

July 1962

FEDERAL RESERVE BANK OF ST. LOUIS

Review



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FEDERAL RESERVE BANK
OF ST. LOUIS

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Monetary Developments

BUSINESS ACTIVITY ROSE MODERATELY in May and remained at an advanced level in June. The economy expanded at a relatively rapid rate from January to April, partly as a result of an inventory buildup in anticipation of a steel strike. The May advance occurred despite declines in steel output. Expenditures on new construction rose during May and June, more than regaining the levels reached in late 1961. Employment increased from mid-April to mid-June as gains in the auto industry more than offset declining employment in the steel industry. Nonetheless, employment in June was somewhat below the levels reached in February and March of this year.

Despite the rise in activity, unused resources remained relatively high. The proportion of the labor force which was unemployed in mid-June was 5.5 per cent, seasonally adjusted. This may be compared with an unemployment rate of 4.2 per cent in the comparable period of the 1954-55 recovery. During the like period of the 1958-59 expansion there was a major strike in the steel industry, making comparisons with that period less meaningful. Unused plant capacity was greater in May of this year than in the comparable period of the 1954-55 expansion. Capacity utilization for production of major materials was estimated to be 77 per cent, compared with 92 per cent in the like period of the 1954-55 expansion.

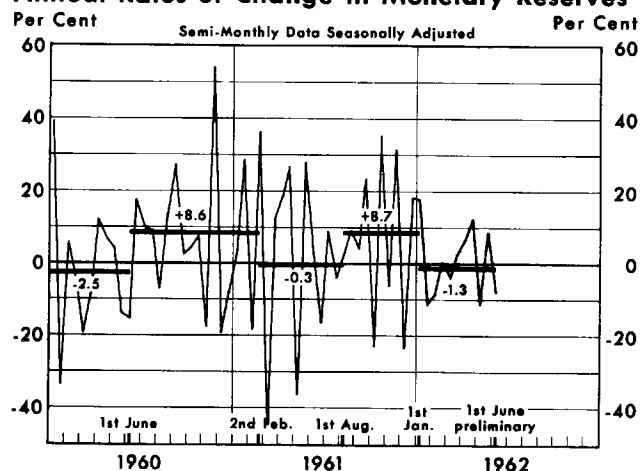
This article briefly outlines some recent monetary developments. Movements in key indicators reflect in varying degree both monetary action and market forces. In studying recent developments, it is not always possible to distinguish the effects of monetary actions from the influences of other economic developments.

Bank Reserves

Total member bank reserves, seasonally adjusted, increased at an annual rate of about 4.4 per cent from the second half of April to the first half of June. Since late last year total reserves have increased at a rate of 2.0 per cent.

Monetary reserves (total reserves less reserves behind Treasury deposits) decreased \$90 million, or at an annual rate of about 3.6 per cent from late April to early June. The decline in monetary reserves occurred despite the rise in total reserves, reflecting a greater than seasonal increase in Treasury deposits. Since early this year monetary reserves have been virtually unchanged. During the comparable months of the two previous cycles monetary reserves were increasing at rates slightly in excess of 1 per cent.

Annual Rates of Change in Monetary Reserves*



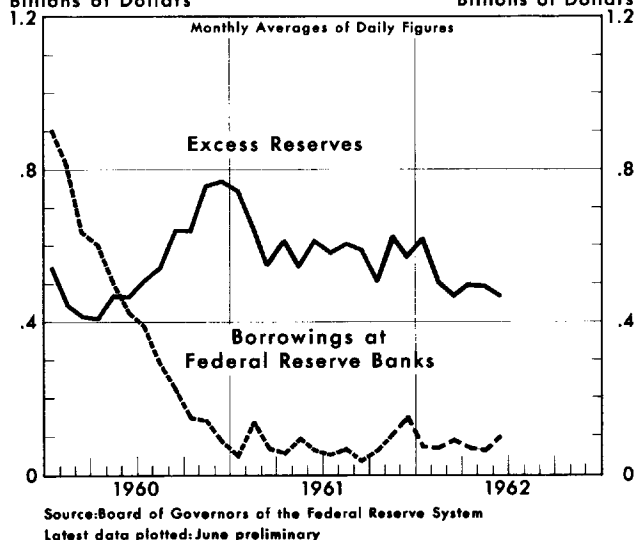
*Reserves of member banks adjusted for changes of reserves required, less reserves behind Treasury deposits.
For a similar presentation beginning with 1951 and a discussion of the data, see "Monthly Review" of this bank for March 1962.
Bars on charts are periods of no marked and sustained changes in the rates of change.

Excess reserves, the amount of reserves which member banks hold above the amount which they are required to maintain, declined to an average of about \$470 million in June. Excess reserves averaged about \$500 million from February through May and \$600 million during most of 1961 and early 1962. Member bank borrowing from Reserve Banks, which had been fluctuating around a \$75 million level, averaged \$145 million in the two weeks ending June 27.

Excess reserves less member bank borrowing, a commonly used indicator of conditions in the money market, averaged about \$370 million in June. This

was \$70 million less than in May and over \$100 million less than the level which was maintained during most of last year and in early 1962.

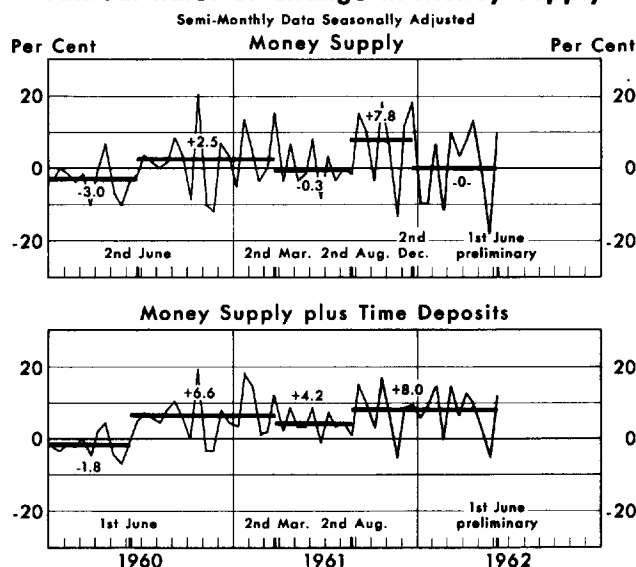
Excess Reserves & Borrowings of Member Banks



Money Supply

The money supply (demand deposits adjusted plus currency in circulation) decreased \$600 million from the second half of April to the first half of June, after adjustment for seasonal variation. Since late December 1961 the money supply has been virtually unchanged. At the similar stages of the 1958-59 and 1954-55 recoveries the money supply increased at annual rates of 3.4 per cent and 1.3 per cent, respectively.

Annual Rates of Change in Money Supply



For a similar presentation beginning with 1951 and a discussion of the data, see the March 1962 and October 1961 issues of this bank's "Monthly Review."

Bars on charts are periods of no marked and sustained changes in the rates of change.

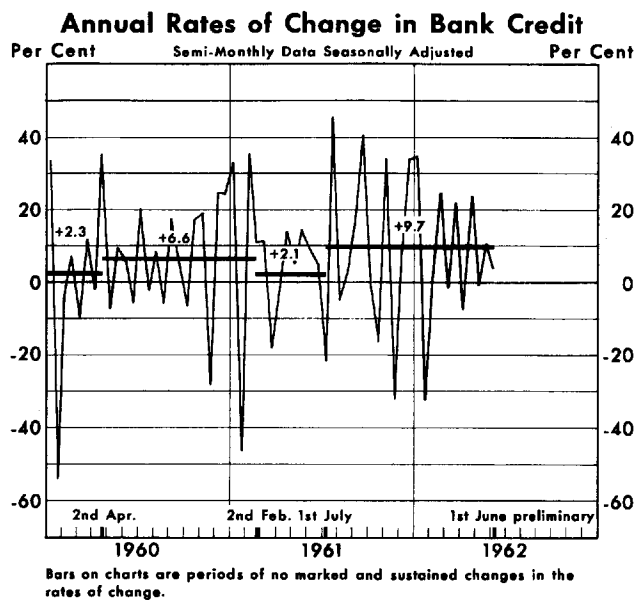
Time deposits expanded \$1.5 billion, or at an annual rate of 13.5 per cent, from late April to the first half of June, after adjustment for seasonal variation. Thus far this year time deposits have increased at about a 20 per cent rate. From mid-1960 to the end of 1961 time deposits increased at a rate of 14 per cent. The rapid growth of time deposits since mid-1960 probably reflects the higher returns available on time deposits relative to market rates. During the past ten years time deposits have increased most rapidly during periods when short-term market interest rates were relatively low. Short-term rates fell either just prior to or during each of the three most recent recessions and increased sharply during the 1958-59 and 1954-55 recoveries. Following the February 1961 trough, however, short-term rates have risen only moderately, and the rate of increase of time deposits has continued to be rapid for a longer period.

As a result of the increase in time deposits, total deposits plus currency in circulation increased \$1 billion, or at an annual rate of about 3 per cent, from the second half of April to the first half of June. From August to date money supply plus time deposits increased at an annual rate of 8 per cent. This is a substantially greater rate of increase than during comparable months of the two previous cycles. Some analysts regard money supply plus time deposits as a most significant indicator of monetary developments, while others focus attention primarily on money supply in the narrower sense. The diverse movement of these two series may lead to different conclusions regarding developments thus far in 1962.

Bank Credit

Total bank credit rose at about a 4.5 per cent rate from late April to early June, seasonally adjusted. Since mid-1961 bank credit has increased at an annual rate of about 10 per cent. During the last half of 1961 investments increased at an annual rate of 8.8 per cent and loans at an annual rate of 11.5 per cent. Thus far in 1962 investments have been about unchanged, but loans have expanded at an annual rate of 7.3 per cent, with most categories of loans sharing in the expansion.

The rapid increase in bank credit since the middle of last year reflects a combination of forces. Total reserves increased sharply from late July to late November 1961, but the rate of increase has moderated significantly in recent months. Banks reduced their excess reserves during the early months of this year.



Thus, there has been a more intensive utilization of the existing volume of total reserves. The rapid increase in time deposits (which have a lower reserve requirement than demand deposits) has resulted in a steady reduction in the average reserve requirement behind total deposits; this too has enabled bank credit to expand more rapidly than total reserves.

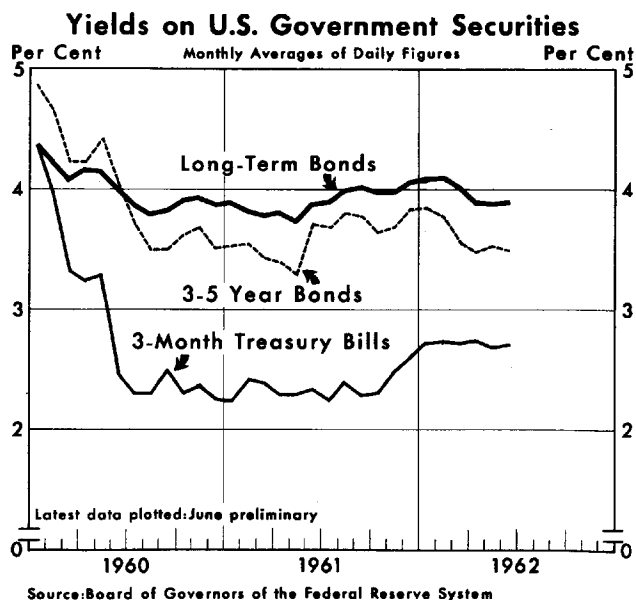
Interest Rates

Yields on three-month Treasury bills increased markedly from about 2.67 percent in early June to 2.94 per cent in early July, the highest rate since June 1, 1960. Interest rates on intermediate- and long-term Government bonds rose during late June. Yields on both intermediate- and long-term securities declined earlier this year. Yields on state and local bonds increased in May and June, but remained below levels reached earlier in the year. Common stock prices fell steadily from mid-March to June. From December to June the Standard and Poor's index of 500 stocks declined about 22 per cent. Although average earnings-price ratios of common stocks have increased rapidly in recent months, they are still much lower than a decade ago.

Debt-Management and Fiscal Developments

In recent weeks the Treasury has increased the amount of its weekly auction of three- and six-month Treasury bills by \$100 million each. The greater supply of these issues was a factor in the rise of short-term interest rates. At this stage of the two previous recoveries the Treasury also increased the volume of short-term securities outstanding; in addition, loan demand was strong, and banks were net sellers of short-term securities. In contrast, there has been little net change in bank holdings of short-term securities in recent months. As a result, the nonbank public's holdings of liquid Government debt rose at more rapid rates in the comparable periods of the two previous recoveries.

Government fiscal developments, as measured by the cash budget, were less expansionary during the second quarter of 1962 than during the previous quarter. With the expansion in economic activity, the cash receipts of the Government rose at a more rapid rate than expenditures. The cash deficit declined from a \$13 billion seasonally adjusted annual rate in the first quarter to an estimated \$5 billion in the second quarter. In the income and product accounts, there was an estimated \$2.5 billion deficit in the second quarter of 1962, about the same as in the previous quarter.



District Business Activity

BUSINESS ACTIVITY IN THE EIGHTH DISTRICT continued to rise during the first half of 1962. The tempo of expansion during this period slowed somewhat compared with the rate of increase during 1961, though the pattern of change varied from one area of the district to another.

This note reviews business and financial developments during the first half of 1962 in the major metropolitan areas of the Eighth District. Developments in these major centers during 1961 were discussed in the February issue of this *Review*.

St. Louis

Business activity in the St. Louis area showed a mixed pattern during the first half of this year. Industrial use of electric power, employment, and department store sales increased, while the value of residential construction declined.

Industrial use of electric power, an indicator of movements in production, rose nearly 3 per cent from December to May 1962 after adjusting for seasonal influences.¹ As Chart 1 shows, the increases in 1962 continue an upward movement which began in the late summer of last year. The value of residential construction contracts awarded declined slightly, seasonally adjusted, from December to May of this year. A marked rise from December to January was more than offset by a sharp decline in April. Despite an increase from April to May, end-of-year levels were not regained. (See residential construction chart on back cover of this *Review*.)

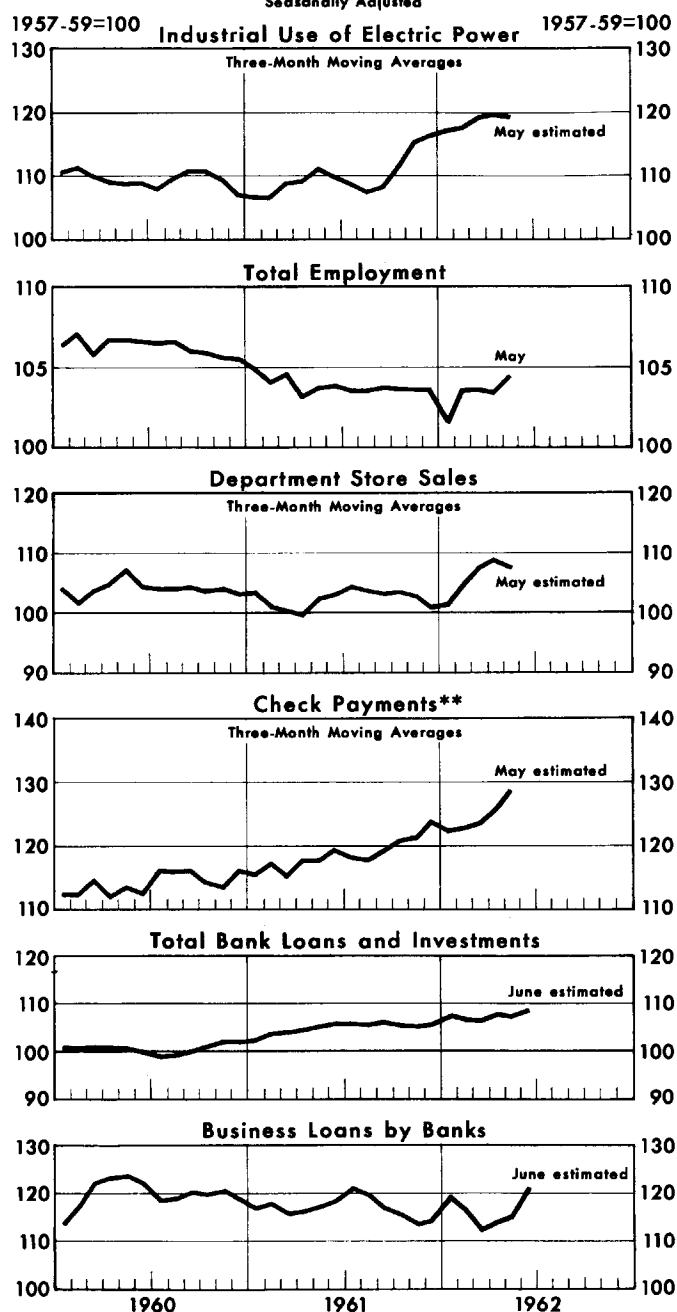
Employment in the St. Louis labor market was little changed from December to May after adjusting for seasonal influences. Indeed, total employment has been virtually unchanged since early 1961, and remains below the levels which prevailed prior to the 1960 downturn in general business.

Department store sales, seasonally adjusted, rose almost 7 per cent from December to May of this year.

¹ In addition to adjusting for seasonal influences, a three-month moving average has been applied to the electric power, department store sales, and check payments series. The three-month moving average serves to reduce erratic month-to-month movements which are characteristic of these data.

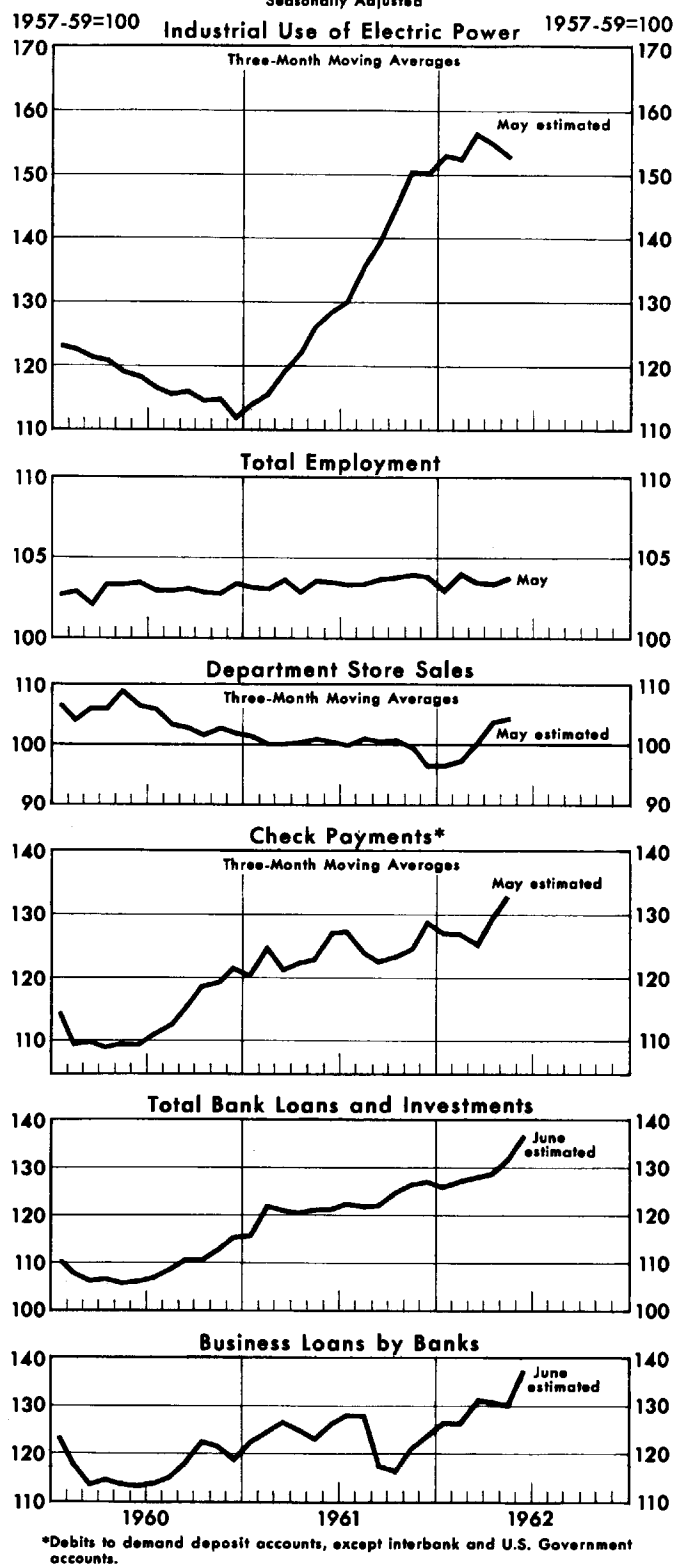
Sales in May were well above the level of early 1961, when the general economy was at the trough of the 1960-61 recession, and were somewhat above the levels attained prior to the mid-1960 downturn in gen-

Chart 1
St. Louis Economic Indicators
Seasonally Adjusted



**Debits to demand deposit accounts, except interbank and U.S. Government accounts.

Chart 2
Memphis Economic Indicators
 Seasonally Adjusted



eral business. The volume of check payments, regarded by some analysts as an indicator of local business activity,² increased markedly from January through May.

Loans by banks in the St. Louis metropolitan area expanded almost 4 per cent during the first half of 1962, while investments rose about 2 per cent. Business loans increased 6 per cent, declining during the first quarter but rising sharply in the second quarter. Real estate loans rose steadily but consumer loans were little changed on balance from the end of 1961 to June. Although total bank credit expanded during the first six months of this year, total deposits declined moderately. Demand deposits declined sharply but time deposits continued to expand.

Memphis

Business activity in the Memphis area improved moderately during the first half of 1962. Production appears to have risen, unemployment declined more than seasonally, and department stores sales increased steadily during the period.

There was a small net increase from December to May in the industrial use of electric power. A rapid increase during the first quarter was followed by declines through May (see Chart 2). Residential construction in the Memphis area, as indicated by the dollar volume of contract awards, was virtually unchanged on balance from December 1961 to May (see chart on back cover).

Total employment in the Memphis labor market was about unchanged from December to May after adjusting for seasonal influences. The relative stability in employment coupled with a moderate decline in unemployment resulted in some decrease in the size of the Memphis work force. Unemployment as a percentage of the work force declined from 4.8 per cent in December to 4.4 per cent in May.

Sales of department stores, seasonally adjusted, rose more than 8 per cent from December to May, reversing a sharp downward movement from October to December of last year. The volume of check payments edged downward from December 1961 to March but advanced sharply during April and May to well above the end-of-year levels.

² These payments include both payments for currently produced goods and services and payments for such existing goods as real estate, used cars, etc. Check payments may stem from financial transactions which may bear little relation to current economic activity and transactions from outside the area. In addition, some expenditures do not result in debits.

Total credit outstanding at Memphis banks rose an estimated 8 per cent from the end of 1961 to June. A sharp rise in loans was accompanied by a modest expansion in investments. Consumer and real estate loans expanded, and business loans increased markedly during the period. Time deposits increased sharply at banks in the Memphis area while demand deposits were about unchanged.

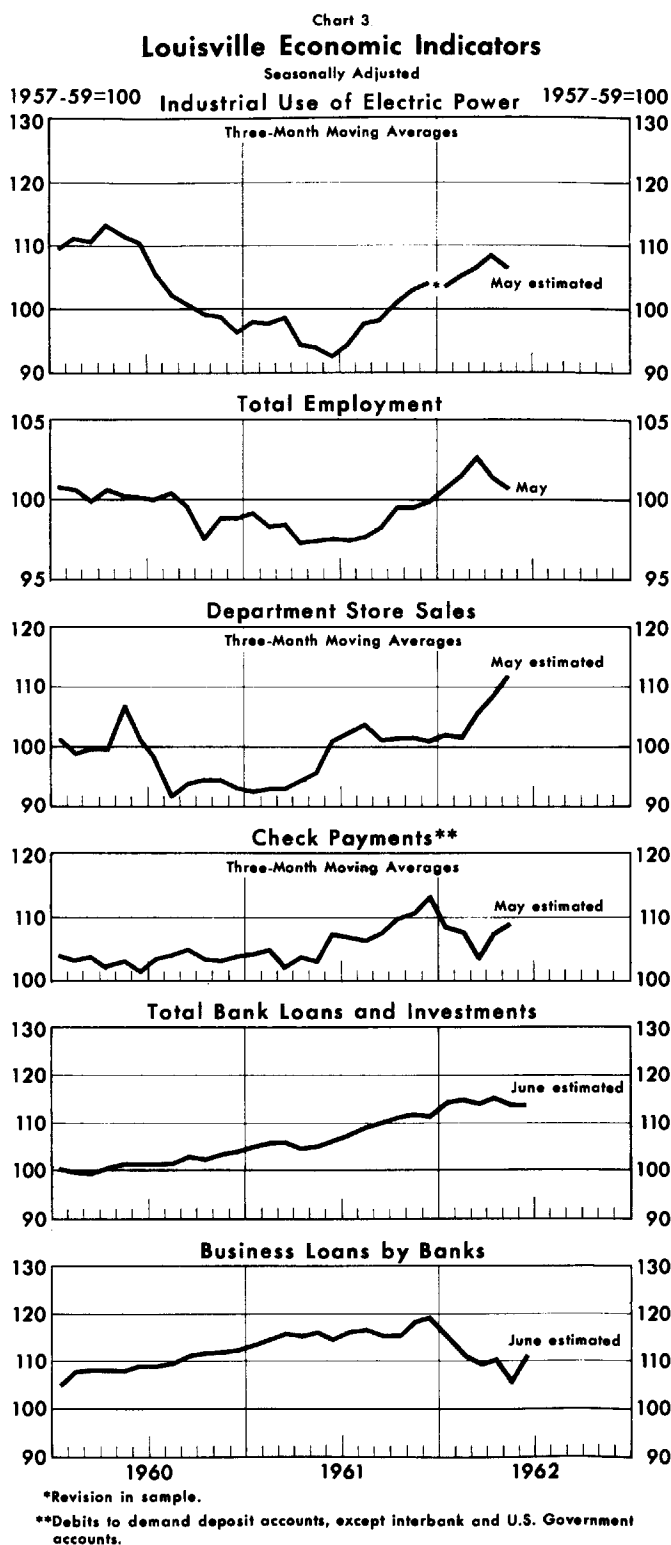
Louisville

Business activity in the Louisville metropolitan area during the first half of this year probably rose slightly from the level which prevailed in late 1961. Electric power consumption rose fractionally; there was a small net increase in employment; and department store sales increased substantially. On the other hand, the volume of check payments and business loans outstanding at Louisville banks declined during the period.

From January to May industrial use of electric power increased about 3 per cent, continuing the upward movement which began about mid-1961. Despite this year-long rise, the rate of power consumption in May appears to have been little changed from the rate of use prior to the 1960 downturn (see Chart 3). The value of residential construction contracts awarded declined sharply, about 32 per cent, during the first five months of this year. This decline is in marked contrast to experience from May through December 1961, during which time contract awards almost doubled (chart on back cover).

Employment in the Louisville metropolitan area increased about 1 per cent from December 1961 to May of this year after adjusting for seasonal influences. The increase in employment was more than matched by a sharp decrease in unemployment. Hence, the work force declined moderately during the period. The unemployed portion of the work force was a seasonally adjusted 4.6 per cent in May compared with 6.1 per cent in December 1961.

Department store sales, seasonally adjusted, increased during the first half of 1962. From December 1961 through May sales rose approximately 11 per cent. The volume of check payments declined during the early part of the year, and, despite an increase in April and May, did not regain the level which obtained in November and December of last year.



Total loans and investments at Louisville banks rose slightly, seasonally adjusted, from the end of last year to June 1962. Total loans were about unchanged on balance, but investments rose 5 per cent. Business loans declined sharply during the period, while consumer and real estate loans expanded. Total deposits

declined, as a rise in time deposits was only partially offset by a drop in demand deposits.

Little Rock

Business activity in the Little Rock metropolitan area made substantial gains during the first half of 1962. Electric power consumption of manufacturing firms rose markedly from the end of 1961 to May of this year. Employment increased and the number of unemployed declined. Department store sales also rose during the period.

Industrial use of electric power, an indicator of productive activity, rose nearly 6 per cent from December to May, after adjustment for seasonal influences. Although there was a sharp decline in power consumption from March to May, the earlier upswing, which began about October of last year, was only partially offset (see Chart 4). Construction improved more than seasonally during the first four months of 1962. The value of residential contracts, seasonally adjusted, rose 18 per cent from December to April.

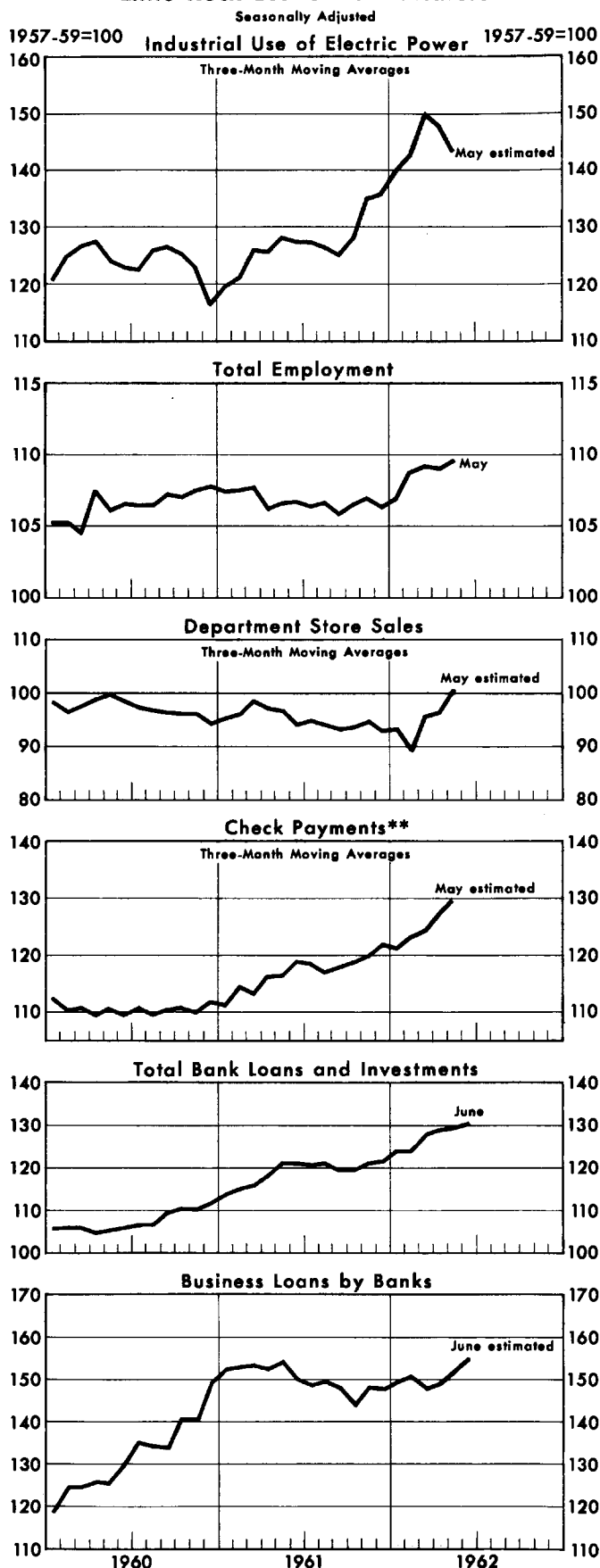
Total employment in Little Rock, which was about unchanged during the last half of 1961, rose more than 3 per cent from December to May 1962 after adjusting for seasonal influences. The proportion of unemployed in the work force declined from a seasonally adjusted 5.1 per cent in December to 3.5 per cent in May.

Department store sales rose about 8 per cent from December to May, as gains during the three months ending in May more than offset a moderate decline early in the year. The volume of check payments rose about 7 per cent from December to May.

Both loans and investments of commercial banks in the Little Rock area increased during the first six months of 1962. Reflecting the rise in economic activity, business loans rose in the first half of the year, and most other categories of loans also expanded during the period. Time deposits increased sharply, while demand deposits were virtually unchanged.



Chart 4
Little Rock Economic Indicators



**Debits to demand deposit accounts, except interbank and U.S. Government accounts.

BUDGETS OF THE FEDERAL GOVERNMENT

THE FEDERAL GOVERNMENT'S FISCAL ACTIVITIES are reported in a variety of accounting frameworks. Three summary statements of the receipts and expenditures of the Government have come into general use. Each statement is designed for a special purpose: the administrative budget for budgetary control, the cash budget to record cash flows in and out of the Government, and the national income and product accounts budget to measure the impact of the Government on current output. The purpose of this article is to describe the three budgets and their interrelationships as an aid to evaluation of the Government's impact on the level and composition of economic activity.

The Administrative Budget

The administrative budget, sometimes referred to as the conventional budget, probably is the most widely reported measure of Federal receipts and expenditures (see Table I). Most receipts and expenditures in the administrative budget are recorded on a cash basis (i.e., on the date of actual receipt or payment rather than on the date in which the obligation arises), although interest expense is accrued. This budget is used by the President for reconciling and totaling his fiscal program for presentation to Congress. Since it is a tool primarily for administrative control rather than for economic analysis, the administrative budget emphasizes Government spending and taxing activities which are subject to annual legislative review.

Partly as a consequence of this emphasis, gross receipts are understated in the administrative budget. For example, Government cash inflows are recorded on a net rather than gross basis because the net inflow is a better measure of capacity to support spending. Thus, individual income taxes are budgeted net of refunds. Receipts of Government trust funds, most notably those of the social security program, are also omitted because they are not available to support general spending programs.

Similarly, the administrative budget understates expenditures. Some Government-owned enterprises are included on the expenditure side only to the

extent that the enterprise expenditures exceed receipts, or *vice versa* (negative expenditure). This amount represents the net financial burden or gain of the enterprise for the Government, rather than its gross impact on the economy. For example, the \$2.6 billion expenditures listed in 1961 for Commerce and Transportation includes \$0.9 billion, representing the net postal service deficit. Actual Post Office receipts totaled \$3.5 billion, and expenditures \$4.4 billion, in fiscal 1961. On the other hand, the gross receipts and expenditures of other Government enterprises (e.g.

Table I

U. S. Government Administrative Budget Receipts and Expenditures (in billions of dollars)

	Fiscal 1961 actual
BUDGET RECEIPTS	
Individual income taxes.....	41.3
Corporation income taxes.....	21.0
Excise taxes	9.1
Estate and gift taxes.....	1.9
Customs	1.0
Miscellaneous budget receipts.....	4.1
Total	78.3
Deduct interfund transactions.....	.7
Total, budget receipts.....	<u>77.7</u>
BUDGET EXPENDITURES	
National defense	47.5
International affairs and finance.....	2.5
Space research and technology.....	.7
Agriculture and agricultural resources.....	5.2
Natural resources	2.0
Commerce and transportation.....	2.6
Housing and community development.....	.3
Health, labor, and welfare.....	4.2
Education .....	.9
Veterans' benefits and services.....	5.4
Interest	9.1
General government.....	1.7
Allowances for pay adjustments and contingencies.....	.....
Total	82.2
Deduct interfund transactions.....	.7
Total, budget expenditures.....	<u>81.5</u>

Source: *The Budget of the United States Government for the Fiscal Year Ending June 30, 1963.*

Note: Detail may not add to totals due to rounding.

the Panama Canal Company) are not reported in the conventional budget at all.¹

Finally, trust fund expenditures are omitted. A justification for omission of trust fund receipts and expenditures is that these represent legal commitments of the Government which are relatively unaffected by the annual legislative decisions summarized in the administrative budget.

The Cash Budget

The cash budget, or consolidated cash budget, records receipts from and payments to the public. Because the intent of this accounting system is to consolidate all the cash-flow relations between the public and the Federal Government, trust fund receipts and expenditures are within its scope. This makes it more significant as an economic document than the administrative budget. The cash budget also eliminates intragovernment payments which occur as both receipts and expenditures (largely interest on Federal debt held by trust funds) because these payments do not represent cash transactions between the public and the Government.

As in the administrative budget, receipts are recorded net of refunds. Furthermore, the Government enterprises which are in the administrative budget on a net earnings or deficit basis are on the same basis in the cash budget. As a result, while the cash budget is more inclusive than the administrative budget, neither reflects the total flows of cash into and out of the Government. There is no budget currently in use which attempts to record the gross impact of the Government's cash operations on the economy. The extent of understatement can be indicated by Government receipt totals during calendar 1960: total receipts amounted to an estimated \$127 billion, but receipts reported in the cash budget totaled \$98 billion, and receipts in the administrative budget were \$80 billion.

The National Income and Product Accounts Budget

The Department of Commerce prepares data concerning the levels of gross national income and product—goods and services currently produced and purchased. The activities of the Federal Government which appear in these accounts are measures of those

receipts and expenditures which are considered part of current output and income. This emphasis results in Government receipts and expenditures figures conceptually different from those in the administrative and cash budgets.

One of the most significant differences is in timing. On the receipts side, personal income taxes are recorded on the basis of amounts withheld, and corporate income taxes are on an accrual basis. These treatments stem from the observation that most individuals keep their records—and measure their incomes and taxes—on a cash basis; most corporation books are on an accrual basis, earmarking a portion of profits for future taxes.

The emphasis on current income and output also is carried over into the timing of Government expenditures. For example, interest on the national debt is recorded on an accrual rather than cash basis. Commodity Credit Corporation purchases of inventory are recorded when nonrecourse loans are extended, since agricultural products in effect are acquired by the Government at the time the loan is extended rather than at the later point when the loan is formally liquidated in the Government's books by surrender of the commodities used as collateral.

Another significant difference in accounting treatment concerns the recording of credit transactions. Whereas the administrative and cash budgets record the purchases and sales by the Government of existing assets (mainly financial assets), the income and product accounts do not, on the grounds that no current production or consumption of such assets is involved. For example, FNMA purchases of mortgages are recorded as Government expenditures in the cash budget, but are eliminated from the income and product accounts budget.

Relationship of the Budgets

The relationship of these Government budgets to each other can best be appreciated through examination of a sample reconciliation statement—a table of the three budget totals and the adjustments by which they are related. Table II presents such a reconciliation for fiscal year 1961.

The principal adjustments in deriving the cash budget totals from the administrative budget are to delete intragovernmental transactions and to add trust fund totals to both receipts and expenditures. The net result of these adjustments for fiscal 1961 was to increase Government receipts from \$77.7 bil-

¹ Interest payments to the Treasury by these latter enterprises, which initially are reported as both receipts and expenditures, are deducted as interfund transactions.

Table II
Relation of the Income Accounts Budget to the Administrative Budget and the Cash Budget
(Fiscal 1961. In Billions of Dollars)

	Admin. Budget Totals	Adjustments from Administrative to Cash Budget	Cash Budget Totals	Adjustments from Cash to Income Accounts Budget	Income Accounts Budget Totals
RECEIPTS					
Administrative budget receipts.....	77.7	....	....	....	....
Less: Intragovernmental transactions.....		4.2	....	....	....
Receipts from exercise of monetary authority.....		.1	....	....	....
Plus: Trust fund receipts.....		23.8	....	....	....
Equals: Federal cash receipts from the public.....		....	97.2	....	....
Adjustments for agency coverage:					
Less: District of Columbia revenues.....		....	....	.3	....
Adjustments for netting and consolidation:					
Less: Interest and other earnings.....		....	....	1.1	....
Plus: Contributions to Federal employees' funds, etc.....		....	....	1.7	....
Adjustments for timing:					
Plus: Excess of corporate tax accruals over collections, personal taxes, etc. ....		....	....	—1.3	....
Adjustments for capital transactions:					
Less: Realization upon loans and investments, sale of Government property, etc. ....		....	....	1.5	....
Equals: Receipts—national-income accounts.....		....	....	....	94.8
EXPENDITURES					
Administrative budget expenditures.....	81.5	....	....	....	....
Less: Intragovernmental transactions.....		4.2	....	....	....
Accrued interest and other noncash expenditures.....		.8	....	....	....
Plus: Trust fund expenditures.....		23.2	....	....	....
Government-sponsored enterprise expenditures (net).....		— .2	....	....	....
Equals: Federal cash payments to the public.....		....	99.5	....	....
Adjustments for agency coverage:					
Less: District of Columbia expenditures.....		....	....	.3	....
Adjustments for netting and consolidation:					
Less: Interest received and proceeds of Government sales.....		....	....	.6	....
Plus: Contributions to Federal employees' retirement funds, etc. ....		....	....	1.7	....
Adjustments for timing:					
Plus: Excess interest accruals over payments.....		....	....	.2	....
Excess of deliveries over expenditures and other items.....		....	....	.5	....
Less: Commodity Credit Corporation foreign currency exchange.....		....	....	1.0	....
Adjustments for capital transactions:					
Less: Loans—FNMA secondary market mortgage purchases, redemption of IMF notes, etc. ....		....	....	1.3	....
Trust and deposit fund, land, and other items.....		....	....	1.8	....
Equals: Expenditures—national-income accounts .....	....	....	....	....	97.0
Surplus (+) or Deficit (—).....	— 3.8	....	—2.3	....	— 2.2

Source: *The Budget of the United States Government for the Fiscal Year Ending June 30, 1963.*

Note: Detail may not add to totals due to rounding.

lion to \$97.2 billion and expenditures from \$81.5 billion to \$99.5 billion. As a consequence, the deficit of the U. S. Government, which totaled \$3.8 billion in the administrative budget, was somewhat smaller (\$2.3 billion) in the cash budget.

The adjustments required to derive the national income and product accounts budget totals from the cash budget are more complicated. Two of these—timing and capital transactions—were discussed above. In addition, adjustments are made for coverage (the District of Columbia is included as a state in the

national income accounts) and for netting and consolidation of intragovernmental transactions. The net effect of these adjustments was to make both receipts and expenditures for fiscal 1961 smaller than in the cash budget. Government receipts in the national income and product accounts were \$94.8 billion in contrast to \$97.2 billion in the cash budget. Expenditures totaled \$97.0 billion, as opposed to \$99.5 billion in the cash budget. As a result of these differences, the Government's deficit as recorded in the income and product accounts totaled \$2.2 billion, \$100 million less than in the cash budget.

The Budgets and Fiscal Policy

Most discussions of the proper accounting framework in which to analyze the economic impact of Government fiscal activities focus on the merits of the cash budget and the income and product accounts budget. Surpluses or deficits in the cash budget must be financed by changes in net Government debt or in cash balances. Changes in the magnitude, terms, and ownership of the Government debt have a significant influence on the level and structure of interest rates and the liquidity of the public. The income and product accounts budget indicates the Government's direct impact on current income. Because fiscal actions have interest rate, liquidity, and income effects which are significant for economic stabilization, both sets of budget accounts are used in fiscal analyses.

The need for considering both budgets becomes evident when the data by quarters are analyzed. Substantial timing differences in the recording of receipts and expenditures under the cash and accrual approaches can lead to different pictures of the Government's current fiscal position. These timing differences can be illustrated by examination of the Government's fiscal position during the most recent business cycles. The accompanying table and chart describe the Federal deficits and surpluses by quarters in both cash and income accounts budgets.

As economic downturn began in the third quarter of 1957, the Federal Government's fiscal position was relatively restraining: the cash surplus was at an annual rate of \$1.6 billion, and the Government's surplus in the national income and product accounts was at a \$2.6 billion annual rate. In the subsequent three quarters, fiscal developments according to both budgets shifted from surplus to deficit. During the trough quarter (second quarter 1958) the Government's income account deficit was at an \$11.1 billion annual rate. At the same time, the cash deficit ran at a \$4.4 billion rate. The principal reason for the larger and more rapid shift (\$13.7 billion) in the income accounts budget was the immediate reflection of declining corporate profits in Government tax receipts. The cash budget, which does not record such receipts on an accrual basis, shifted less (\$6.0 billion) during this period.

As the 1958-59 recovery got under way, the national income and product accounts budget moved almost immediately toward a balanced position, while the cash deficit continued to increase (partly because of increased FNMA purchases of mortgages designed to

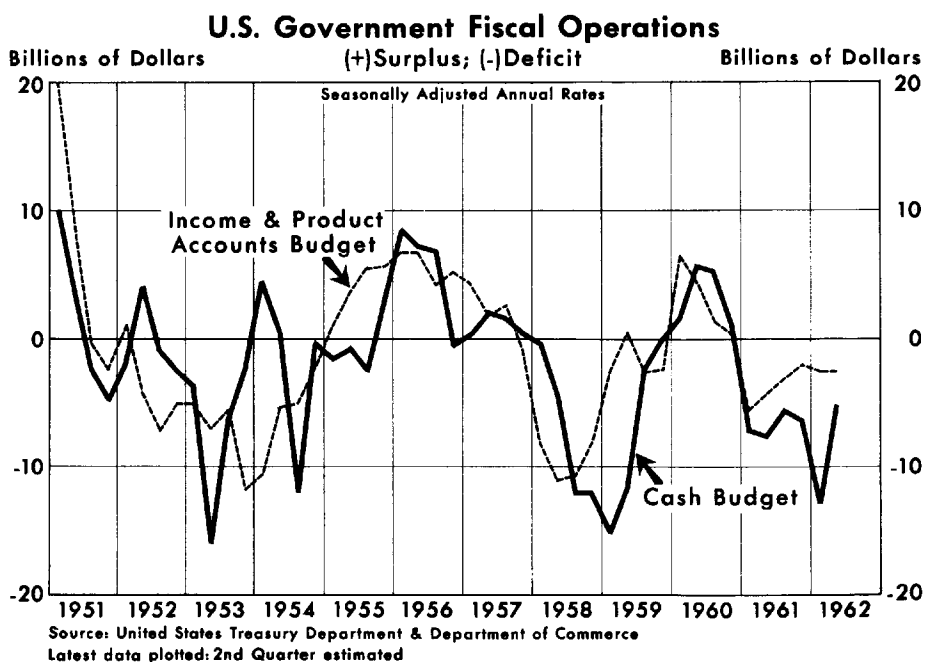
Table III
Federal Government Budget Surpluses (+) and Deficits (—)
(Seasonally adjusted annual rates. In billions of dollars)

Quarter of calendar year	Cash budget		Income and product accounts budget	
	Surplus or Deficit	Change in direction from previous period*	Surplus or Deficit	Change in direction from previous period*
1957 III	\$+ 1.6	\$—0.4	\$+ 2.6	\$+0.8
IV	+ 0.4	—1.2	— 0.9	—3.5
1958 I	— 0.4	—0.8	— 8.1	—7.2
II	— 4.4	—4.0	—11.1	—3.0
III	—12.0	—7.6	—10.7	+0.4
IV	—12.0	0.0	— 8.1	+2.6
1959 I	—15.2	—3.2	— 2.7	+5.4
II	—11.6	+3.6	+ 0.5	+3.2
III	— 2.4	+9.2	— 2.5	—3.0
IV	0.0	+2.4	— 2.4	+0.1
1960 I	+ 1.6	+1.6	+ 6.5	+8.9
II	+ 5.6	+4.0	+ 4.5	—2.0
III	+ 5.2	—0.4	+ 1.4	—3.1
IV	+ 1.2	—4.0	+ 0.4	—1.0
1961 I	— 7.2	—8.4	— 5.5	—5.9
II	— 7.6	—0.4	— 4.3	+1.2
III	— 5.6	+2.0	— 2.8	+1.5
IV	— 6.4	—0.8	— 2.0	+0.8
1962 I	—12.8p	—6.4p	— 2.5e	—0.5e
II	— 5.2e	+7.6e	— 2.5e	0.0e

* + toward surplus; — toward deficit

p—preliminary

e—estimated



speed recovery) until the first quarter of 1959, reaching a rate of \$15.2 billion. Both budgets recorded surpluses at the outset of the most recent recession, the second quarter of 1960, but the cash budget position had shifted more rapidly from deficit to surplus. Some analysts consider the sizable shift toward restraint in the Government's fiscal position from early 1959 to mid-1960 an important factor in the shortness of the economic upturn.

The fiscal pattern of the current business cycle has been similar to the 1957-1960 experience. From surplus positions (\$5.6 billion annual rate in the cash budget and \$4.5 billion annual rate in the income accounts) in the peak second quarter of 1960, both budgets shifted quickly to deficit levels. The cash budget shifted more rapidly, to a \$7.2 billion rate of deficit in the trough quarter (first quarter of 1961). In comparison to the cash budget shift of \$12.8 billion, the income accounts balance declined \$10.0 billion to a deficit of \$5.5 billion per annum.

During the remainder of 1961 the income and product accounts deficit became smaller, primarily reflecting the rapid accrual of corporate taxes which accompanied the recovery of profits. The President's budget message predicted a surplus through 1962. The cash budget deficit continued through 1961, increasing to about \$13.0 billion annual rate in the first quarter of 1962.

Conclusion

Three budgets are widely used to summarize the Federal Government's fiscal activities. Of these summary statements, the administrative budget is primarily a tool for control, while the cash and income accounts budgets are more meaningful as economic documents. Both of the latter two budgets are considered in evaluations of current fiscal posture. The income accounts measure the direct impact of the Government on current income; the cash budget surplus or deficit is matched by changes in the net Government debt or cash balances, which, in turn, have an impact on interest rates and the liquidity of the public.

It is evident that the Government's cash budget and Federal Government sector in the national income and product accounts convey, at any time, different impressions of the Government's fiscal position. By inclusion of a wider range of receipts and expenditures the cash deficits and surpluses tend to be larger than those of the income accounts. In the most recent business cycles, cash deficits have increased beyond the recession troughs and have declined rapidly only when recovery has been under way for several months; this has reflected largely the lag of corporate tax receipts behind changes in profits. The income and product accounts usually have shown smaller Federal deficits and surpluses because these accounts encompass a narrower range of Government activity and are more responsive to changing economic conditions.

Yields on Corporate Stocks

YIELDS ON CORPORATE STOCKS rose from last November to June this year but are still low relative to most past periods. The recent rise in yields resulted primarily from a decline in prices of common stocks. This article attempts to place current stock yields in historical perspective and to set forth some facts bearing upon their level.

Historical Comparisons with Interest Rates

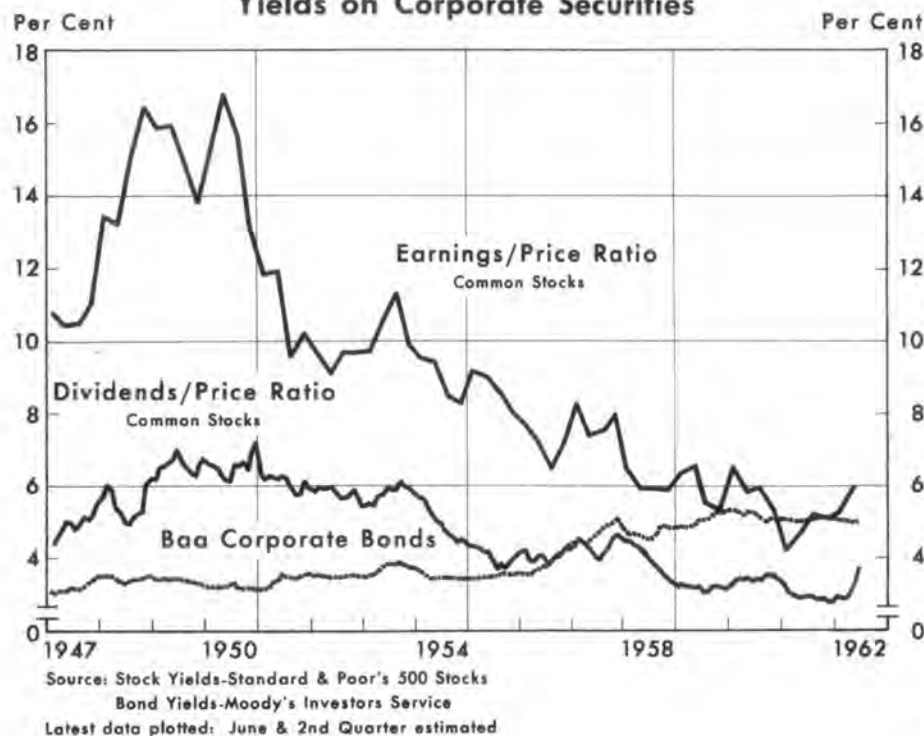
Corporations may raise money either by issuing stocks (ownership) or by issuing bonds (debt), and stocks and bonds compete for funds of investors. In June 1962 the dividend-price yield on common stocks averaged an estimated 3.75 per cent and the

earnings-price yield averaged over 6.00 per cent. By comparison, interest rates on medium-grade (Baa) corporate bonds averaged 5.01 per cent in the month.

Last November the dividend-price yield was at a low of 2.83 per cent and the earnings-price ratio was about 5.05 per cent. Interest rates on Baa bonds averaged 5.11 per cent in the month. The rise in stock yields since November 1961 reflects primarily a 22 per cent decline in average stock prices.

During the past twelve years yields on stocks have trended downward and bond rates have risen (see chart). In 1950 the dividend-price ratio averaged 6.57 per cent, the earnings-price ratio averaged 15.08 per cent, while Baa bonds averaged 3.24 per cent. In 1957 the yield calculated from dividends averaged

Yields on Corporate Securities



cations are that even the ratio of cash flows to stock prices has declined in the past decade, although the decrease is not as great as with earnings or dividends.

The value of securities may be based in considerable measure on anticipated profits. Shareholders expect to participate in greater corporate profits as the economy and businesses expand. However, corporate earnings and dividends have not shown a vigorous upward trend in the last decade (see chart). In the late forties corporate profits after taxes averaged over \$18 billion, in 1954-56 they averaged \$21.1 billion, and during 1961 they were \$23.3 billion. Corporate earnings have not kept pace with the growth in total production of goods and services. Profits of corporations after taxes decreased from 7.8 per

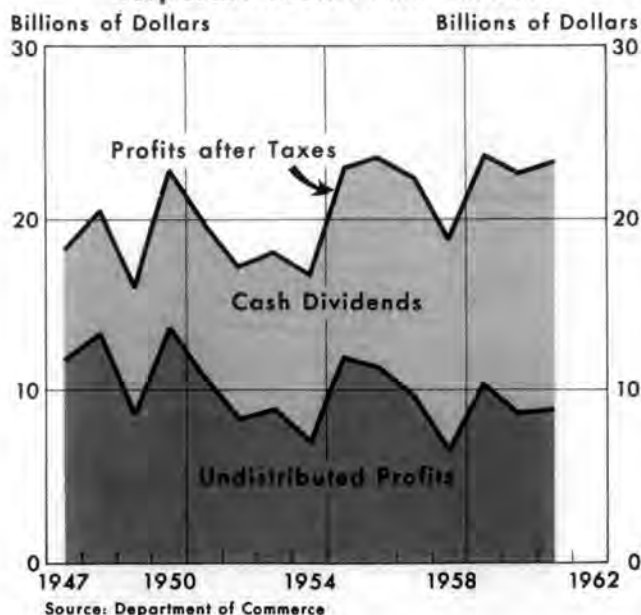
4.35 per cent on stocks, based on net earnings it averaged 7.76 per cent, and interest rates on Baa bonds were 4.71 per cent.

Stock yields also declined during the twenties as stock prices rose at a more rapid rate than corporate earnings. However, it should be noted that market data for that time are not exactly comparable to data today. In the first six months of 1929 the earnings-price yield averaged about 5.50 per cent, while the dividend-price yield averaged 3.36 per cent. The earnings-price ratio probably fell slightly below 5 per cent in September of that year, the month that stock prices reached their peak, and the dividend-price yield dropped to 2.92 per cent. During the first half of 1929 interest rates on medium-grade corporate bonds averaged 5.77 per cent.

Factors Contributing to Relatively Low Yields

Several factors have been cited by investors in explaining their willingness to invest in stocks at yields that are low both historically and compared with yields available on other instruments. One consideration is that many corporations have taken actions which adversely affect reported earnings, such as accelerating depreciation charges. Aggregate data are not available on total corporate cash flows after covering only operating expenses. Nonetheless, indi-

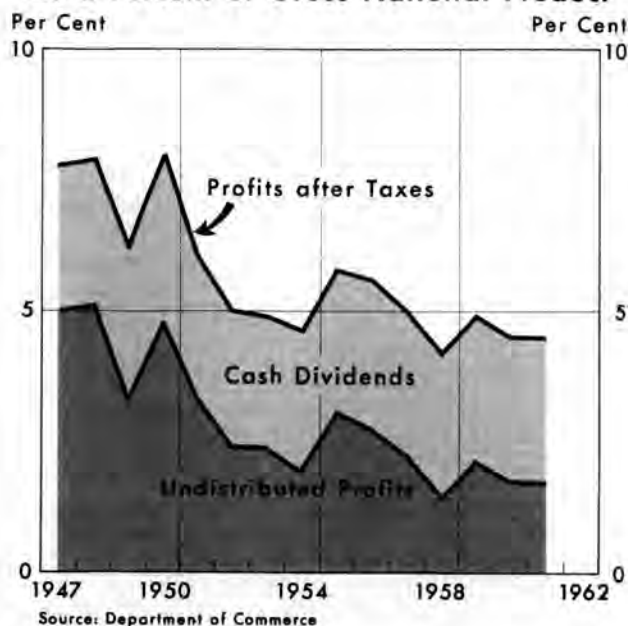
Corporate Profits After Taxes



cent of gross national product in 1947 to 4.5 per cent in 1961 (see chart).

Some investors believe that stocks, despite their low yields, are good buys because they provide a hedge against price inflation. Shareholders are the residual owners of the corporation, and if general commodity prices rise the monetary value of the corporations' assets and earnings would be expected to

Corporate Profits After Taxes as a Percent of Gross National Product



increase, protecting or even increasing the purchasing power of the investor. The future trend of commodity prices is not clear, however. Since World War II average prices have risen, but the rate of increase in recent years has been considerably lower than the rate in the early postwar years. There is a view that since 1952 average prices have not risen or at least have risen less than appear from the indexes if an adequate allowance is made for quality improvements and other changes.¹ During several earlier periods of history consumer prices increased at a faster rate and for a longer period than they have since 1947, and the peacetime increases have on the whole been offset by declines.²

Some investors are willing to accept low yields on stocks because they anticipate good returns through capital gains. Low yields imply high prices, but the

investor may expect still higher prices in the near future, regardless of possibilities for future earnings, dividends and the general price level. Since stock prices rose phenomenally during the 1950's, many have assumed the trend will continue. However, the situation today is not necessarily the same now as it was then. In the early postwar years there was a weak demand for stocks as an investment medium, which may have been a reaction to the losses suffered after the 1929 crash. Hence, most investors in stocks during the late 1940's received liberal dividends on their investments and corporate capital structures were bolstered by sizable retained earnings.

During the postwar period there has been a great expansion in the volume of investment funds seeking profitable outlets. Personal incomes and savings were rising, and there was a substantial growth of such institutions as pension funds and trust funds which desired to place a portion of their portfolios in equities. The returns available on stocks attracted a sizable volume of the new funds into the market. The demand for stocks became vigorous, exceeding the supply at existing prices, and prices rose (yields fell). The higher stock prices brought either paper or realized profits, and, in turn, attracted additional investment funds. Repetition of the pattern of profits attracting funds causing more profits, plus tax laws that discourage the withdrawal of capital gains, may have been a factor in the strong bull market for stocks.

Conclusions

Stock yields have risen since last fall in response to a decline in stock prices. Although yields are still relatively low, the rise has produced a relation of stock yields to interest rates more in line with past experience. This adjustment does not necessarily indicate a lack of confidence in the future of the economy. Indeed, a more normal relationship between interest rates and stock yields might mean an increase in confidence in reasonable price stability. Further, it might suggest confidence in a viable competitive economy in which those subject to risk, the residual owners of business, receive a higher return than the holders of the less risky debts of business.



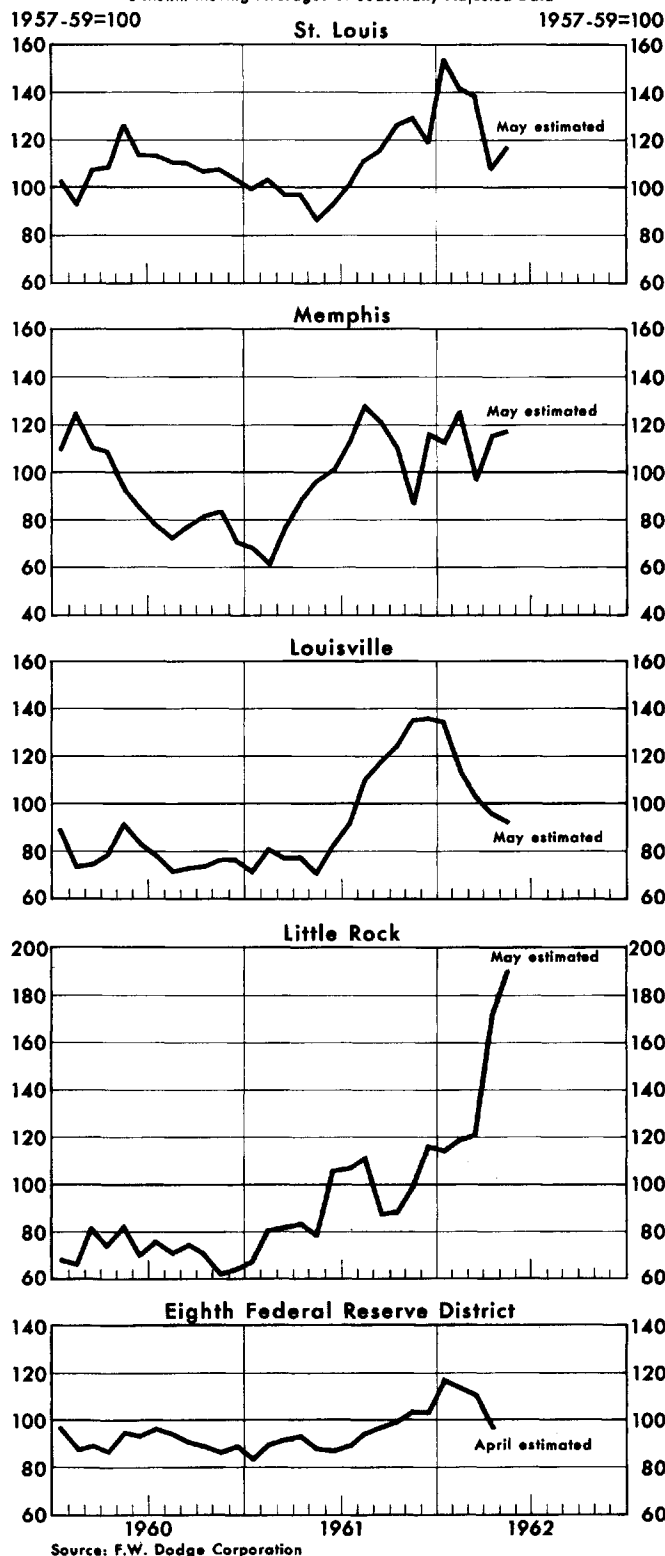
¹ See "The Price Statistics of the Federal Government," *Joint Economic Hearings on Government Price Statistics*, Part I, January 24, 1961, pp. 21-99.

² See article "Price Movements in Perspective" in the July 1961 issue of this *Review*.

Residential Construction

Residential Construction Contract Awards

3-Month Moving Averages of Seasonally Adjusted Data



Contract Awards in Four Major Cities and the Eighth District

CHANGES in the dollar volume of residential construction contract awards are important indicators of changes in the basic trend in residential construction activity. Contract awards to some extent reflect current economic conditions and are one of several indicators of the course of general business activity. The awards data are based on statistics of building permits and interviews with contractors, owners, real estate brokers and others.

Residential construction includes all types of dwellings, primarily houses (both for owner occupancy and for sale or rent), apartments, hotels, and dormitories. Additions and alterations of existing dwellings are also included, but contracts let for maintenance and repair are not.

The dollar value of contract awards should not be interpreted as an indication of the actual volume of construction work done in the reference month. The award of a contract precedes construction expenditures by a varying period; moreover, some of the construction may even fail to materialize. For example, the increase in contracts awarded in Little Rock during the latest month may not result in increased construction outlays for several months.

Residential construction is subject to wide month-to-month fluctuations, both from seasonal factors and from erratic influences such as the awarding of a few large contracts in a particular month. The data in the accompanying charts have been adjusted for seasonal variation. A three-month moving average has been applied in order to reduce the effects of irregular influences.