structure of the banking industry. Interest expenses have mounted as a result of both the enlarged volume of time and savings deposits and the higher rates paid on such deposits. In their annual reports to stockholders for 1962, many commercial banks pointed to higher deposit-interest costs as a significant factor contributing to higher bank expenses during the year. Certificate interest expenses, per deposit dollar, probably have been lower than those of savings deposits, since certificate rates, partly reflecting the value of the instrument's negotiability, are often lower than the rates paid for savings deposits. Certificate rates are also more flexible than those on savings deposits. They may be raised or lowered in response to money market rates and, most importantly, in response to the individual bank's desire for time deposit funds; by contrast, interest rates for savings deposits tend to be relatively inflexible. While certificate rates may demonstrate upward flexibility during a period of rising money rates, this trend probably will be resisted if deposit costs mount more quickly than the return on the bank use of these funds. Certificates can be offered aggressively when it is profitable to do so, and less eagerly when profitability declines. In the latter circumstances banks might permit issuing rates for new certificates to become noncompetitive, relative to other money market rates.

In addition to their implications for the operations of commercial banks themselves, certificates have exerted an influence on interest rates. By absorbing funds that otherwise would probably have entered the markets for other short-term instruments, they have exerted an upward pressure on short-term interest rates, thereby contributing to Treasury and Federal Reserve efforts to maintain these rates and to reduce incentives for short-term investments abroad.

The Business Situation

The pickup in the strength of the domestic economy that began in the first quarter has carried over into spring. Retail sales were maintained at a record level in April, and such other monthly measures as industrial production, nonfarm employment, personal income, housing starts, and new orders for durable goods all continued strongly upward. To be sure, a significant portion of the April gains in production and orders was attributable to the special situation in the steel industry. It is noteworthy, however, that there were also widespread increases in industries other than steel. For May, the data at hand point to gains in automobile assemblies and a continued high level of steel ingot production. Retail sales apparently declined, but the latest survey of consumer buying intentions—according to which plans to purchase new cars and household durables within six months were appreciably above the advanced January level—suggests some strengthening in the consumer sector in the months ahead.

While the available evidence would thus seem to indicate that the economy has gained renewed momentum, aggregate activity continues to run well below capacity levels. Indeed, few forecasts for 1963 envisage that the rate of unemployment will be materially reduced over the balance of the year. The unemployment problem is, of course, likely to become more troublesome in the weeks ahead, since the number of teenagers leaving their classrooms to enter the labor market at the end of the current school year will probably be significantly larger than in the past.

CONTINUED GAINS IN PRODUCTION AND EMPLOYMENT

The Federal Reserve's index of industrial production moved up by nearly 2 percentage points in April and thus registered its largest increase in almost two years. This latest gain represented the third consecutive month of advance and brought output to 122.4 per cent of the 1957-59 average (see Chart 1). About a third of the over-all April increase was attributable to a continued sharp rise in steel production, reflecting efforts to build up steel inventories as a strike hedge as well as some step-up in the rate of steel consumption. Resumption of publication of New York City and Cleveland newspapers, by contributing to the rise in the printing and publishing component of the index, was an additional factor in the over-all production gain. Even apart from such special factors, however, output in most industries registered rather sizable increases.

Fragmentary data on production in May suggest continued gains. Thus, although a strike-caused automobile
parts shortage temporarily cut back production on some assembly lines, May output in the automobile industry as a whole pushed somewhat above the high plateau of the previous ten months. At the same time, steel ingot production maintained its high April level. The delay of the steelworkers’ union in reopening its labor agreement apparently led some steel users to reassess the need for a further build-up in steel inventories, but this occurred too late to have any significant effect on May ingot production.

Continued strength in production over the near term was suggested by the growing volume of new orders placed with manufacturers of durable goods. In April, such orders moved upward by 3 per cent (seasonally adjusted), marking the fourth consecutive month of advance (see Chart 1). Backlogs of unfilled orders held by durables manufacturers also rose for the fourth month in a row. While the volume of new bookings received by the steel industry jumped further in April, this accounted for only about half of the over-all increase in new orders. Indeed, total orders received by durables industries other than steel moved up appreciably.

Paralleling the gain in production, seasonally adjusted nonfarm payroll employment rose by 276,000 persons in April, the third sizable advance in a row (see Chart 1). Almost one third of the April increase was in construction employment, as warmer weather permitted some step-up in outdoor activity. Most of the rest was attributable to a strong rise in the number of persons at work in manufacturing. Indeed, factory employment has been restored to its high level of last July. In contrast to typical past experience, these gains in manufacturing employment were not foreshadowed by any particularly noticeable rise in the average workweek. Thus, average weekly hours in manufacturing have remained between 40.2 and 40.4 since last November and are somewhat below the April 1962 peak (see Chart 1). Fragmentary data on claims filed for unemployment compensation in May suggest that employment in that month may at least have held near its advanced April level.
DEVELOPMENTS IN SELECTED DEMAND SECTORS

Like industrial production, activity in the housing sector has shown renewed buoyancy in recent months. After being curtailed by unusually severe weather during the winter—a factor not fully taken account of in the seasonal adjustment procedures—outlays for private residential construction rose by about $1 billion (seasonally adjusted annual rate) in April and by an even greater amount in May (see Chart II). A prospect of still further advances over the near term is suggested by the 28 per cent jump from February to April in the number of housing units started. Moreover, despite the sharp increase in starts and recent declines in the number of building permits issued, the backlog of unused permits has apparently remained at a high level.

In the area of capital spending, the winter survey of the Commerce Department and the Securities and Exchange Commission and the spring McGraw-Hill survey had pointed to increases in outlays for plant and equipment of 5 per cent or more for the year as a whole. A later reading of such plans will be available with the release of the second-quarter Commerce-SEC survey in early June. In the meantime, available monthly indicators related to capital spending show a mixed pattern. In April, output moved up in industries producing construction materials and business equipment, and orders placed with manufacturers of machinery and equipment edged somewhat above the plateau that had been maintained in the preceding five months. Despite their latest gains, however, these indicators are still below, or only slightly above, the high levels already attained during the second half of last year. Moreover, outlays for commercial and industrial construction continued sluggish in May, and were below their level at the end of 1962, having declined in three of the five months so far this year. The performance of these various indicators thus continues to raise questions as to the extent of the rise in actual plant and equipment spending that can be expected in 1963.

Developments in the consumer sector, on balance, appear to be encouraging. To be sure, in recent months the net increase in consumer credit outstanding has been somewhat below its rate in the fourth quarter of 1962, as repayments of existing loans have increased at a faster rate than new loan extensions. Moreover, retail sales apparently declined somewhat in May. Their volume remains at an advanced level, however, and consumer incomes have continued to expand—with the April gain the largest of any this year. In addition, consumer buying plans moved up in April, according to a survey conducted by the Census Bureau. Intentions to purchase new cars and household durables increased from their already high levels at the start of this year and were above the levels reported in April 1962.

The Money Market In May

The money market became somewhat firmer during May. Federal funds traded almost entirely at 3 per cent, and in the last half of the month the demand for Federal funds at that rate often exceeded their availability. Average member bank borrowings from the Reserve Banks—at $190 million—were accordingly somewhat higher than in other recent months. Rates posted by the major New York City banks on call loans to Government securities dealers were quoted predominantly within a 3¼ to 3½ per cent range. Treasury bill rates moved up moderately after midmonth in the firmer money market atmosphere.

On May 15, approximately $9.0 billion of the $9.5 billion of Treasury notes and certificates eligible for conversion in the May refunding were exchanged for the two issues included in the offering. Subscriptions for the new 3½ per cent certificates of May 1964 and for the reopened 3½ per cent notes of February 1966 totaled $5.7 billion and $3.3 billion, respectively. Only $0.5 billion of the three maturing issues was redeemed for cash, with redemptions by the public amounting to about 8½ per cent of its maturing holdings.

Prices of outstanding Treasury notes and bonds moved irregularly higher in the first half of May, as the market reacted favorably to the short-term offerings in the Treasury's May refunding. Demand was also buoyed by the market's feeling that there would be no further Treasury financing operations in the immediate future, by the lowering of the Canadian bank rate on May 7, and by a feeling that interest rates would change little over the near term, whatever might be their movement over the longer term.