# Recent Banking and Monetary Developments

Total bank credit advanced substantially in the second quarter. To be sure, the rise was less rapid than in the unusually strong January-March period, primarily reflecting some slowdown in the pace of over-all economic expansion following the exceptional first quarter. Nonetheless, the advance held above the average recorded earlier in the current business upswing. Business loan demand remained the dominant factor in the general strength of bank credit. Despite scattered evidence of somewhat less liberal lending conditions, funds extended to business borrowers rose during the quarter at a rate more than half again as fast as in 1964. At the same time, commercial bank deposit liabilities, created during the quarter as a counterpart to the over-all credit extended by these banks, continued to grow more rapidly than the nation's output of goods and services. A larger than average rise in the Treasury's cash balance, which closed the fiscal year ended June 30 at a record level, contributed to this growth in total deposits. The public's holdings of deposits along with other liquid instruments, however, also rose to new highs. As a result, for the quarter as a whole, the ratio of total liquid assets held by the nonbank public to gross national product moved up again, virtually equaling the highest level of the past ten years.

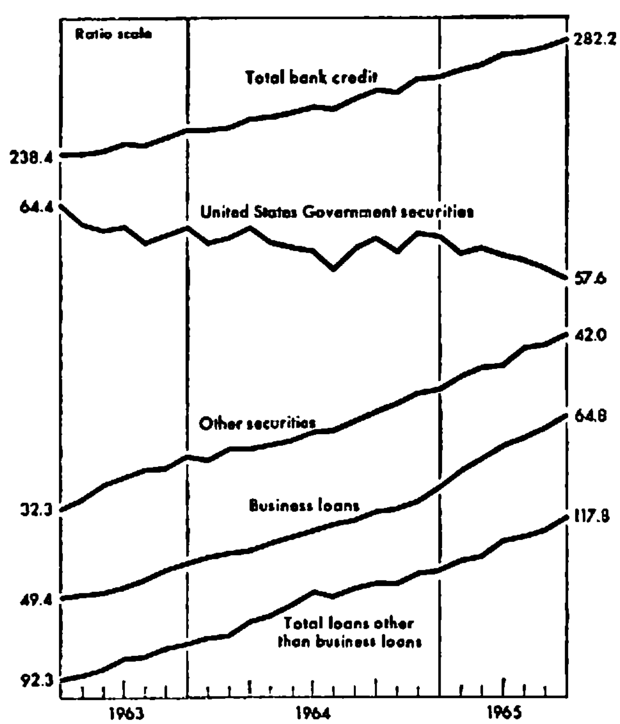
## COMMERCIAL BANK CREDIT AND LIQUIDITY

Total loans and investments at all commercial banks increased at a 9.7 per cent seasonally adjusted annual rate in the second quarter, following an exceptionally rapid 12.4 per cent rate of advance in the first quarter. Over the first six months of the year as a whole, bank credit grew at an annual rate of 11 per cent, compared with the generally steady 8 per cent per annum rate of growth that had characterized the preceding four years of general business expansion.

As has been generally true since mid-1963, the second-quarter advance in bank credit was accounted for almost entirely by a further expansion of loans. Indeed, banks again ran down their holdings of Government securities during the quarter (see Chart I), but continued to acquire other securities (primarily obligations of state and local governments) so that total investments were about unchanged.

Among the loan categories, gains were widespread. Loans to commercial and industrial borrowers were up sharply during the quarter, at an annual rate of 18 per cent at all commercial banks. While this was less than the extraordinary 26 per cent annual rate of increase in such loans in the first quarter, which stemmed in part from enlarged foreign lending, it remained appreciably above

Chart I
RECENT DEVELOPMENTS IN BANK CREDIT AT ALL COMMERCIAL BANKS
Billions of dollars; seasonally adjusted




Source: Board of Governors of the Federal Reserve System.

the 12 per cent rise experienced during 1964. In part, this strength in business loans probably reflects the need for financing the further buildup in steel inventories that occurred during the second quarter. Loan demand extended far beyond steel-using industries, however, as businesses generally sought funds to finance their expanding capital investment projects. There was also heavy borrowing over the June dividend and tax dates, a good part of which apparently remained on bank ledgers for a longer period after the mid-June period had passed than had been the case in other recent years.

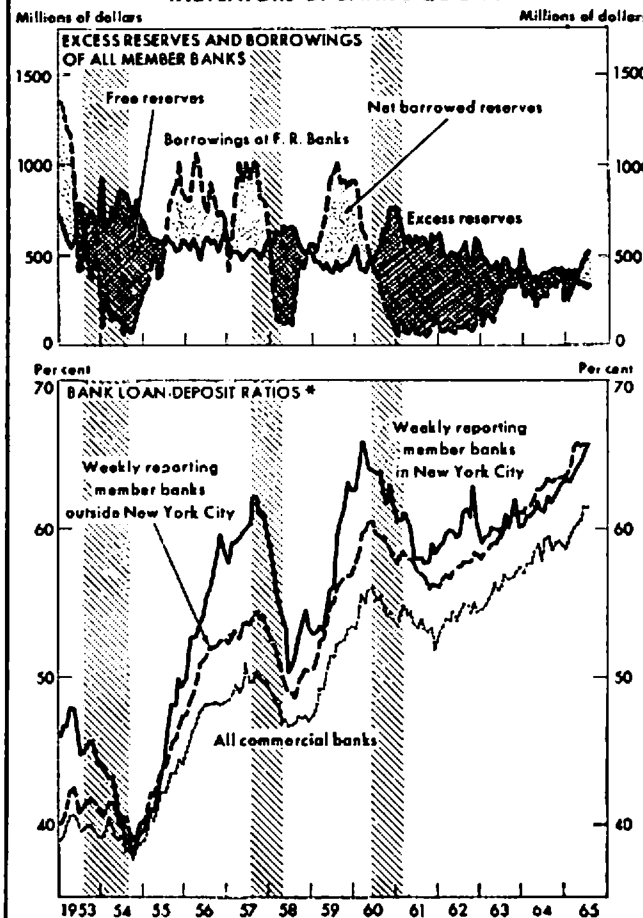
With bank asset growth continuing to take place mainly in loan portfolios, loan-deposit ratios[1] moved further upward in the second quarter. At the end of June, the ratio for all commercial banks as a group stood at 61 per cent (see Chart II), the highest level since the end of World War II. The willingness of bankers to channel a larger proportion of their funds into loans appears to be related to a number of factors. Portfolio management has become more effective. In addition, the ability of banks to cover their liquidity needs through purchase of Federal funds, and sometimes through sale of negotiable certificates of deposit, has probably made them willing to live with higher loan-deposit ratios. These developments, together with a rise in the proportion of deposits held in relatively nonvolatile forms, such as savings accounts, would tend to permit banks to operate with average loan-deposit ratios that would have represented considerable stringency in times past. Moreover, a long period of relatively stable growth in economic and financial activity has also encouraged the acceptance of relatively high loan-deposit ratios.

Nevertheless, there appears to have been some concern developing on the part of bankers about declines in liquidity positions, and there have been increasingly frequent reports that some banks are introducing or enforcing more selective lending policies in an attempt to prevent their portfolios from becoming unbalanced. To the extent that banks give closer attention to their loan-deposit ratios, further increases in total bank credit may begin to be split more evenly between loans and investments, rather than consisting almost entirely of loans as has been the case since mid-1963. If this were to happen, businesses and individuals could find it somewhat less easy to obtain accommodation in the months ahead than earlier in the current business expansion.

[1] Loan-deposit ratio equals loans (adjusted), less loans to brokers and dealers, as a percentage of total deposits (less cash items in process of collection).

Chart II

INDICATORS OF BANK LIQUIDITY




Note: Shaded areas represent recession periods, according to National Bureau of Economic Research chronology.
* Ratios computed by this Bank (see footnote 1 in text).
Source: Board of Governors of the Federal Reserve System.

**DEPOSITS AND BANK RESERVES**

With bank credit continuing to expand, total commercial bank deposits and the private money supply also moved up during the second quarter. During the first two months of the year, time deposits were rising at an unusually rapid rate in the wake of the November rise in maximum interest rates permissible under Regulation Q, while the daily average money supply showed no net growth. In the March-June period, however, the money supply grew at a seasonally adjusted annual rate of 3.9 per cent, only moderately below the 4.3 per cent expansion that had occurred in 1964. Over the same March-June period, time deposits grew at an 11.2 per cent annual rate, moving back to a rate of expansion actually slightly below the 12.8 per cent rise in 1964.

Private deposits probably would have grown more rapidly during the first half of the year had it not been for an abnormally large buildup in Treasury deposits. This buildup reflected both lower Federal cash outlays and larger tax receipts than had been foreseen at the beginning of the year. Treasury deposits always show very wide fluctuations over the year in response to differences in timing of expenditures and tax receipts. Typically, Government deposit balances are low at the end of a calendar year and then rise appreciably during the spring and early summer to a peak around midyear. This year the size of the upswing was much larger than in other recent years. By the end of June, Treasury balances at commercial banks had reached a postwar record of $11.9 billion, up $3.5 billion from the end of March and almost double the balance at the end of 1964. Addition of this growth in public deposits (after some estimate to allow for normal seasonal movements) to the advance in private deposits produces a series for total deposits that more adequately reflects the large size of the recent expansion in bank credit.

Supporting the growth of deposits, bank reserves increased further in the second quarter. The rise in member bank nonborrowed reserves mainly reflected Federal Reserve net open market purchases of $1,509 million of Government securities over the three months from the beginning of April to the end of June. These purchases more than offset reserve drains stemming from movements of market factors, primarily a $629 million decline in the gold stock and a $872 million net increase in currency in circulation. The rise in the average level of nonborrowed reserves for the quarter as a whole was, however, not so great as the buildup of reserves required to support deposit growth. Member banks thus found it necessary to resort to the Federal Reserve "discount window" on a larger scale to meet their reserve needs, with total borrowings averaging $501 million in the second quarter, compared with an average of $373 million in the first quarter. With these increased borrowings, the net borrowed reserve position of member banks (borrowings less member bank excess reserves) rose to an average of $157 million for the quarter as a whole. This is the first calendar quarter since 1960 in which average borrowings of the banking system have exceeded average excess reserves (see Chart II).