of assets to make sure that cash and secondary reserves are adequate.

Despite a decline in liquidity at some banks, requiring more conservative lending policies, the overwhelming majority of commercial banks are able to continue supplying credit to businesses, consumers, and real estate owners. Fear that the country may suffer a shortage of total bank credit and money as a result of a decline in bank liquidity is unfounded, since the Reserve System can provide additional cash reserves to the banking system whenever monetary policy objectives call for an expansion in bank credit.

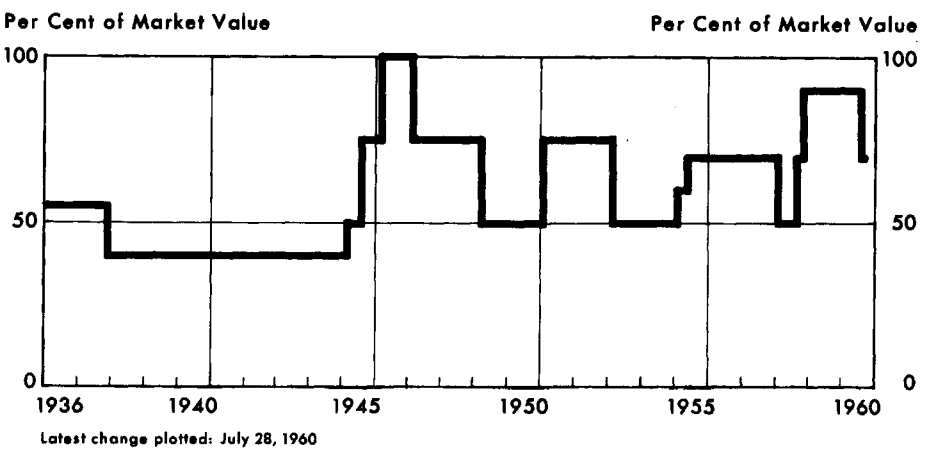
## *Margin Requirement Reduction* *(Continued from Page 5)*

the thirties and early forties (see chart). Reflecting a rapid increase in volume of credit extended on stocks, cash margin requirements were raised in three steps to 100 per cent during 1945 and early 1946. Hence, new purchases of stocks had to be made entirely without borrowing, but there was no requirement to liquidate outstanding indebtedness on stocks. Since early 1947 margin requirements have fluctuated between 90 per cent and 50 per cent, in general being raised at times when the volume of stock market had been expanding and being lowered when credit had been contracting.

## *Volume of Credit*

The volume of credit extended on stocks has probably amounted to less than 2 per cent of the total value of stocks on the New York Stock Exchange in recent months. In June the total amount of credit being used to purchase or carry stocks was $4.2 billion, down about 12 per cent from the peak in April and May 1959.

**Margin Requirements**



# *Bank Debits in the Eighth District*

DURING THE THREE MONTHS ENDING WITH JULY debits to deposit accounts, that is the volume of checks and other charges against bank balances, at reporting banks in the St. Louis District totaled nearly $18 billion. This was about 3 per cent more than in the corresponding three months a year earlier.

Since the bulk of the flow of money payments is made by check or other transactions affecting deposits, debits figures have been frequently used as a measure of the trends in local business activity. However, figures on debits can be influenced by certain financial transactions and other movements of funds which may not reflect the state of economic activity, especially within short periods of time.

District cities which had relatively large increases in debits from the May-July quarter last year to the like quarter this year were: Cape Girardeau, Missouri, Owensboro, Kentucky, and Jefferson City, Missouri. Of the 22 reporting centers, 10 were higher in the period under review this year than in the comparable period last year, 10 were lower, and 2 were virtually the same.

**BANK DEBITS[1]**

**Reporting Banks in Eighth District**

**(In Millions of Dollars)**

| | May, June and July 1960 | May, June and July 1959 | Per Cent Change |
|---|---|---|---|
| **Six Largest Centers:** | | | |
| East St. Louis—National Stock Yards, Illinois | $ 445 | $ 452 | — 1.6% |
| Evansville, Indiana | 554 | 580 | — 4.5 |
| Little Rock, Arkansas | 742 | 740 | + 0.3 |
| Louisville, Kentucky | 2,782 | 2,913 | — 4.5 |
| Memphis, Tennessee | 2,613 | 2,490 | + 4.9 |
| St. Louis, Missouri | 8,510 | 7,997 | + 6.4 |
| Total—Six Largest Centers | $15,646 | $15,172 | + 3.1% |
| **Other Reporting Centers:** | | | |
| Alton, Illinois | $ 142 | $ 148 | — 4.1% |
| Cape Girardeau, Missouri | 69 | 62 | +11.3 |
| El Dorado, Arkansas | 97 | 108 | —10.2 |
| Fort Smith, Arkansas | 190 | 200 | — 5.0 |
| Greenville, Mississippi | 96 | 98 | — 2.1 |
| Hannibal, Missouri | 42 | 42 | –0– |
| Helena, Arkansas | 36 | 37 | — 2.7 |
| Jackson, Tennessee | 96 | 95 | + 1.1 |
| Jefferson City, Missouri | 409 | 380 | + 7.6 |
| Owensboro, Kentucky | 172 | 159 | + 8.2 |
| Paducah, Kentucky | 118 | 111 | + 6.3 |
| Pine Bluff, Arkansas | 145 | 151 | — 4.0 |
| Quincy, Illinois | 160 | 158 | + 1.3 |
| Sedalia, Missouri | 58 | 57 | + 1.8 |
| Springfield, Missouri | 353 | 360 | — 2.0 |
| Texarkana, Arkansas | 82 | 82 | –0– |
| Total—Other Centers | $ 2,265 | $ 2,248 | + 0.8% |
| Total—22 Centers | $17,911 | $17,420 | + 2.8% |

[1] Debits to demand deposit accounts of individuals, partnerships and corporations and states and political subdivisions.