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FEDERAL RESERVE BANK OF ST. LOUIS Review

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FEDERAL RESERVE BANK
OF ST. LOUIS
P. O. Box 442 • St. Louis 66, Mo.

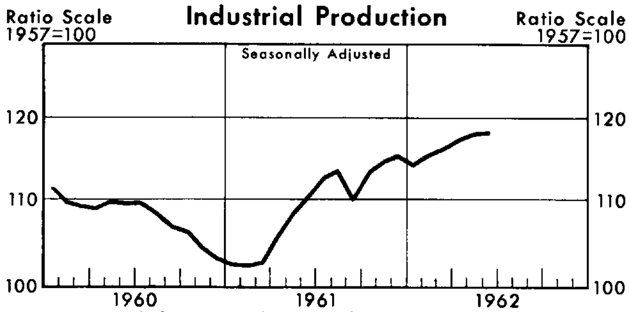
Recent Monetary Developments

Business Background

THE NATION'S TOTAL OUTPUT of goods and services was at a $552 billion annual rate in the second quarter of 1962, an increase of $7 billion, or 5 per cent per annum, over the first quarter. The rate of increase from the first to second quarter was the same as that from the fourth quarter of last year to the first quarter of 1962. Since the most recent trough in business activity, first quarter 1961, gross national product has increased at an annual rate of about 8 per cent, about the same as during the 1958-59 expansion but somewhat less than the comparable 1954-55 experience.

Despite the rise in total output during the second quarter, recent data suggest that the current economic expansion may be losing some of its strength. Business activity has paused since May, after having recovered at a lively pace from recession levels during most of 1961 and having expanded moderately during the first five months of 1962. Throughout the expansion there has been a substantial volume of unemployment and unused factory capacity.

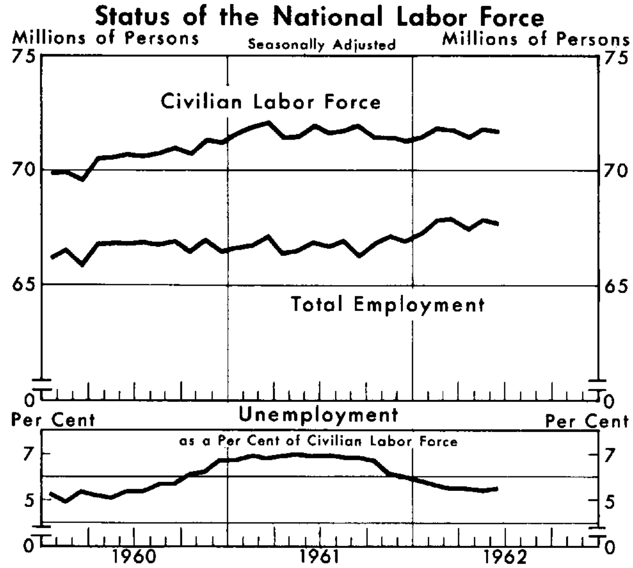
Industrial production rose at an annual rate of 15 per cent from the February 1961 trough to December. In the first five months of this year production increased at an annual rate of 6 per cent. By contrast, from May to June output of the nation's factories, mines, and utilities was approximately unchanged at 118 per cent of the 1957 average, and



Source: Board of Governors of the Federal Reserve System
Latest data plotted: June preliminary

early indications are that production changed only slightly from June to July. Relatively low production of steel was a major factor in the recent leveling of industrial activity. The volume of new construction, however, continued to rise moderately from May to July with major strength in residential building.

Moderation of the upward thrust to the economy is disturbing in view of the extensive underutilization of resources, both human and material. Unemployment continued to be a significant symptom of weakness in July. The proportion of the civilian labor force unemployed was estimated to be 5.3 per cent, little



Source: United States Bureau of Labor Statistics
Latest data plotted: June preliminary

changed from the level which prevailed since February. The July rate compares with 4.0 per cent at the similar stage (seventeenth month) following the 1954 recession low. At the corresponding point in the 1958-59 recovery there was a major steel strike, but just before the strike the unemployment rate was 5.1 per cent. Also, there was little net change in the labor force from the beginning of 1961 to July of this year, an unusual development for this phase of the cycle. Lack of employment opportunities may have discouraged persons from seeking work.

Unused facilities for the production of basic materials have been large and increasing in recent months. Earlier this year output of major materials exceeded 80 per cent of capacity, but in May output was 77 per cent and in June about 76 per cent. During 1955 production of these materials averaged 90 per cent and during 1959 (excluding the period of the steel strike) about 85 per cent of capacity.

There has been virtually no change in average prices in recent months. The consumer price index was at 105.3 per cent of the 1957-59 average in June, and has moved within a narrow range about the 105 level since last February. The wholesale price index was 100.1 in June, down slightly from 100.2 in May. The decrease from May to June was the fourth successive monthly decline in average wholesale prices. Prices of key industrial commodities in "spot" markets in the first two weeks of July were slightly lower than June averages.

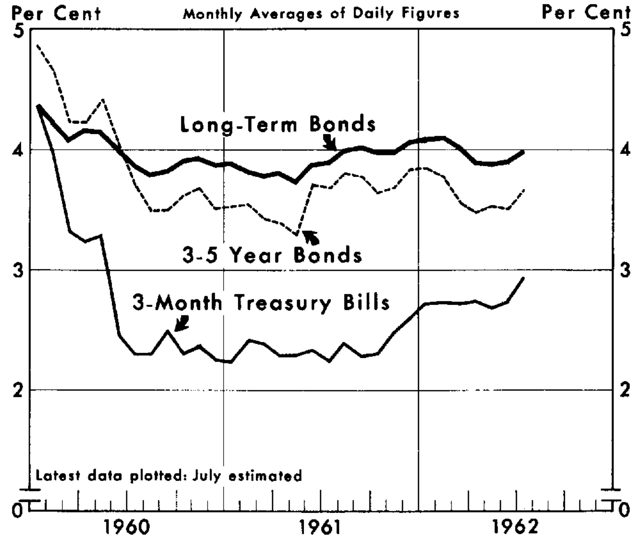
The pause in the economic expansion during the past two months reflects a moderation in demands for goods by both businesses and consumers. The growth in manufacturers' inventories has slowed noticeably in recent months from the pace in the first quarter. Presumably, this slowdown has been largely a reaction from the earlier buildup of steel inventories.

Retail sales declined 2.6 per cent from April to June but, according to preliminary data, probably increased slightly in July. Sales of automobiles in July were close to the June average after adjustment for seasonal influences. Department store sales in July, seasonally adjusted, were somewhat above the June level.

Interest Rates

The pattern of rising interest rates on most marketable securities suggests that credit conditions have become noticeably more restrictive since the middle of June. Yields on three-month Treasury bills began to rise around mid-June and since early July have averaged about 2.90 per cent, the highest level in over two years. The recent rise in three-month bill yields was the second pronounced increase since mid-1960. During late 1961 such yields rose rapidly from a 2.25-2.40 per cent range to the 2.70 per cent level prevailing until June.

Yields on U.S. Government Securities



Source: Board of Governors of the Federal Reserve System

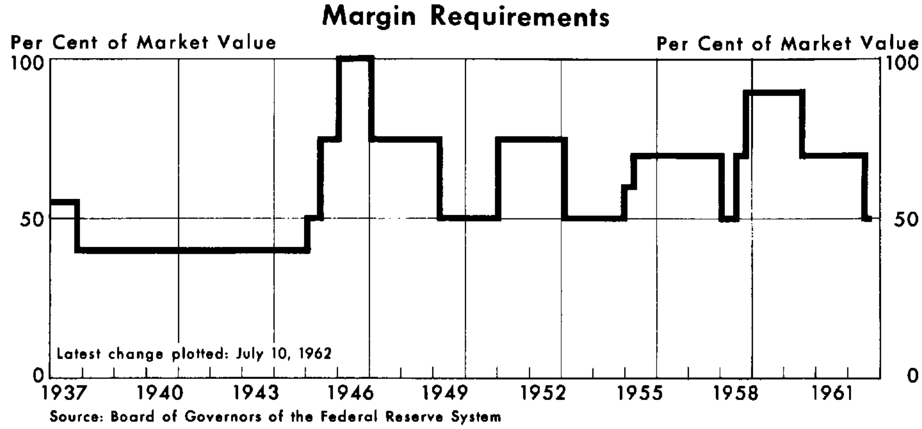
Rising interest rates usually accompany an expansion in economic activity and are frequently explained by a strengthened business demand for credit. During the first five months of this year business loans rose, but, according to reports from weekly reporting banks, there was a moderation of this demand in June and early July. The Treasury, however, borrowed a substantial volume of short-term funds in the past two months. These forces may have combined to produce a firmer money market. Evidence of such firmness may be found in the behavior of interest rates on Federal funds (interbank loans of temporarily excess funds). Federal funds rates fluctuated around 2.50 per cent during most of May and early June, but since mid-June have been within the 2.75-3.00 per cent range most of the time.

Rates on intermediate- and long-term Government securities, which in the earlier months of 1962 had been drifting downward, also turned up about the middle of June. Yields on 3- to 5-year Government bonds rose from 3.46 per cent in the middle of June to 3.66 per cent in the week ending August 3, while in the same period rates on long-term Government bonds rose from 3.87 to 4.03 per cent.

On July 9 the Board of Governors of the Federal Reserve System amended Regulations T and U, relating respectively to margin requirements for stock market credit extended by brokers and banks, by reducing margin requirements from 70 to 50 per cent, effective July 10, 1962. In general terms, the Board's margin regulations require credit buyers of stocks to put up a minimum equity when the purchase is made.

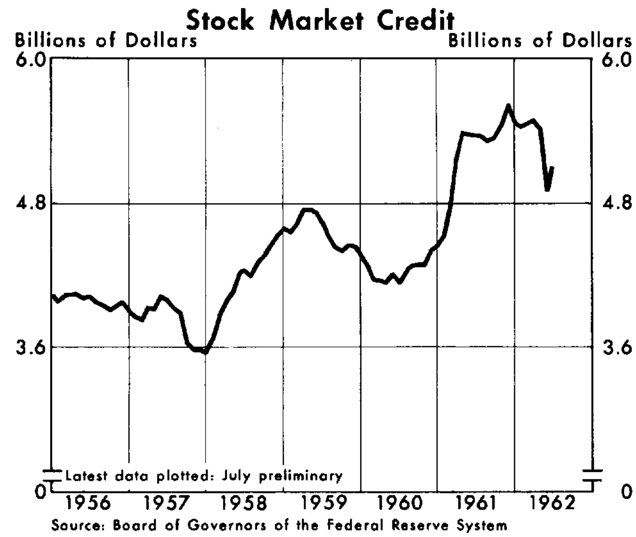
Under the new amendment, that equity must be at least 50 per cent rather than 70 per cent.

Margin requirements were established under the Securities Exchange Act of 1934 for the purpose of preventing excessive use of credit for purchasing or carrying securities. The Board's action at this time brings margin requirements back to the lowest level of the postwar period, the level in effect during 1949-1950, 1953-1954, and 1958 (See chart).

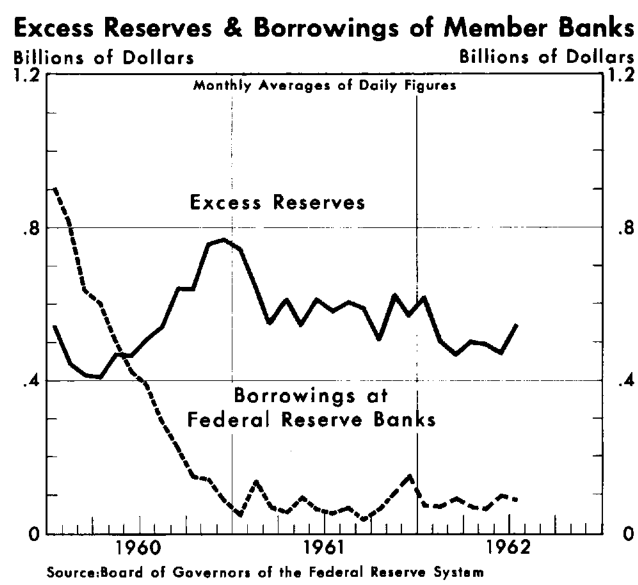


Member Bank Reserves

Member banks of the Federal Reserve System are required to maintain reserves equal to a certain fraction of their deposits. These reserves can be held either on deposit with Reserve Banks or as cash in vault. The volume of bank reserves influences the quantity of bank credit, bank deposits, and the money supply.[1]



Excess reserves are those reserves held by banks above the amounts required to support existing deposits. Such reserves averaged around $600 million during the first year of the current business expansion, from February 1961 to February of this year. From February to April excess reserves fluctuated around $500 million. They declined to the $400 million level for one week in the early part of June, and then moved back to about the $500 million range.



Individual member banks can adjust to reserve deficiencies in several ways, chiefly by selling money market debt instruments, by borrowing from other commercial banks, or by borrowing from Reserve Banks. As interest rates have risen and the money market firmed, banks have been making relatively less of their short-term adjustments by selling short-term securities and borrowing from other commercial banks and relatively more by borrowing from Reserve Banks. Consequently, borrowings from Reserve Banks rose in the middle of June and since then have averaged about $100 million, compared to an average of $75 million during the first fifteen months of the present business expansion.

As a consequence of these developments in excess reserves and member bank borrowings, "free" re-

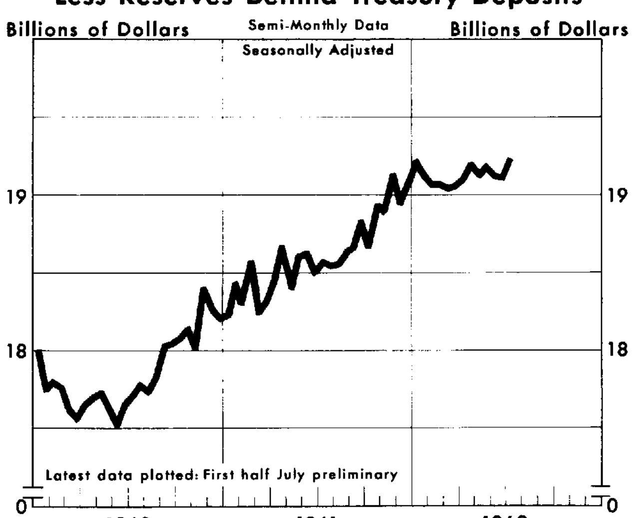
[1] Since the reserves are only a fraction of deposits (about one-seventh on the average), a change in reserves usually results in a multiple change in deposits. For a discussion of how a change in reserves affects bank credit and the quantity of bank deposits, see *The Federal Reserve System, Purposes and Functions*, Board of Governors of the Federal Reserve System.

serves, the difference between excess reserves and borrowings, declined to $339 million for three weeks in June from the $425 million average of February through May. The June decline was temporary, however, as free reserves quickly rose again to their previous level, averaging around $450 million in July. During the first year of recovery, free reserves fluctuated around the $500 million level.

Total member bank reserves, seasonally adjusted, have increased at an annual rate of about 4 per cent since the end of 1961. Most of the rise occurred in late April and May. The gain in reserves resulted from net open-market purchases of Government securities by the Federal Reserve System, amounting to about $925 million during the period from the last half of December 1961 to the first half of July. Money market factors (e.g. changes in float, gold, and currency in circulation) taken together tended to reduce bank reserves by slightly more than the seasonal amount.

Monetary reserves, that is, total member bank reserves less reserves held behind Treasury deposits, are a measure of member bank capacity to support privately owned deposits. Monetary reserves were about unchanged since April. Since the end of 1961 monetary reserves have risen at an annual rate of 1.6 per cent compared with a rate of 3.7 per cent per annum during the first ten months of recovery. A buildup of Treasury cash balances at commercial banks about offset the moderate increase of total

Total Reserves of Member Banks Less Reserves Behind Treasury Deposits*



*Reserves of member banks adjusted for changes in the percentages of reserves required, sometimes referred to as "effective" reserves.
Basic data source: Board of Governors of the Federal Reserve System

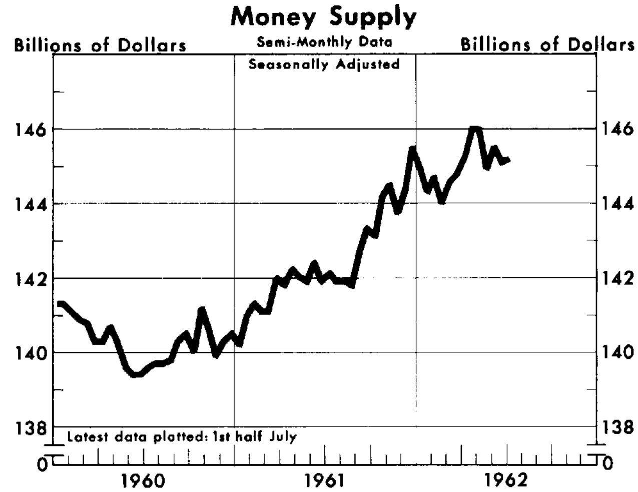
reserves in recent months. The only other times in the last decade when monetary reserves increased at such moderate rates or declined for sustained periods were from the spring of 1952 to the end of 1953, during 1957, and from mid-1959 to mid-1960.[2]

Monetary reserves less reserves behind time deposits indicate the capacity of the banking system to support privately held demand deposits. Changes in these reserves usually bear a closer relationship to the money supply of the country than total reserves. Because of the rapid growth of time deposits in 1962, such reserves declined sharply from late 1961 through early July. The contraction for sustained periods during the past decade of monetary reserves less reserves held behind time deposits has been roughly coincident with the contraction of monetary reserves.

Money Supply

The supply of money (demand deposits adjusted plus currency in the hands of the public) has declined since April. From April to the month ending mid-July money contracted at an annual rate of 2.0

Money Supply



Source: Board of Governors of the Federal Reserve System

per cent. For a short period in early spring of this year the money supply grew sharply, but on balance there has been little change in money thus far in 1962. Over the past decade the average annual rate of expansion of money was 2.1 per cent. The rise in spending in recent months, with little change in the stock of money, has been accommodated by a more

Continued on page 11

[2]See "Member Bank Reserves and the Money Supply' in the March issue of this *Review*.

Seasonal Patterns of Business Activity

ECONOMIC ACTIVITY does not proceed at a constant pace during the course of a year. Individual businesses and entire industries experience swings in activity according to the time of year—or according to the time of the month, week, or day.

The accompanying charts show the seasonal pattern of activity in six economic indicators for the major metropolitan areas in the Eighth Federal Reserve District. Looking broadly at the indicators, it may be seen that there are general declines in activity during the early part of the year. Business tends to pick up during the spring and early summer, to "lull" during the late summer months, and to rise again toward the end of the year.

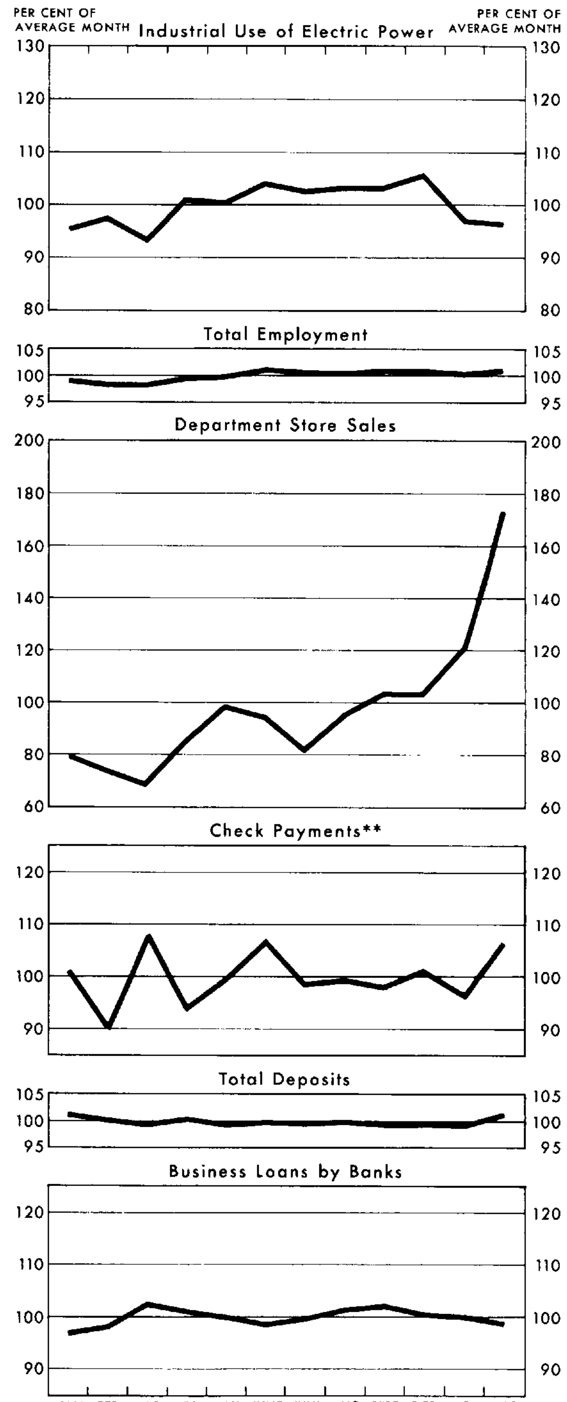
The most pronounced seasonal movement occurs in department store sales. Because of the Christmas season, sales are much higher in December than during any other month of the year. According to the charts, in each of the areas department store sales in December are substantially higher than during the "average" month. In contrast, sales in January, immediately after the Christmas season, are usually much below the average month.

There is only a small seasonal movement in employment during the course of a year. Employment tends to be low in January, February, and March, as cold weather prevents construction work and other outdoor activity. Although employment is depressed during these months, the number of workers is down only slightly from the average month. As weather improves, employment moves up steadily. During the early summer, as schools let out and as teenagers enter the work force, employment tends to rise. The number of workers declines slightly later in the summer. The pickup in November and December in the St. Louis, Memphis, and Louisville areas reflects the hiring of retail and postal employees for the Christmas season.

There are differences in seasonal patterns from one area to another. For example, in contrast to the general end-of-year pickup in employment the Little Rock labor market registers a seasonal decline in November and December. In this labor market several large manufacturing firms cut back their operations for inventory taking, product changes, and vacations. These decreases in employment are sufficiently large to offset increased employment in trade. The business loan patterns show substantial differences from area to area. The seasonal patterns for business loans in St. Louis and Little Rock are moderate, while the patterns in Louisville and Memphis are quite pronounced. In the Louisville area there is an end-of-year rise in business loans as banks extend credit for

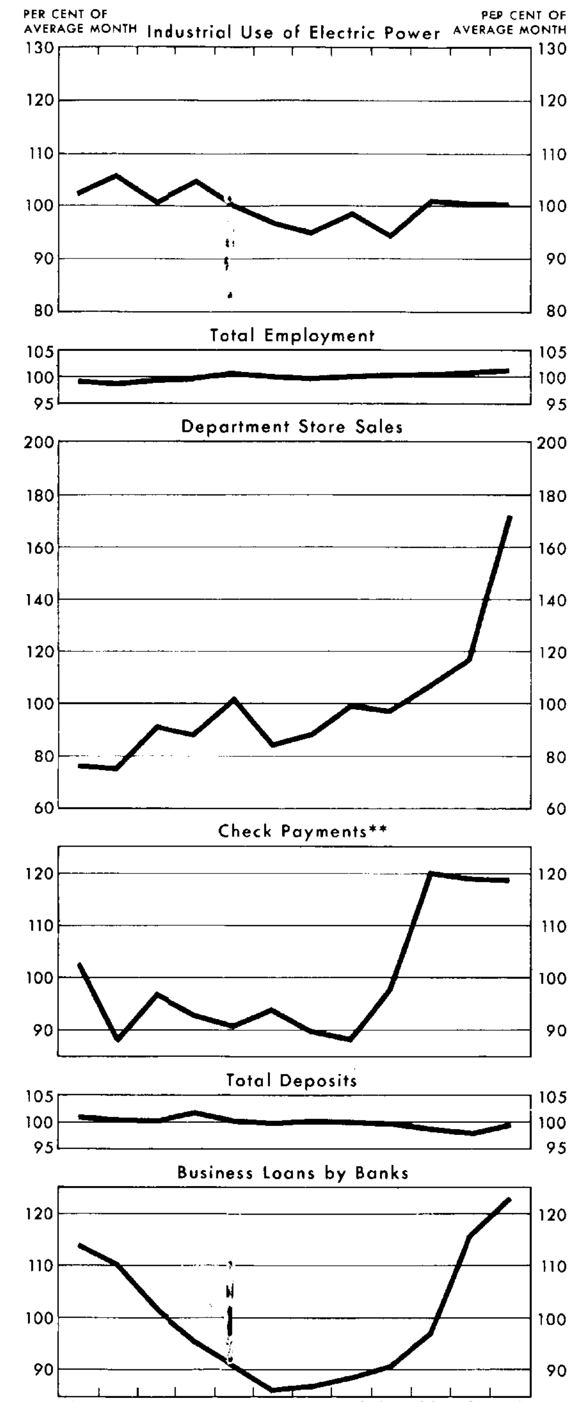
Continued on page 9

Chart 1
St. Louis Seasonal Patterns



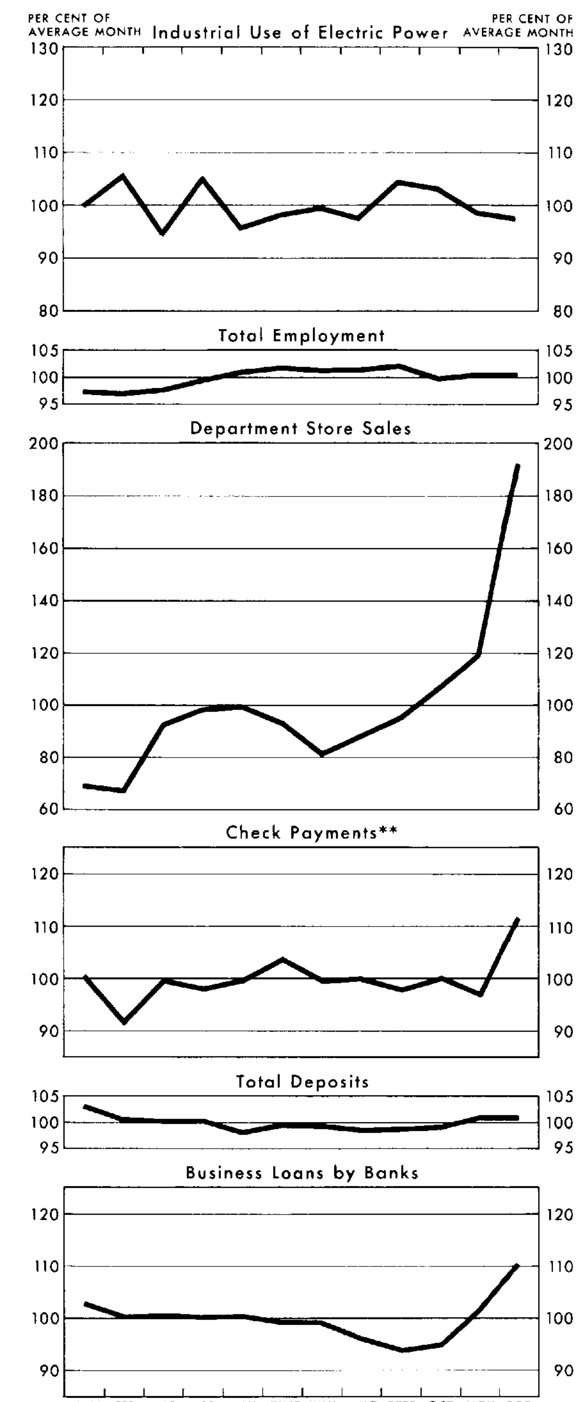
**Debits to demand deposit accounts, except interbank and U.S. Government accounts.

Chart 2
Memphis Seasonal Patterns



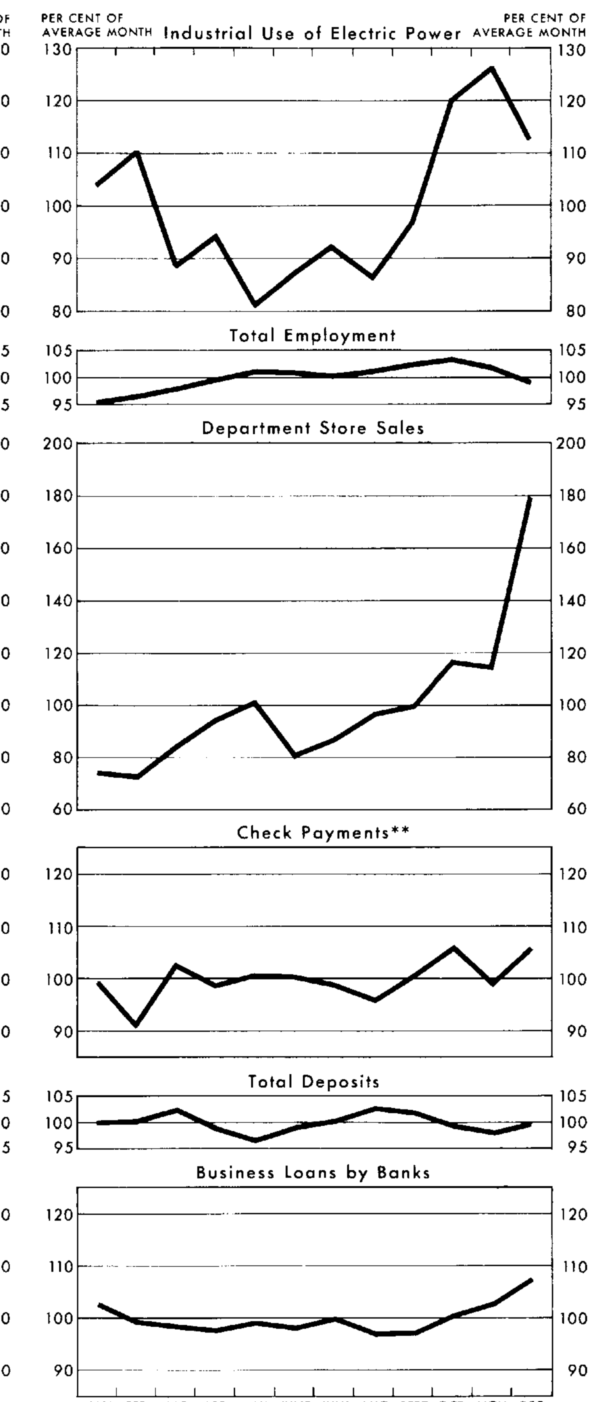
**Debits to demand deposit accounts, except interbank and U.S. Government accounts.

Chart 3
Louisville Seasonal Patterns



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

Chart 4
Little Rock Seasonal Patterns



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

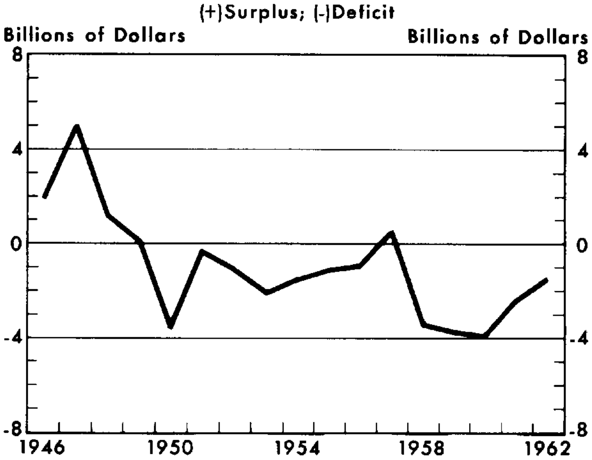
International Comparisons

FOR ABOUT A DECADE the United States has had greater payments than receipts in its dealings with other countries (Chart 1). How to deal with this matter is one of the current concerns of public policy. During 1960 the United States had a net adverse balance of payments of nearly $4 billion. In 1961 the net payments deficit amounted to $2.5 billion, and in the first half of 1962 it was probably running at an annual rate of under $1.5 billion.

Chart 1

Net Payments Position of the U.S.

(+)Surplus; (-)Deficit



Source: U.S. Department of Commerce
1962 based on first half year.

In the discussion that has grown out of the nation's balance-of-payments problem, questions have been raised concerning the rate at which prices have increased in this country compared with movements in price levels abroad. In this connection, there has been some concern about the degree of monetary expansion in this country compared with that of foreign nations.

The accompanying charts showing consumer prices and the money supply since 1953 for several leading industrial countries throw some light on these questions. The year 1953 was selected as a base year in order to avoid the distortions in the price levels of various countries caused by the Korean War.

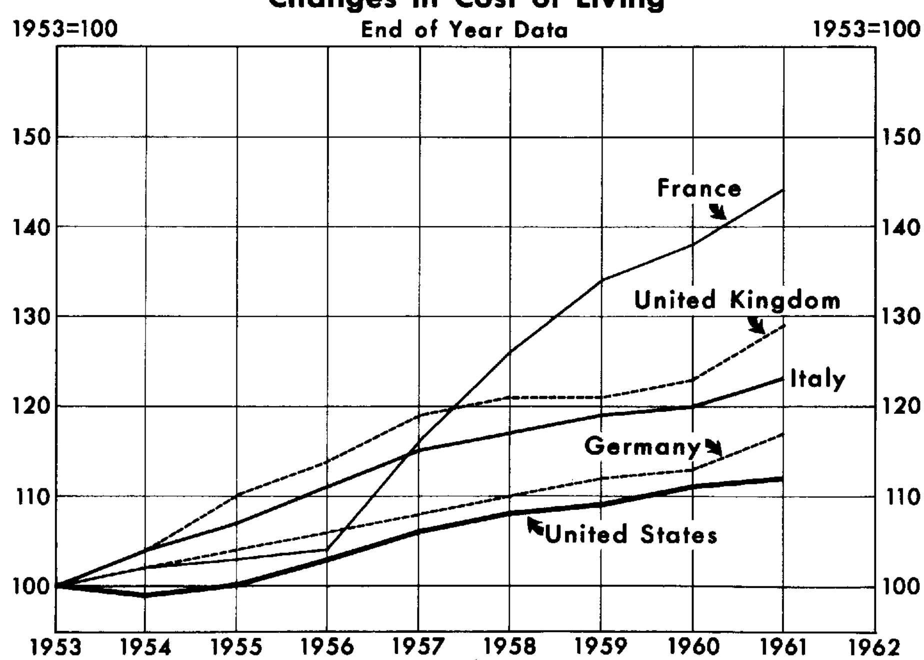
Prices as measured by consumer price indexes showed a great variety of performance from 1953 through 1961 as can be seen in Chart 2.[1] The rise in the United States was about 12 per cent, in Germany 17 per cent, in Italy 23 per cent, in the United Kingdom 29 per cent, and in France 44 per cent.

[1] Price indexes are not exactly comparable from country to country. Sampling and other statistical procedures differ. Because of the difficulty of adjusting fully for quality and other changes, the rise in the consumer price index in the United States since 1953 may be overstated. See: "Price Movements in Perspective" in the July 1961 issue of this *Review*. Price indexes in other countries may have similar problems and reflect different adjustment procedures.

Chart 2

Changes in Cost of Living

End of Year Data

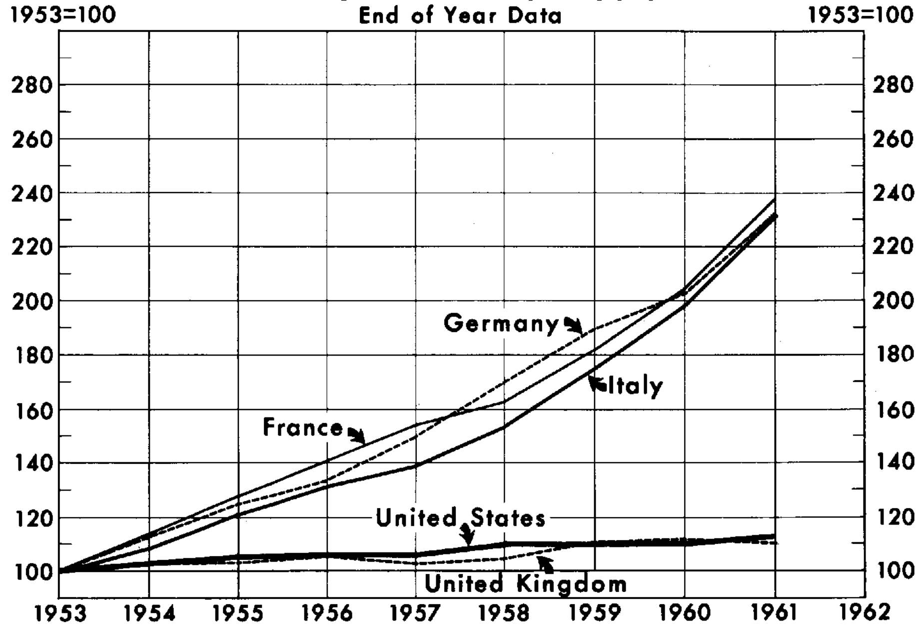


Source: International Monetary Fund, International Financial Statistics. June 1962

Changes in the money supply for these same five leading nations are shown in Chart 3. From 1953 to the end of 1961 the money supply of the United States increased about 12 per cent. The increase in the United Kingdom was at a similar rate. During the same period the money supply rose 130 per cent in Italy, 132 per cent in Germany, and 138 per cent in France. The much sharper rate of increase in money than consumer prices in Italy, Germany, and France reflects in part a very rapid growth in economic activity.

Chart 3

Changes in Money Supply*



*Currency and demand deposits.

Source: International Monetary Fund, International Financial Statistics. June 1962

Seasonal Patterns of Business Activity—*Continued from page 7*

the marketing and processing of the burley tobacco crop. Reflecting the financing of cotton marketing and processing, business loans in Memphis rise in the fall of the year and remain at an advanced level through about February as dealers continue to carry large inventories. The processing of cotton is also reflected in the pronounced seasonal movement for electric power consumption in Little Rock. Cotton oil mills, which use a relatively large volume of electricity at certain periods, reach the height of their operations in the fall of the year, continue at advanced levels through the winter, but cut their power use sharply during the spring and summer months.

Because of these seasonal swings, month-to-month changes in and of themselves are often not meaningful. It is important to know whether changes are more than or less than would have been expected on the basis of average experience.

Earlier issues of this *Review* have presented charts of these indicators for the large metropolitan areas in the Eighth Federal Reserve District. The data in these charts were adjusted for seasonal influences. This means that each month of actual data was revised according to the degree to which that month, on the basis of history, exceeded or was less than the average month. If, for example, business loans at St. Louis banks in September are usually 102 per cent of the average month (because banks expand loans to businesses for inventory accumulation) the September business loan figure is divided by 1.02. This division serves to reduce the original loan figure by the amount that was considered "seasonal." Thus, the seasonal influence has been "removed." The following table illustrates the process.

Business Loans Outstanding at St. Louis Banks
(in millions of dollars)
1961

	Unadjusted Data	÷	Seasonal Adjustment Factor	=	Seasonally Adjusted Data
Jan.	376.4		96.9		388.4
Feb.	383.7		98.2		390.7
Mar.	394.5		102.6		384.5
Apr.	390.1		101.2		385.5
May	389.2		100.1		388.8
June	387.2		98.5		393.1
July	401.2		99.9		401.6
Aug.	402.5		101.4		397.0
Sept.	396.0		102.0		388.2
Oct.	384.7		100.4		383.2
Nov.	377.1		100.1		376.7
Dec.	373.9		98.7		378.8
Totals	4,656.5		1,200.0		4,656.5

FEDERAL RESERVE SYSTEM ACTIONS FOR SEVEN MONTHS DURING 1962

Discount Rates

In effect January 1, 1962	3%
In effect July 31, 1962	3%

Reserve Requirements

	Percentage Required			
	Demand Deposits			Time Deposits
	Central Reserve City Banks	Reserve City Banks	Country Banks	All Member Banks
In effect January 1, 1962	16½	16½	12	5
In effect July 31, 1962	16½	16½	12	5

Margin Requirements on Stocks

In effect January 1, 1962	70%
July 10, 1962	50%
In effect July 31, 1962	50%

Open Market Operations

	Net Purchases (+) or Net Sales (—) Changes in Daily Average Figures (Millions of Dollars)	
	Unadjusted	Seasonally Adj.
January	$—579	$— 13
February	—135	+ 492
March	+186	+ 247
April	+573	+ 611
May	+360	+ 396
June	+ 65	— 237
July	+ 13	— 283
Total	+483	+1,213

intensive use of the money supply. Turnover of demand deposits (outside the seven largest financial centers) rose from an annual rate of about 27 times a year last December to 28 times since May.

Time deposits expanded at an annual rate of 23 per cent during the first four months of 1962 when the stimulus of a wider spread between rates paid on such deposits and yields on short-term securities greatly accelerated time deposit expansion. From April to the month ending July 15 the rate of increase of time deposits was 15 per cent, only slightly higher than the 1957-61 annual rate of 12 per cent. As a result, the money supply plus time deposits rose at a 4 per cent annual rate from April to mid-July, a markedly slower rate of expansion than the 8 per cent of the previous eight months. Over the past decade this measure of the public's liquidity rose at an average annual rate of 3.7 per cent.

Bank Credit

Total loans and investments of commercial banks, seasonally adjusted, increased at an annual rate of about 8.3 per cent from April to the month ending mid-July, about the same as during the previous nine months. The growth of commercial bank credit in 1962 has been relatively rapid compared to similar periods of the two previous business cycles, a fact largely explained by the sharp rate of increase since last December of commercial bank time deposits.

Investments of commercial banks have risen only moderately both in recent months and since the beginning of the year. The major part of the bank credit expansion has been in loans, with most categories sharing in the growth. Indications from weekly reporting banks are that there has been a moderating of the growth of business loans since May.

Balance of Payments

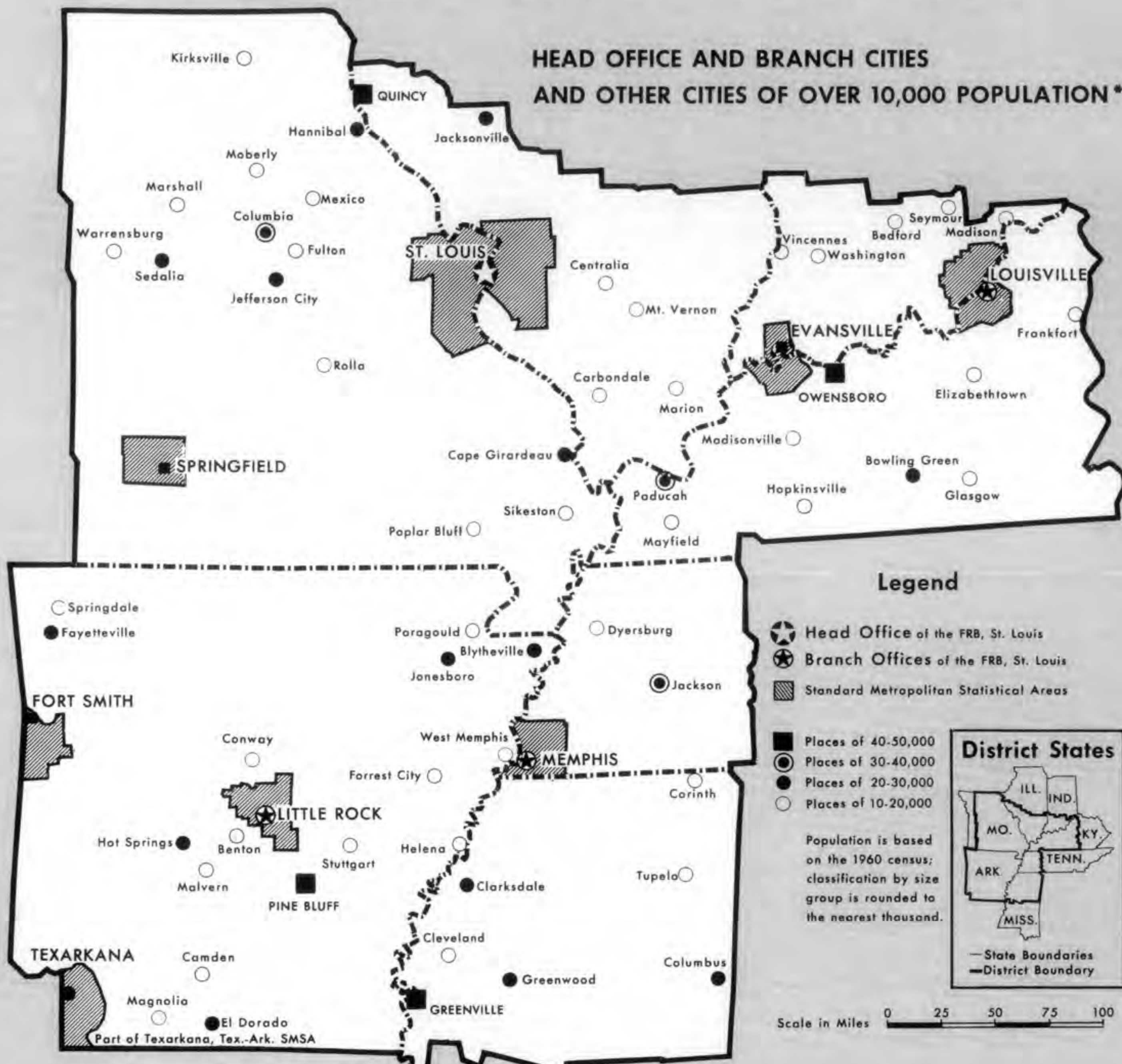
Preliminary data indicate that the United States balance-of-payments deficit in the second quarter, seasonally adjusted, may have been at an annual rate of less than $1 billion. Much of the improvement from the first quarter $1.9 billion rate was in the recorded category. With the prospect of special prepayments to the United States of foreign loans it is now estimated that the 1962 final deficit may be around $1.5 billion, compared with $2.5 billion in 1961 and $3.9 billion in 1960.

The continuing adverse balance of payments has resulted from a number of sources, including an outflow of both short- and long-term capital. Relatively low interest rates in this country compared with rates in most other leading industrial countries may have been one factor in the outflow. Another chief factor may be the greater availability of funds here than abroad because of both larger money and capital markets and the absence of restrictions on movements of funds. An additional source of the payments deficits of recent years has been Government spending abroad for defense and economic aid. Except for 1959, the United States has been operating at a substantial surplus on goods and services accounts.

Fiscal Developments

The Treasury in July announced a broad revision of Bulletin F, which establishes guidelines for the lengths of useful life allowable for tax purposes on classes of depreciable assets. The new set of guidelines, known as Revenue Procedure 62-21, would permit more rapid depreciation on an estimated 70 to 80 per cent of the machinery and equipment used by businesses and farmers. The announced purpose of the revision was to bring allowable tax write-offs for machinery and equipment more into line with actual business practice, and thereby stimulate needed investment, making American productive equipment more competitive with that of other industrial nations. The Treasury estimated that use of the new guidelines will reduce tax revenues by $1.5 billion during fiscal year 1963. This tax revenue reduction will also make the Government's fiscal position more stimulative than originally planned in the budgets for fiscal 1963.

EIGHTH FEDERAL RESERVE DISTRICT CITIES



Population of Standard Metropolitan Statistical Areas and Cities of over 10,000 Population Located in These Areas in the Eighth Federal Reserve District

SMSA of St. Louis, Mo.-Ill.	2,060,614
ILLINOIS:	
Alton	43,047
Belleville	37,264
Cahokia	15,829
Centreville	12,769
Collinsville	14,217
East St. Louis	81,712
Edwardsville	9,996
Granite City	40,073
Wood River	11,694
MISSOURI:	
Bellefontaine Neighbors	13,650
Berkeley	18,676
Brentwood	12,250
Clayton	15,245
Crestwood	11,106
Ferguson	22,149
Florissant	38,166
Jennings	19,965
Kirkwood	29,421
Maplewood	12,552
Overland	22,763
Richmond Heights	15,622
St. Ann	12,155
St. Charles	21,189
St. Louis	750,026
University City	51,249
Webster Groves	28,990
SMSA of Louisville, Kentucky	725,139
INDIANA:	
Jeffersonville	19,522
New Albany	37,812
KENTUCKY:	
Louisville	390,639
Pleasure Ridge Park	10,612
Shively	15,155
Valley Station	10,553
SMSA of Memphis, Tennessee	627,019
Memphis	497,524
Whitehaven	13,894
SMSA of Little Rock-North Little Rock, Arkansas	242,980
Little Rock	107,813
Jacksonville	14,488
North Little Rock	58,032
SMSA of Evansville, Indiana	199,313
INDIANA:	
Evansville	141,543
KENTUCKY:	
Henderson	16,892
SMSA of Springfield, Missouri	126,276
Springfield	95,865
SMSA of Texarkana, Tex.-Ark.	91,657
Only the Arkansas portion of the Texarkana SMSA is in the Eighth District.	
ARKANSAS:	
Texarkana	19,788
SMSA of Fort Smith, Arkansas	66,685
Fort Smith	52,991