Recent Banking and Monetary Developments

Bank credit and deposits continued to expand at a good clip in the third quarter, as the economy moved further ahead. Bank credit, in fact, has advanced at a relatively steady rate throughout the current expansion. The growth in demand deposits caused a spurt in the money supply during the quarter, but over the year as a whole the money supply has shown about the same rate of increase as last year. Commercial bank time deposits, in contrast, have grown less rapidly this year than in 1963.

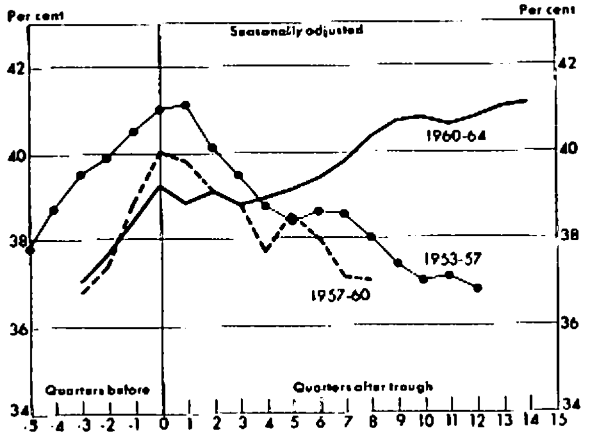
The third-quarter rise in total bank credit included a sizable increase in loans to commercial and industrial businesses. The growth in such loans this year, though nowhere near a match for the record postwar surge in 1955-56, has been at a more rapid pace than in earlier years of the current business upswing. While these recent developments suggest that banks for the most part have not felt inhibited in making new loans, the putting-on of these loans has gradually reduced the liquidity position of the banking system as a whole. Indeed, the aggregate loan-deposit ratio at all commercial banks at the end of September was at 58.5 per cent, up from 56.5 per cent a year earlier. Moreover, there have been reports of more frequent requests by some smaller banks to have their big city correspondents participate in new loans, a development which indicates that the especially rapid rise in loan-deposit ratios at banks outside the money centers is already having an effect on lending practices. To the extent that banks as a whole are becoming somewhat less willing to allow their loan-deposit ratios to rise appreciably further, additional gains in bank loans may be more closely dependent on deposit increases, and ultimately on advances in bank reserves, than has been true thus far in the current expansion.

CHANGES IN LOANS AND INVESTMENTS

Total bank credit at all commercial banks increased by $5.4 billion (seasonally adjusted) in the third quarter, or at an annual rate of 8.4 per cent. This gain extended further the relatively steady upward trend in commercial bank loans and investments that has now persisted for several years. Indeed, the steadiness of the growth rate in total bank credit over the past three years of general economic upswing is one of the striking aspects of the current business expansion. Federal Reserve policy during the upswing as a whole has, of course, shifted gradually toward supplying member bank reserves—the underlying support for bank credit—a little more reluctantly and toward allowing credit demands to produce a firmer tone in the money market and somewhat higher levels of short-term interest rates. On the other hand, public demand for bank deposits and credit—stemming from the growing pace of economic activity—has increased. In terms of bank credit, the net result of these two forces has been to leave the actual growth rate since 1961 essentially unchanged. To be sure, the period can be divided into two distinct parts. Between the fourth quarter of 1961 and the second quarter of 1963, bank credit grew at a faster rate than the over-all economy, as evidenced by the appreciable rise in the ratio of bank credit to gross national product (see Chart I). Since the middle of 1963, on the other hand

Chart I

TOTAL BANK CREDIT AS A PERCENTAGE OF GROSS NATIONAL PRODUCT IN THREE BUSINESS CYCLES



Note: Troughs in general business activity: 1954-III, 1958-II, 1961-I. Each of the lines begins and ends with the quarter designated as the business-cycle peak, except for the line for 1960-64 which ends with the latest quarter available (1964 III). In computing the ratios, bank credit is taken as the averages of the figures for the last Wednesday of the month preceding, and the three months in, each quarter.

Sources: Board of Governors of the Federal Reserve System; United States Department of Commerce.

GNP and bank credit have grown at about the same rate and the bank credit-GNP ratio has shown only a very small net upward movement. In the two previous business-cycle expansions, in contrast, the bank credit-GNP ratio declined rather steadily throughout the upswing.

The third-quarter advance in total bank credit reflected gains in most loan categories and a particularly sharp rise of $2.4 billion in bank holdings of securities. Until this recent rise, bank investments in securities had fluctuated around a $96 billion level since March 1963, as a net decline in holdings of Governments was about offset by an uptrend in holdings of other securities. Investments in other securities continued to rise in the third quarter (see Chart II), but, departing from the pattern of earlier in 1964, this advance was accompanied by a $1.2 billion increase in holdings of Governments.

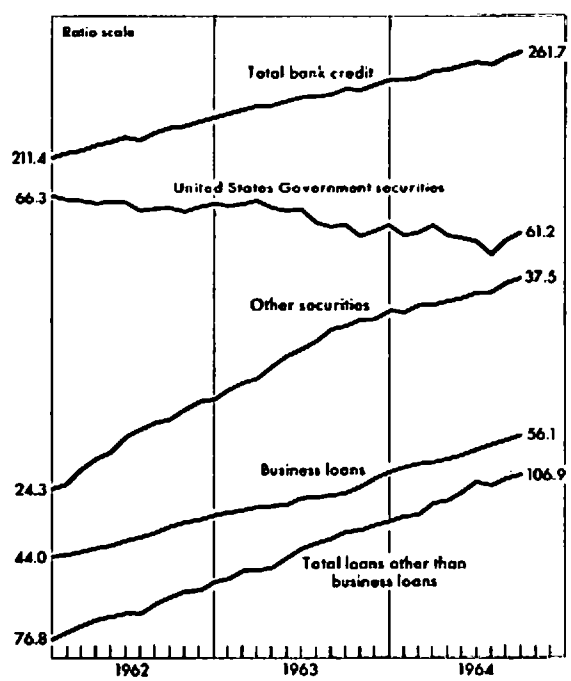
Judging from data for the weekly reporting member banks, holdings of Government issues maturing in over five years have actually risen since the end of 1963, reflecting in part the success of the Treasury's advance and regular debt refunding programs. Positions in one- to five-year issues and in Treasury bills and certificates of indebtedness, on the other hand, drifted downward through the end of July. During August and September, however, the weekly reporting banks increased their bill holdings by more than $1.6 billion, and this probably accounts for a good portion of the third-quarter rise in over-all commercial bank holdings of all Government securities. Banks apparently preferred during this period to invest their excess funds in bills rather than even more heavily in higher yielding long-term securities—a preference possibly reflecting a desire to maintain sufficient liquidity to be able to meet loan demands expected during the coming months. With Treasury bill rates up and longer term yields essentially unchanged since midyear, the costs of maintaining such liquidity (in terms of additional income foregone) were not so great as they had been.

The largest rise in commercial bank loan portfolios during the third quarter was apparently in commercial and industrial loans ("business loans"). At weekly reporting member banks, such loans rose by $1.2 billion over the quarter, substantially more than the increases registered in the comparable quarters of preceding years. After a rather sluggish rate of growth during the first two and one-half years of the current business upswing, business loans surged last fall; in the first nine months of this year these loans have been growing at an annual rate of about 10 per

Chart II

RECENT DEVELOPMENTS IN BANK CREDIT AT ALL COMMERCIAL BANKS

Billions of dollars; seasonally adjusted



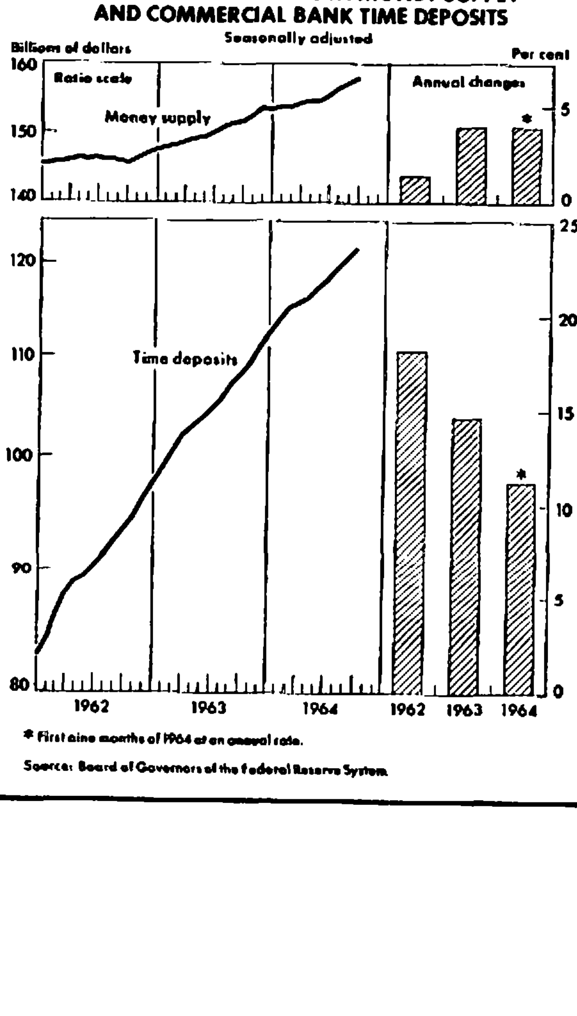
Source: Board of Governors of the Federal Reserve System.

cent at all commercial banks. It should be noted, however, that such a growth rate still reflects a relatively moderate business loan demand. Business inventory accumulation has so far remained relatively modest, and corporations have generated a large internal flow of funds as a result of record corporate profits and depreciation allowances. Hence, businesses simply have not needed to borrow to the extent required in some earlier economic expansions. In 1955 and 1956, for example, business loans at all commercial banks grew at record postwar rates averaging about 20 per cent per year.

Chart III

RECENT DEVELOPMENTS IN MONEY SUPPLY AND COMMERCIAL BANK TIME DEPOSITS

Seasonally adjusted



* First nine months of 1964 at an annual rate.

Source: Board of Governors of the Federal Reserve System.

MONEY SUPPLY AND TIME DEPOSITS

As a closely related counterpart of the rise in bank credit during the third quarter, commercial bank deposit liabilities also rose appreciably, which in turn contributed to a sizable increase in the money supply.[1] On a daily average basis, the seasonally adjusted money supply in September was $158.0 billion, or $2.4 billion above the June average. While this recent increase in the money supply substantially exceeds the long-term rate of growth in this series, it should be noted that money supply growth had been fairly slow earlier in the year (see Chart III). For the first nine months of the year as a whole, the money supply grew at an average annual rate of 3.9 per cent, virtually the same as the 4.0 per cent growth registered during 1963.[2]

Time deposits at commercial banks also moved further ahead in the third quarter, but their rate of growth throughout this year has been noticeably slower than the rapid increases registered in 1962 and 1963.[3] Time deposit growth benefited in those years both from increases in interest rates paid on such deposits (following changes in Regulation Q) and from the development of the negotiable certificate of deposit (C/Ds). These factors have not been so important in 1964. Thus, over the first nine months of 1964, time deposits grew at an annual rate of 11.2 per cent, compared with increases of 14.7 per cent during 1963 and 18.2 per cent in 1962.

[1] Defined to include demand deposits at commercial banks other than those of the United States Treasury (and certain other net adjustments) plus currency held by the nonbank public.

[2] These growth rates for the full year of 1963 and for the first nine months of 1964 have both been computed on the basis of a three-month (November-January) average figure for the money supply at the end of 1963. Monthly averages are used for the figures for December 1962 and September 1964. The annual changes shown in Chart III are computed in the same way.

[3] It might be noted that bank capital apparently has risen at a faster rate this year than in 1963. The effect of this acceleration has been to absorb a greater portion of the counterpart of bank credit growth, relative to deposits, than was the case in the previous year.