Banking and Monetary Developments in the Fourth Quarter

The fourth quarter of 1967 witnessed a moderation of the bank credit and deposit expansion in progress since late 1966. While the growth of most banking and monetary indicators declined for the quarter as a whole, the slowdown was uneven. The growth of total commercial bank credit dropped sharply during November and December and was negligible in the latter month. The money supply—privately held demand deposits plus currency outside banks—continued to advance in October and November at about the same high rate as over the first nine months of the year, but grew very little in December. During the quarter, both long- and short-term interest rates on Government and private debt issues reached peaks for the year. Treasury bill rates attained their highs in early December and receded slightly over the balance of the month. Yields on intermediate- and long-term Treasury securities peaked in mid-November and declined gradually throughout the second half of the quarter. On the other hand, corporate bond yields reached a 1967 high near the end of December.

These developments emerged against a background of movement toward a firmer monetary policy during the latter part of the September-December period. On November 19 it was announced that the Board of Governors of the Federal Reserve System had approved an increase in the discount rate from 4 per cent to 4½ per cent, effective the next day, at ten Federal Reserve Banks. (The same action was approved for the two remaining Reserve Banks shortly thereafter.) This action was taken after the devaluation of the pound sterling and the concurrent increase in the British bank rate. On December 27 the Board of Governors announced an increase of ½ percentage point in reserve requirements on demand deposits in excess of $5 million, effective in January.[1] The effective rate on Federal funds moved up to about 4½ per cent from 4 per cent after the discount rate increase, and Federal funds generally traded at 4⅝ per cent in the second half of December. During December, daily average free reserves declined to $103 million, after having ranged generally between $250 million and $300 million since March.

BANK CREDIT

The growth of total commercial bank credit slowed to a seasonally adjusted annual rate of 5.8 per cent in the fourth quarter (see Chart I), well below the 12.6 per cent growth rate for the first nine months of the year. Quarterly bank credit growth rates varied substantially throughout 1967, and—as in other quarters—the change in bank credit in the fourth quarter reflected in large part changes in bank holdings of United States Government securities and securities loans—loans made primarily for the financing of securities dealers. In contrast, the growth of the sum of all other components of bank credit (other securities plus total loans minus securities loans) was quite even from quarter to quarter during 1967.

During the fourth quarter, bank holdings of Government securities declined at a 10.4 per cent annual rate. The reduction was concentrated in December, when a net liquidation of $1.8 billion was recorded. At the beginning of the month, banks were still distributing the fifteen-month and five-year notes acquired in the mid-November Treasury financing. In addition, the banks apparently liquidated some intermediate- and longer term Governments for tax purposes during December. To some extent, the December decline may also have reflected the larger than anticipated gain in business loans and sizable outflows of funds from maturing certificates of deposits (C/D's).

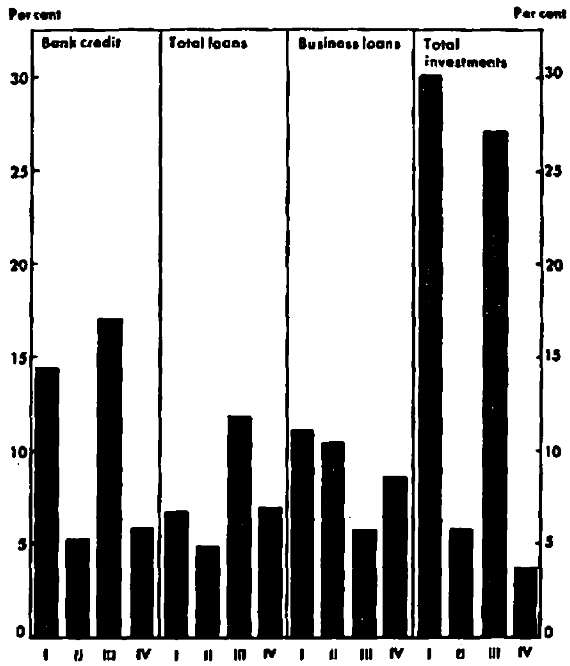
The decline in bank holdings of United States Government securities in the fourth quarter was more than offset by acquisitions of other securities—primarily in the tax-exempt sector—so that total investments showed a modest rise. Bank acquisitions of securities other than Governments rose at an annual rate of 18.7 per cent in the fourth quarter, almost twice the rate of growth in the previous quarter, in spite of the fact that such additions were negligible in December. In part, the slowdown in that month may be attributed to a somewhat lighter volume of new tax-exempt offerings.

[1] See this *Review* (January 1968), page 6.

Chart I

QUARTERLY RATES OF CHANGE IN BANK CREDIT AND COMPONENTS AT ALL COMMERCIAL BANKS DURING 1967

Seasonally adjusted annual rates



Source: Board of Governors of the Federal Reserve System.

The sharp decline in securities loans in the fourth quarter exerted a moderating influence on the growth of total loans, which expanded at a 6.9 per cent annual rate over the quarter as compared with an 8 per cent rise during the first nine months of the year. The demand for bank credit by business, which had been weak from July through November, was very strong in December. Indeed, the rate of growth of business loans for that month was the highest in almost eighteen months and carried the quarterly gain in business loans to 8.6 per cent annually, only slightly below the 9.3 per cent rate for the first nine months. Although corporate tax payments on December 15 were not unusually large, borrowings during the tax week were much larger than in the same period of previous years. There was also a very large volume of special loans to firms in the extractive industries (e.g. mining, petroleum)—often referred to as "carve-out" loans—during December. These transactions, secured by assignments of production, often involve tax benefits. Moreover, preliminary data indicate that, on a seasonally adjusted basis, retail sales dropped slightly in December. The impact of the weakness in sales on liquidity positions of retail firms was reflected apparently in a greater than seasonal December rise in bank credit to this sector.

Real estate loans posted a strong 10 per cent gain in the fourth quarter, and net additions on a seasonally adjusted basis equaled those for the entire first half. This faster growth was also evident in the third quarter, when additions of other securities and business loans were moderate. Much the same pattern applied to extensions of consumer credit by commercial banks. The 9 per cent fourth-quarter expansion was slightly above the third-quarter increase, and both were well above consumer loan growth rates in the first two quarters of the year.

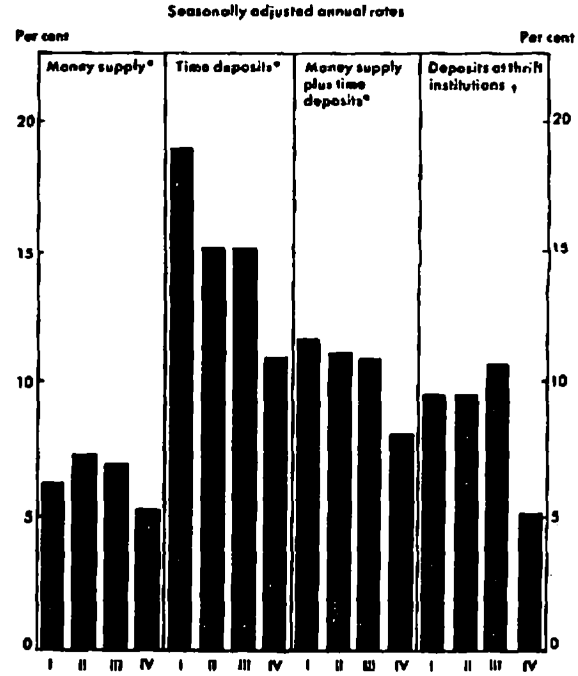
MONEY SUPPLY AND DEPOSITS

Although the expansion of the daily average money supply slowed substantially in the fourth quarter of 1967, it nevertheless averaged a relatively high annual rate of 5.1

Chart II

QUARTERLY RATES OF CHANGE IN LIQUIDITY INDICATORS DURING 1967

Seasonally adjusted annual rates



*Average of daily figures.

† Computed from levels at the beginning and end of each quarter for savings and loan associations and mutual savings banks.

Source: Board of Governors of the Federal Reserve System.

per cent (see Chart II). In October and November, the money supply expanded at a 6.7 per cent annual rate—the same as that for the first nine months of the year—but in December the rate of increase fell to 2.0 per cent. Erratic movements in the money supply are not unusual in December, and developments in that month should be viewed in the context of a longer period. In fact, the money supply grew very rapidly again in January 1968.

The growth of daily average time deposits at commercial banks during the fourth quarter also fell short of the rapid pace of expansion over the first nine months. This development was significantly influenced by changes in outstanding amounts of large negotiable C/D's. During October and November, C/D's outstanding at large weekly reporting banks rose more than in the same months in earlier years, while in December the decline in outstandings appeared to be somewhat larger than seasonal. By the end of November, interest rates on certificates with maturities of ninety days or more were at the 5½ per cent Regulation Q ceiling. Rates in the thirty- to eighty-nine-day sector ranged from 5⅛ per cent to 5½ per cent during December, and new issues of C/D's were predominantly in this maturity sector. On balance, large commercial banks lost $731 million of C/D's during the December 15 tax week, about $200 million more than in the September tax week. However, the December outflow was somewhat smaller than had been anticipated by the banks, and no unusual money market pressures resulted. Movements of savings deposits and other time deposits, although less volatile than C/D's, generally followed similar patterns throughout the period. For the quarter as a whole, the growth rate was 10 per cent, down from the 13.5 per cent expansion of the first nine months, and this slowdown reflected in part the increasing attractiveness of yields on alternative forms of investment.

NONBANK LIQUID ASSETS

Liquid asset holdings of the nonbank public rose at a seasonally adjusted annual rate of 8.4 per cent in the fourth quarter, slightly above the 7½ per cent growth rate for the first nine months of 1967. However, for the first time since the second quarter of 1966, expansion of deposits and share accounts at mutual savings banks and savings and loan associations failed to keep pace with the aggregate gain in other liquid assets: commercial bank deposits, Government savings bonds, and other Government securities maturing within one year. The growth in holdings by the nonbank public at savings banks and savings and loan associations slowed to 5.3 per cent in the fourth quarter, about one half of the increase during the preceding three quarters. In fact, the advance of deposits and share accounts with thrift institutions in December (on a seasonally adjusted basis) was the smallest on a monthly basis since the critical period in mid-1966.

The sharpest relative increase in components of nonbank liquid assets in the fourth quarter was in holdings by the public of Government securities maturing within one year. The growth of $2.3 billion (seasonally adjusted) during the fourth quarter—or 19 per cent—was in sharp contrast to the decline of $5.7 billion over the first nine months of the year. Indeed, in December alone holdings rose by $1.4 billion. This reversal was undoubtedly influenced by the increasingly attractive yields on these issues—particularly in relation to rates offered on bank C/D's and consumer-type thrift deposits.

The ratio of total liquid assets to GNP, a measure of relative liquidity of the nonbank public, was 79.5 per cent in the fourth quarter. This level was little changed from the previous quarter and close to the average of 79.4 per cent for all quarters of 1967.