Term Lending by New York City Banks in the 1960's*

One of the outstanding features of lending to business by New York City banks is its strong orientation toward medium-term lending. Term lending has developed unevenly over the past three decades, with the sharpest advances occurring in the midfifties and midsixties when business demand for longer term funds was especially strong. The latest rise in term lending—an increase of about 70 per cent from mid-1964 to late 1966—established term loans as the largest single category of assets in the portfolios of New York City banks. Many factors undoubtedly contributed to this development. The investment spending boom of the sixties, which in its later stages greatly exceeded the internal financial resources of business, was unquestionably the major reason for increased term-loan demand at New York City banks. On the supply side, the rapid growth of time deposits at city banks—a growth facilitated by the development and promotion of the certificate of deposit—greatly enhanced the supply of loanable funds available to these banks, and served to strengthen their preferences for higher yielding and longer maturity earning assets. This article seeks to provide some information and perspective on these developments, and to assess the role of New York City banks in the national market for term loans.

RECENT TRENDS IN NEW YORK CITY TERM LOANS

The two major expansions during the past fifteen years in term lending by New York City banks were associated with upsurges in capital expenditures by business. In the first of these expansions, lasting from early 1955 to mid-1957, outstanding term loans at city banks rose at the very high rate of about 25 per cent a year, and the amount outstanding grew to over $5 billion from $3 billion at the start of the period.[1] Moreover, in the second expansion, roughly covering the 2½-year period ended in December 1966, term loans grew just as rapidly in percentage terms, and the amount outstanding rose from about $7 billion at the start of the period to over $12 billion at the close (see Chart I).

During the seven years that separated these two expansions, term-loan growth was comparatively slow. From mid-1957 to mid-1964, term loans of New York City banks grew only about 4 per cent a year, on average. This sluggish growth was due to the relatively weak demand for external financing by business firms (see Chart II). From mid-1957 to mid-1964, expenditures of business firms for fixed investment were about equal to their internal cash flows (retained earnings and depreciation allowances), whereas capital expenditures had exceeded cash flows by an average of nearly $2 billion annually during the two-year period ended in mid-1957. The reduced need for external financing was particularly pronounced for large corporations, the typical customers of New York City banks. Thus, the medium-term bank indebtedness of large manufacturing corporations (those with assets of $50 million or more) rose between June 1957 and June 1964 by only 2 per cent a year, compared with a 26 per cent growth rate during the 1955-57 investment boom.[2]

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[1] Developments during the 1950's were described in "Term Lending by New York City Banks", this *Review* (February 1961), pages 27-31. That article also described the statistics covering term loans by New York City banks, which were first collected by the Federal Reserve Bank of New York in 1960. These statistics underlie the analysis presented in this article. Term loans are defined here as commercial and industrial loans with an original term of more than one year. Term loans secured by real estate are not included; they are currently estimated at only 5 per cent of the term-loan total of city banks.

[2] Estimates of bank indebtedness of corporations are derived from statistics compiled by the Federal Trade Commission and the Securities and Exchange Commission and published in the *Quarterly Financial Report for Manufacturing Corporations.*

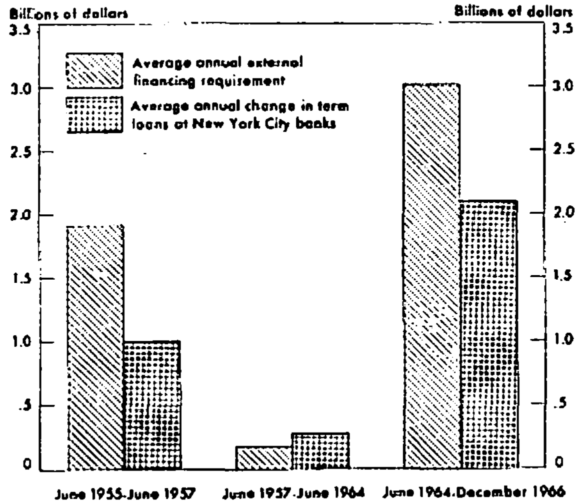
The strong term-loan expansion at New York City banks that followed this slack period started around mid-1964. The annual rate of growth of term loans accelerated to 17 per cent in the second half of 1964, and then jumped sharply in the first half of 1965 to an unprecedented rate of nearly 40 per cent. After mid-1965 term-loan growth slowed somewhat, but nonetheless continued at an unusually strong rate of over 25 per cent a year before coming to a gradual halt in the second half of 1966.

The especially rapid surge during late 1964 and early 1965 in term lending at city banks was due in part to rising demand from foreign borrowers as well as from domestic corporations. The strong foreign demand during this period probably stemmed largely from expectations—later borne out—that the United States would soon impose restrictions on domestic bank lending to foreigners for balance-of-payments reasons. From the limited data available, it is estimated that New York City banks extended a net of about $500 million to $750 million in term loans to foreign businesses over the nine-month period ended in March 1965, representing roughly half of the sharp increase in total outstanding term loans during those months. After March 1965, however, when the Federal Reserve announced voluntary guidelines for the foreign lending activities of commercial banks under the President's balance-of-payments program, the growth of term lending to foreign businesses came to a halt. In mid-1967 the amount of term loans outstanding to foreign businesses was reported by city banks at $1.6 billion, equal to about one eighth of these banks' total outstanding term loans and to about three quarters of term loans to foreigners outstanding at all commercial banks.[3]

Thus, after March 1965 demand from domestic sources, sparked mainly by the sharply rising level of capital expenditures by nonfarm business, became for all practical purposes the exclusive source of term-loan growth. Although capital expenditures had expanded very substantially each year since 1963 (at an annual rate of about 14 to 17 per cent), business firms had been able early in the boom to finance their needs largely from internal

Chart II

EXTERNAL FINANCING REQUIREMENTS OF BUSINESS AND CHANGES IN TERM LOANS

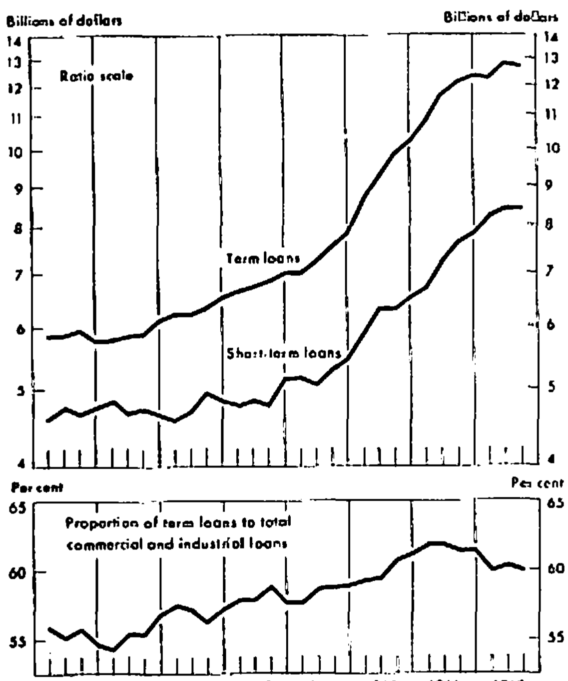


Note: External financing requirements are defined as the excess of fixed investment spending by domestic nonfarm, nonfinancial businesses over funds available internally from retained earnings and depreciation allowances. The figures for term loans include those made to foreign businesses, and the figures for external financing requirements exclude funds needed for working capital.

Source: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York.

Chart I

COMMERCIAL AND INDUSTRIAL LOANS AT LARGE NEW YORK CITY BANKS



Note: Data plotted are seasonally adjusted March, June, September, and December averages of Wednesday figures.

[3] Banking statistics on business loans to foreigners became available on a current basis for the first time in January 1967.

sources of funds. In 1965, however, internal cash flows fell short of fixed investment expenditures by $3 billion, and in 1966 by $4 billion. The financing needs of nonfarm business during these years were swollen still further by increased inventory accumulation, which rose from $6½ billion in 1964 to over $13½ billion in 1966, and by the speedup in Federal income tax payments of corporations.

This greatly expanded business demand for external funds was met only in part by new securities flotations: such flotations by nonfinancial corporations rose from a net of $5½ billion in 1964 and 1965 to $11½ billion in 1966. That corporations during this period also borrowed heavily from banks was probably due to the relatively favorable terms on which bank credit could be obtained, especially up until late 1965. From mid-1964 to mid-1965, the bank prime rate—the rate charged the most creditworthy of business borrowers—was maintained at 4½ per cent, only very slightly above offering rates on prime new corporate bond issues. In the second half of 1965, moreover, the issuing rate on high-grade bonds rose above the prime rate for several months preceding the December 1965 prime rate increase.

Favorable rate considerations may also have been reinforced by other features of bank loans. For one thing, bank credit can ordinarily be arranged and drawn down more quickly than capital market borrowings. This may have been especially important in the earlier part of the recent term-loan expansion, when credit from banks was readily available and business plant and equipment spending was persistently outrunning earlier spending plans. Also, part of the heavy borrowing at banks may have constituted interim financing to be paid out of expected future increases in internal funds or subsequent long-term bond flotations. The latter possibility is supported by the trend toward greatly increased bond market flotations in 1966 and 1967, and by the fact that an increased proportion of these issues has been for the stated purpose of repaying bank loans.

The favorable terms of bank borrowing through late 1965 were attributable to the ample supply of funds at banks, especially in the early part of the period. This in turn was due importantly to the banks' ability to raise funds in the money market by means of a new financial instrument—the large-denomination negotiable certificate of deposit. The city banks attracted some $6½ billion over the five-year span ended by mid-1966 through these certificates. They also raised an additional $4 billion from sales of United States Government securities from their own investment portfolios over the same period.

About mid-1966, however, the efforts of New York City banks to raise funds from sales of securities and in the money market became less successful. The financial latitude given the large-denomination certificate of deposit by the action of the Board of Governors in December 1965, which raised from 4½ per cent to 5½ per cent the maximum rate payable on bank time deposits, proved to be short-lived. Money market rates rose swiftly in early 1966, and by midyear banks found themselves unable to offer rates comparable to those on competing credit instruments. As a result, the city banks began to encounter slower growth in total time and savings deposits around mid-1966, and actually suffered a net decline of these deposits toward the end of the year on the order of some $2 billion. During

Table I

ASSETS AND LIABILITIES OF WEEKLY REPORTING MEMBER BANKS IN NEW YORK CITY

June 1964 and December 1966

Assets and liabilities	Amount outstanding			Compound annual rate of growth June 1964-December 1966
	June 1964	December 1966	December 1966	
	Billions of dollars		Per cent	Per cent
Assets				
Commercial and industrial loans with an original maturity of:				
More than one year	7.1	12.2	23.5	24.0
One year or less	5.1	8.0	15.5	20.2
Loans to financial institutions	3.5	4.7	9.1	13.0
Loans for purchasing or carrying securities	3.4	2.6	5.0	− 10.2
Real estate loans	2.0	3.2	6.2	21.3
All other loans	3.5	3.8	7.3	3.2
United States Government securities	5.4	4.4	8.5	− 8.4
Other securities	5.0	5.3	10.2	2.2
Cash	4.3	4.8	9.3	3.8
All other assets	2.4	2.8	5.4	6.8
Total assets	41.7	51.8	100.0	9.1
Liabilities				
Demand deposits	20.3	21.4	41.3	2.2
Time deposits	8.0	11.7	22.7	16.3
Savings deposits	4.4	4.6	8.9	1.4
Capital accounts	4.2	5.1	9.9	8.4
Borrowings	1.5	2.8	5.3	27.3
Other liabilities	3.3	6.2	11.9	29.2
Total liabilities	41.7	51.8	100.0	9.1

Note: Medium-term loans to business secured by real estate were estimated at approximately $0.6 billion in 1966; they are included in the class labeled "real estate loans". The breakdown of commercial and industrial loans into those with an original term of more than one year and those with one year or less was estimated for 2 per cent of the total on the basis of the breakdown available for 98 per cent of the total. All loan figures are shown gross. Cash figures exclude cash items in process of collection. Demand deposit figures are gross demand deposits less cash items in process of collection. Valuation reserves are included in "other liabilities". Percentage distribution and dollar figures are monthly averages of Wednesday figures.

this period, they began to bid aggressively through their European branches for Euro-dollar deposits, and raised about $1¼ billion by these means. But, with shrinking time deposits and depleted holdings of United States Government securities, banks were able to meet loan demands after midyear only by effecting some net reduction in their holdings of municipal obligations. The city banks thus were not able in the second half of 1966 to marshal sufficient funds to finance loan expansion at the record high rates of previous months. It was apparently for this reason that the growth of term loans slowed to a 12 per cent annual rate in the second half of 1966, and ceased completely by the end of the year. This marked the end of the rapid 2½-year expansion of the midsixties that had raised the share of term loans in the total of loans and investments of New York City banks to over one quarter, making these loans the largest single category in the banks' assets portfolio (see Table I). In the course of this expansion, term loans also increased in relation to total commercial and industrial loans, reaching about 60 per cent as compared with an average of about 55 per cent during 1960-61. (The proportion was 47 per cent in 1955 and 51 per cent in 1957.)

Table II

TERM LENDING BY WEEKLY REPORTING MEMBER BANKS IN NEW YORK CITY AND CAPITAL EXPENDITURES BY BUSINESS, 1961-66

In per cent

Industry of borrower	Distribution of term loans outstanding		Compound annual rate of growth	
	December 1961	December 1966	Term loans December 1961-December 1966	New plant and equipment expenditures 1961-66
Manufacturing:				
Durable goods industries	19.4	21.1	17.3	17.4
Nondurable goods industries	21.8	21.6	15.0	11.9
Mining (including crude petroleum and natural gas)	15.6	18.0	18.6	8.4
Public utilities (including transportation and communications)	30.4	23.4	9.4	11.5
Trade	3.6	4.6	21.5	8.5
All other	9.2	11.3	20.0	
Total	100.0	100.0	15.3	12.0
Total (millions of dollars)	6,081	12,235	—	—

Note: Percentage distribution and dollar figures are monthly averages of Wednesday figures.

Sources: Statistics are based on data from the Federal Reserve Bank of New York, United States Department of Commerce, and the Securities and Exchange Commission.

TRENDS BY INDUSTRY

The growth of term loans at city banks in the mid-1960's was fairly well balanced, with the basic contours of the distribution by industry of borrower showing little change between 1961 and 1966 (see Table II). The proportion represented by manufacturers of nondurable goods remained stationary at 22 per cent. Public utility borrowing (including transportation and communications) lost ground dropping from 30 per cent to 23 per cent, but utilities still represented the largest single borrower group. Offsetting this relative decline were moderate increases distributed rather evenly among the other industries—notably durable goods manufacturing (from 19 per cent to 21 per cent), mining (from 16 per cent to 18 per cent), and trade (from 4 per cent to 5 per cent).

In several industrial classifications, covering about two thirds of the total of term loans, the relative growth rate in term borrowing reflected the relative rate of expansion in capital expenditures. Manufacturers of durable goods, for example, expanded both their capital outlays and their term indebtedness at annual rates that were higher than the average for all business firms; in the nondurable goods manufacturing sector both rates were at the average level; and in the public utilities sector, both were lower than average. Term lending to the mining industry, however, appears to have been little influenced by changes in capital expenditures. In this sector, capital spending grew at a pace well below the average for all industries, but term loans expanded at a higher than average rate. The primary reason was heavy borrowing by firms engaged in crude petroleum and natural gas extraction. This type of business is very well suited to medium-term accommodation by banks, because sales of crude petroleum from underground reserves provide sufficient flows of funds for the retirement of debt in some five to eight years—the typical maturity preferred by commercial banks. In addition, firms engaged in petroleum extraction received several fairly large loans from New York City banks in this period for financing acquisitions of other companies. The extension of sizable credits to foreign petroleum companies also contributed to the relatively fast growth of term lending to the mining industry.

THE CITY BANKS AND THE NATIONAL TERM-LOAN MARKET

The rapid expansion of term lending during the investment booms of the midfifties and midsixties was evident at banks throughout the country, but in New York City the expansion in each period was faster than in other sectors of the country. The extent to which term-loan demands were focused on New York City banks is suggested by the accompanying changes in these banks' share of the national market. One of several measures of this relationship is the city banks' share in total term loans outstanding at all commercial banks.[4] That share, currently estimated at about one third, has fluctuated in the past fifteen years from about 30 per cent to nearly 40 per cent, rising in periods of heavy investment spending and declining in periods of weak demand for funds. This cyclical variation is more clearly evident when measured with regard to the net increase in term loans outstanding: during the 1955-57 and 1964-66 investment booms, the city banks accounted for about 40 per cent of the estimated net increase in term loans of all commercial banks, compared with only a 20 per cent share of the increase in the late 1950's and early 1960's. And, finally, the reliance on New York banks in periods of heavy demand can be judged from the contributions of these banks' term loans to the total net flow of funds to nonfinancial business from external sources. In the late 1950's and early 1960's that figure was only 2 per cent, but it rose to about 8 per cent in the midfifties and the midsixties.

This increased concentration on New York in periods of investment boom is attributable to the fact that the city banks generally cater to large corporations, both domestic and foreign, whereas small- and medium-sized corporations account for most of the business credit outstanding at banks outside New York. Large firms normally finance their operations from internal sources and in the capital market, relying on commercial banks to a much lesser extent than small business. But in periods of high-level capital expenditures large firms make much greater use of bank credit, not only as a supplement to their other sources of funds but possibly also as a temporary substitute for capital market credit to be refunded in long-term bonds when monetary conditions become easier. Smaller firms normally depend on commercial banks more steadily, and thus their demand for bank credit tends to be more evenly spread over time. The relevance of these behavior patterns is indicated by figures on the increase in medium-term indebtedness to banks of manufacturing corporations. For corporations with assets of $50 million or more, the annual rise of such indebtedness during 1965-66 was 45 per cent, but it was only 13 per cent for corporations with assets under that amount. During the preceding seven years, the growth pattern was opposite—2 per cent for the large corporations and about 7 per cent for the small firms.

In addition to the marked cyclical variation in the share of New York City banks in nationwide term loans, there has been a mild long-run downtrend in the city banks' share from the early 1950's to the mid-1960's. Between 1952-53 and June 1964, the city banks' share in total term loans declined from 37 per cent to 30 per cent. A number of factors contributed to this downward trend; the most important were the relatively weak demand for bank accommodation by large corporations during most of the period in question and the relatively slow growth of business activity in New York City. Since mid-1964, the city banks' share of total term loans has advanced sharply, reaching 34 per cent by late 1966. However, it is too early to judge whether this recent gain represents a reversal of the long-run downtrend or is merely a temporary cyclical upswing.

[4] This total can be only roughly estimated, using a variety of sources. In December 1966 it was an estimated $37 billion, consisting of $29 billion of commercial and industrial loans with an original term of more than one year and about $8 billion of medium-term loans to business secured by real estate. The estimate for the comparable total at New York City banks is nearly $13 billion including the real estate loans, which in this section must be admitted to the definition because in the nation as a whole, in contrast to New York City, they represent a substantial fraction of term lending.