Banking and Monetary Developments in the First Quarter of 1966

The banking system came under increased pressure during the first quarter. Demand for bank loans continued very strong, while the reserves needed to support further deposit and credit expansion by the banks were not so readily available as in earlier months. Thus bank reserve positions tightened somewhat.

Banks responded to these pressures in several ways. In some cases customers did not get the loans they requested or received smaller amounts than they had sought, as a number of banks adopted somewhat more selective lending policies. Then, in early March, major banks around the country raised the interest rate charged prime business borrowers from 5 per cent to 5½ per cent, a move which discouraged some potential loan applicants. Despite these moves, the volume of loans actually extended rose substantially during the quarter, and banks found it necessary to liquidate sizable blocks of Government securities in order to finance them. As loans were added and investments liquidated, bank loan-deposit ratios rose further. By the end of March, the aggregate ratio for the banking system as a whole stood above 64 per cent, 1 percentage point above the level prevailing three months earlier.

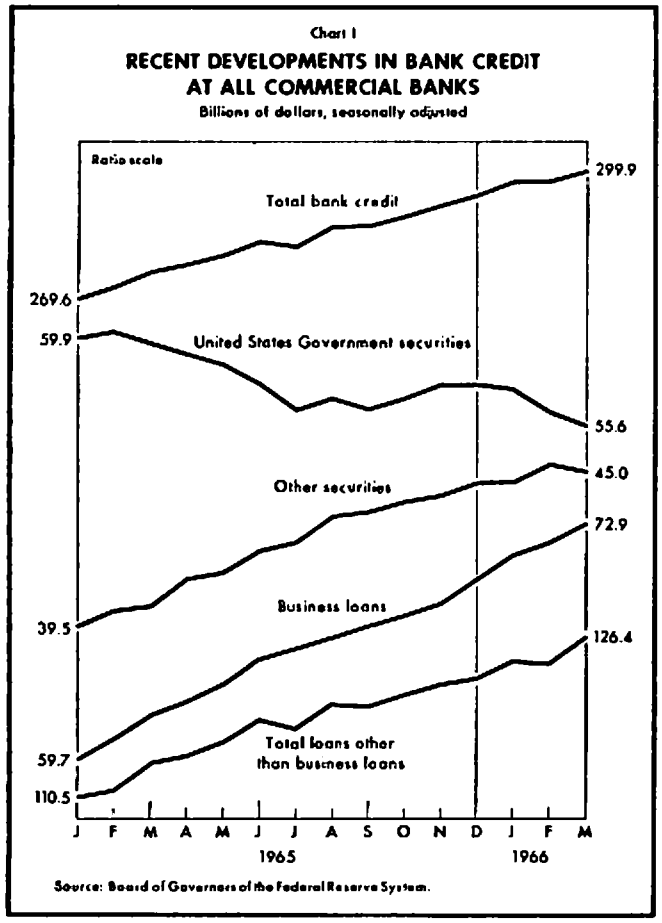
In seeking funds needed to permit the expansion of loan portfolios, many banks continued to bid aggressively in the market for time deposits. By the end of the quarter several banks were posting the maximum permissible rate of 5½ per cent on negotiable time certificates of deposit (C/D's) maturing in nine months or more, and rates paid on shorter term certificates were not far below the ceiling. While the actual flow of new funds into C/D's was rather small during the first two months of the year, it began to pick up during March. For the quarter as a whole, however, total time deposits at all commercial banks increased at a much slower rate than in preceding months. Private demand deposits, on the other hand, increased substantially over the period, contributing to a growth in the money supply that was only slightly less rapid than the fast pace set in 1965.

The first-quarter growth rate in total liquid assets held by the nonbank public was in line with that of the preceding quarter. Within this total, however, there appeared to be a substantially diminished flow of liquid savings, not only to commercial bank interest-bearing accounts, but to mutual savings banks and, to a somewhat lesser extent, to savings and loan associations as well. In contrast, the nonbank public's holdings of United States Government securities maturing within one year showed a sizable increase in the first quarter of this year.

BANK CREDIT

Total loans and investments at all commercial banks rose at an 8.0 per cent seasonally adjusted annual rate in the first quarter of this year, a bit below the 10.9 per cent pace in the preceding quarter. Indeed, the first-quarter growth rate in total bank credit was more in line with the 8.4 per cent annual average recorded in the 1961-64 period than with the somewhat more rapid 10.0 per cent pace that was experienced over the last year as a whole. Banks reduced their holdings of United States Government securities by a substantial $2.0 billion (seasonally adjusted) over the first quarter (see Chart I) and, by the end of March, bank holdings of these instruments stood at their lowest level since March 1960. The decline in holdings of United States Government obligations swamped a $0.4 billion first-quarter increase in holdings of other securities, the smallest quarterly rise in the current expansion. In March, bank holdings of these securities actually declined by $300 million on a seasonally adjusted basis, the first appreciable decline in this series since 1960.

The strong 15.6 per cent annual rate of increase during the first quarter in total loans at commercial banks was paced by a sharp increase in business loans. While the expansion in loans to business borrowers was considerably below the extraordinary first-quarter advance of last year, it was about in line with the growth rate for 1965 as a whole. Underlying the business loan strength have been tighter corporate liquidity positions and a high rate of capital spending and inventory accumulation. Stepped-up corporate tax payments, expectations of continued high rates of investment expenditure, and projections of a slower growth rate in profits this year relative to last year all



point to continued strength in business loan demand. On the other hand, despite net increases in most open market rates during the quarter, the relative costliness to business borrowers of bank financing had risen by the end of the period. The main factor in this development was the increase in the prime rate from 5 per cent to 5½ per cent on March 10.

The sharp advance of loans during the first quarter was accompanied by continued pressure on bank liquidity positions, as evidenced by a further sharp advance in loan-deposit ratios. During the January-March period, the loan-deposit ratio for all commercial banks climbed a full percentage point to 64.1 per cent. Even more striking was the rise of 2 percentage points in the loan-deposit ratio at weekly reporting banks over the quarter to 69.8 per cent by the end of March. Similarly, the loan-deposit ratio at New York City reporting banks had advanced to 72.4 per cent by the end of the quarter, up markedly from 69.9 per cent at the end of December.

BANK DEPOSITS, RESERVES, AND TOTAL LIQUID ASSETS

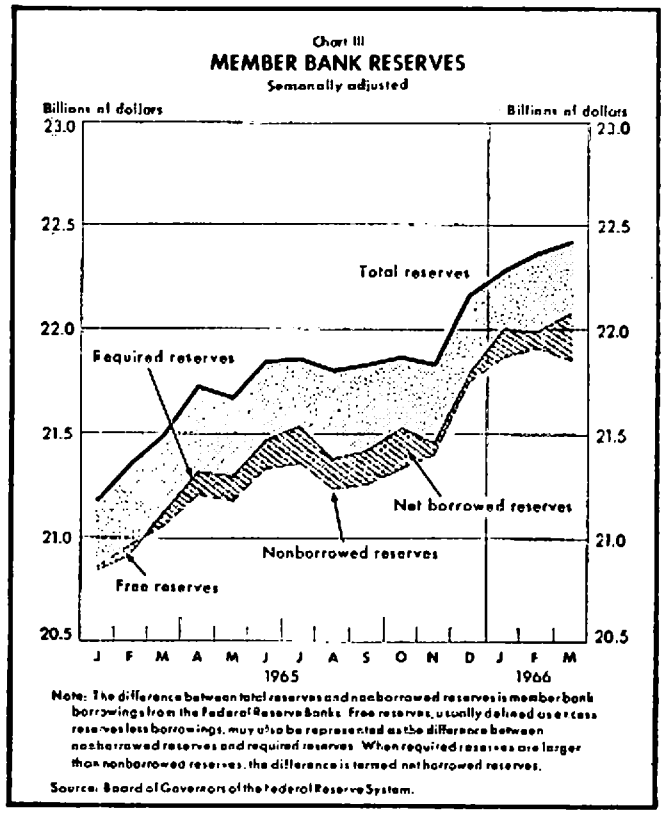
The daily average money supply grew at a 4.3 per cent seasonally adjusted annual rate from December 1965 to March 1966, considerably below the 7.5 per cent pace in the final quarter of last year but not greatly different from the 4.8 per cent growth rate over 1965 as a whole. Month-to-month movements in the money supply reflected in part the frequently observed inverse relationship between short-run changes in its demand deposit component and short-run changes in United States Government deposits. Thus, in February, private demand deposits declined by some $0.6 billion on a daily average seasonally adjusted basis, while Government deposits, measured on this same basis, rose by roughly the same amount. Despite midmonth tax payments, a reverse flow from Government deposits to private demand deposits occurred over the month of March as a whole, with private demand deposits growing by $1.1 billion and Government deposits falling again by an approximately offsetting amount.

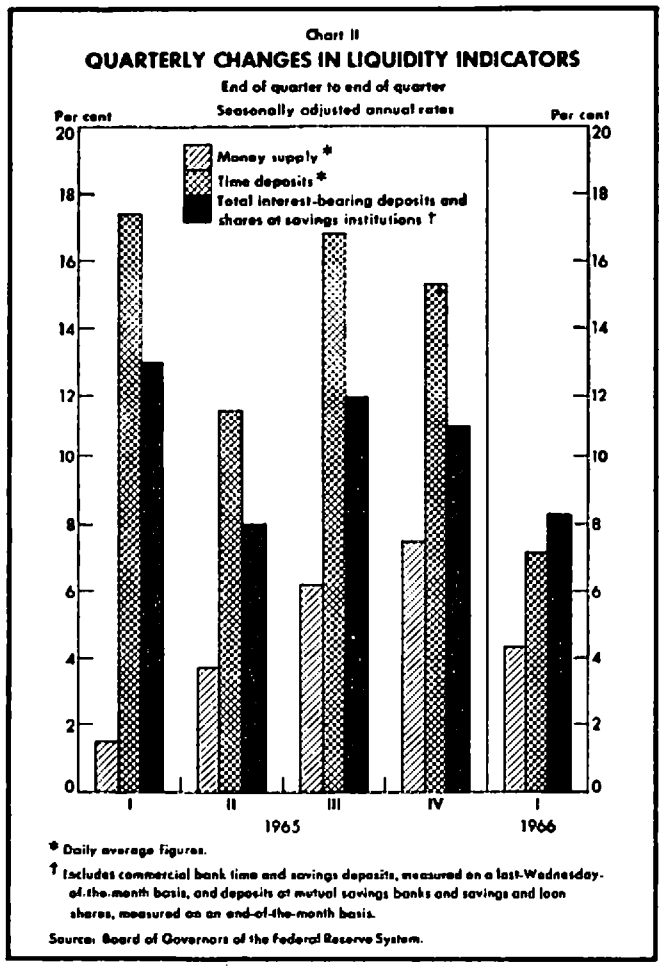
Commercial bank time deposits (seasonally adjusted) rose at a 7.1 per cent annual rate over the first quarter, markedly less than the rapid 16.1 per cent pace for last year as a whole (see Chart II). Largely because of the sluggish advance in these deposits, the money supply and time deposits combined grew at an annual rate of only 5.6 per cent during the first quarter, as against a 9.8 per cent rise in 1965. Data for weekly reporting member banks suggest that the primary factor in the reduced first-quarter growth in time deposits was the diminished public interest in passbook savings accounts. Funds in these accounts at weekly reporting banks actually declined by some $251 million over the quarter, compared with a $1.6 billion rise over the comparable period last year. Moreover, there was some evidence of a diminished flow of new funds into C/D's during the quarter. Despite the sharply higher rates paid on these instruments, C/D's at all weekly reporting banks expanded by only about $700 million from the beginning of this year to the week just preceding the mid-March dividend and tax dates, as against a $1.6 billion gain in the comparable period of 1965. Weekly reporting banks—and especially the New York City reporting banks—were, however, considerably more successful than many had expected in attracting additional C/D's during the last two statement weeks in March, with the net gain amounting to $807 million.

Despite the reduced over-all flow of funds into commercial bank interest-bearing accounts—and into other deposit-type institutions as well—there appears to be some evidence that savings certificates issued by commercial

banks, generally in relatively small denominations, have been growing at a stepped-up pace. This development reflects an increase in the number of banks offering such certificates, some advances in the rates paid on them, and more extensive advertising by issuing banks. Probably a good part of this money represents funds that would otherwise have been lodged in other savings-type accounts, whether outside the commercial banking system or in passbook savings accounts at commercial banks, including passbook accounts of the issuing banks themselves.

In order to help meet the reserve needs occasioned by the over-all expansion in their demand and time deposit liabilities, banks ran down their excess reserves from an average of $358 million in January to a $303 million average in March. At the same time, their borrowings from the Federal Reserve Banks rose from an average level of $402 million in January to $551 million in March. On a seasonally adjusted basis, member bank nonborrowed reserves expanded at a relatively slow 1.5 per cent annual rate in the first quarter (see Chart III). Over 1965 as a whole, the rate of growth had been 4.2 per cent.





The nonbank public's liquid assets[1] expanded at a seasonally adjusted annual rate of 8.5 per cent in the first quarter, closely in line with the rise in the fourth quarter of last year. As already suggested, however, the growth rate in the time deposit and share components of total liquid assets—commercial bank time and savings deposits, deposits at mutual savings banks, and savings and loan shares—dropped markedly below that for last year as a whole. Savings flows to all three types of institutions may have been adversely affected by the rising attractiveness

[1] Total liquid assets are defined to include demand deposits and time deposits (adjusted) at all commercial banks and currency outside banks—all measured on a last-Wednesday-of-the-month basis; also, deposits at mutual savings banks, savings and loan shares, postal savings deposits, United States Government savings bonds, and the public's holdings of United States Government securities maturing within one year—all measured on an end-of-the-month basis.

of yields on open market instruments, such as state and municipal bonds, and by the fact that individuals apparently saved a considerably smaller proportion of their disposable income in the first quarter than in the preceding quarter. Reflecting in part the heavy bank liquidation of Governments, the nonbank public's holdings of such securities maturing within one year rose by a substantial $3.3 billion in the first quarter following a modest decline in the preceding quarter. The ratio of total liquid assets held by the nonbank public to gross national product fell by 0.4 percentage point in the first quarter to 80.9 per cent. Contrary to the experience of earlier business expansions, this ratio rose through much of the current upswing. Since early 1964, however, its movement has been somewhat irregular, and the current position of the ratio is about equal to the level prevailing in the third quarter of 1963.