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PERSPECTIVE ON 1959

ECONOMIC HIGHLIGHTS

OF THE YEAR

FEDERAL RESERVE BANK
OF NEW YORK



FEDERAL RESERVE BANK OF NEW YORK

February 5, 1960

To the Member Banks in the
Second Federal Reserve District:

I am pleased to send you this brief summary of the economic highlights of 1959 as seen by this Bank. Perspective on 1959 outlines the broad contours of economic and financial changes during the year and briefly describes the credit policies pursued by the Federal Reserve System. Deliberately, the detail and qualifications that would be appropriate in a more formal publication have been sacrificed to enhance readability. In a sense, Perspective on 1959 may be considered an informal supplement, primarily intended for the use of our member banks and our own staff, to our regular Annual Report. If additional copies are desired, we shall be glad to supply them.

We expect to release within a few weeks our Annual Report for 1959, which will as usual examine economic and policy developments in much greater detail.

ALFRED HAYES
President

PERSPECTIVE

ON

1959

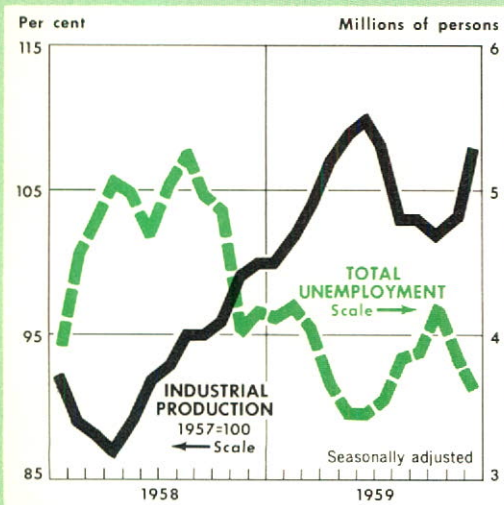


1959 bid fair to be the year when a strong economic recovery would turn into an out-and-out boom. Those prospects withered when a steel strike began around midyear and became, in the end, the longest on record. Although this inactivity in the very center of our industrial strength was necessarily a drag on the expansion for the rest of the year, the American economy, on balance, displayed remarkable staying power and resilience. Despite the strike, credit demands were so strong that the Federal Reserve System had its hands full in framing policies that would assist the economy toward healthy growth while helping to avoid the twin perils of unemployment and inflation.

Expansion on Most Fronts. As the year 1959 began, most sectors of the economy were moving forward at a good pace. The total of goods and services produced had already recovered to the peak levels that had been reached just before the short recession which began in the summer of 1957 and reached bottom in the spring of 1958. But unemployment, which had declined from recession highs only sluggishly in the latter part of 1958, was still above the 4 million mark and remained a major source of concern.

During the first half of 1959, businesses, consumers, and to a more limited extent governments (Federal, State, and local) stepped up their spending, and each month saw new output and income records. By March industrial production had exceeded the previous peak reached two years earlier, and thereafter production rose to successive new highs in April, May, and June. And by May, unemployment had dropped to 3.4 million.

Business spending for the purpose of adding to stocks on hand contributed a strong upward thrust to the economic expansion in the first half of 1959. Businesses had allowed their inventories to run down during the last recession and in the early stages of recovery, but by the fourth quarter of 1958 they were once again filling up their shelves. During the first half of 1959 the process accelerated, and in the second quarter inventory accumulation was more rapid than at any time since the Korean war. Yet there was an artificial aspect to this exceptionally large bulge in inventories. Many businesses were anticipating, correctly as it turned out, that strikes in the steel and copper industries would disrupt the normal flow of these metals, and they accordingly increased their stocks to well above their immediate needs. Part of the spending for inventories was thus borrowed from the future.

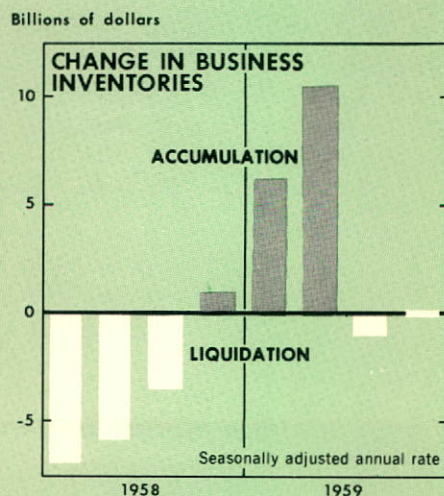


Industrial production rose sharply, and unemployment declined during the first half of 1959 . . .

Business spending on new plant and equipment, which had slumped in 1957-58 and helped account for the recession, had been slow to rise after other forces of recession had turned around. But it began to pick up in the first half of 1959. Since plant capacity had been well in excess of needs throughout 1958, expenditures on equipment, designed in many cases to reduce costs by improving and modernizing existing facilities, turned up sooner and rose further than expenditures on additional plant.

The tendency of consumers to spend a large portion of any increase in personal income, and their further readiness to go into debt for the purchase of homes and other durable goods, also were important factors underlying the economic expansion. In the case of newly constructed houses, outlays had risen sharply toward mid-1958, under the spur of relatively easy credit conditions, and continued to provide a stimulus to recovery into the spring of 1959. But, after holding at record levels through the spring, home building began to subside. In part, this reflected the credit tightening that resulted from increasingly strong credit demands for other purposes.

One such purpose was for spending on other types of consumer durable goods, particularly automobiles. Spending on durables was a powerful source of demand throughout the first half of 1959. The credit needed to support this type of spending was readily available, although at the high, but often unrecognized, rates of interest common to this type of lending. Consumer spending on nondurables and services rose fairly steadily throughout the year, in line with higher personal income and the increasing size of our population.

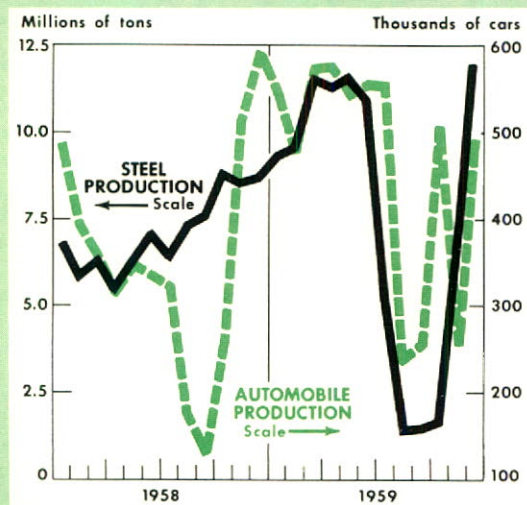


... partly because of the stimulus to economic activity provided by large accumulation of business inventories.

Spending pressures arising from the government sector of the economy lessened somewhat during the first half; it was not that government expenditures declined, but rather that they rose only moderately relative to the pace of the general advance. Federal outlays actually fell slightly in the first half of 1959, but this was offset by higher State and local spending, which has been increasing without interruption for many years. A decline in exports and a rise in imports also exerted a mild drag on the pace of the advance in production.

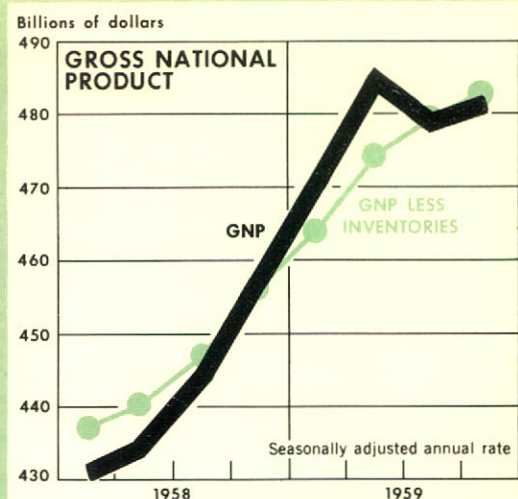
Although economic expansion during the first half of 1959 had from most points of view proceeded at a satisfactory pace, the threatened strike in the steel industry had been hanging over the economy since early in the year. On July 15, the strike materialized.

Steel Strike Blunts the Advance. The onset of the strike had an immediate and sharp impact on employment in the steel industry as well as on the industries which depend upon the production and distribution of steel, such as coal mining and some railroads. At the end of July about 500,000 persons were on strike and about 100,000 others had been laid off as a direct result of the strike. However, industries that use steel in their operations were heavily stocked with all sorts of steel products and, if the strike had been settled within a month or so, as many observers had expected, its effect on the momentum of the general economic advance would have been negligible.



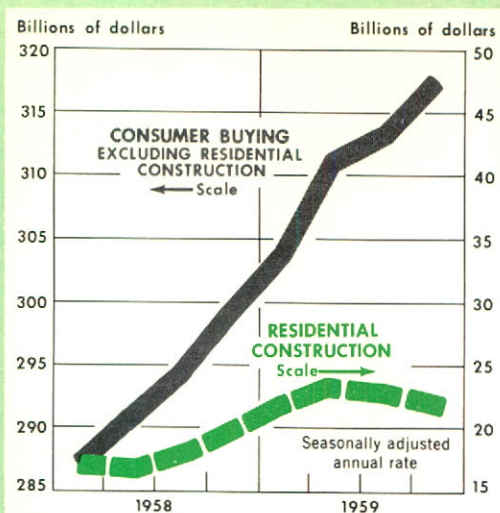
Output of both steel and automobiles (shown monthly) was hit hard by the strike.

Despite the strike GNP declined only slightly and GNP excluding inventory changes continued to advance.



But the strike did not end, and beginning about mid-October its effects began to spread as one after another steel-using firm found its inventories depleted. Production of automobiles, for example, fell substantially short of scheduled levels during November because of steel shortages. And some construction projects, such as stores, office buildings, roads, and bridges, were delayed. A strike in the copper industry which broke out in August further aggravated the situation.

Yet, all things considered, the over-all impact of this prolonged strike in one of our most essential industries was surprisingly light. Industrial production fell by less than 7 per cent between June and October, while the total output of the economy as measured by the gross national product declined by only 1 per cent between the second and third quarters. The decline in GNP was due entirely, moreover, to the sharp turnabout from accumulation of steel and steel product inventories in the second quarter to the depletion of these inventories in the third quarter. Indeed, total output exclusive of inventory changes rose appreciably in the third quarter although not quite at the rapid pace of the four previous quarters. Business expenditures on fixed capital continued to increase, although from all indications the rise was less marked than it would have been had there been no strike. And this was true also of consumer buying which was buoyed by the relative stability in total personal income and the ample availability of consumer credit.



Residential construction subsided somewhat after mid-year, but other consumer buying rose further.

Momentum Resumes as the Strike Ends. If the economy displayed remarkable staying power during the strike, its ability to bounce back soon after the injunction of early November had returned the steelworkers to the mills was no less gratifying. By the month's end production of ingot steel had risen to 90 per cent of capacity, or only slightly below what it had been just before the strike began.

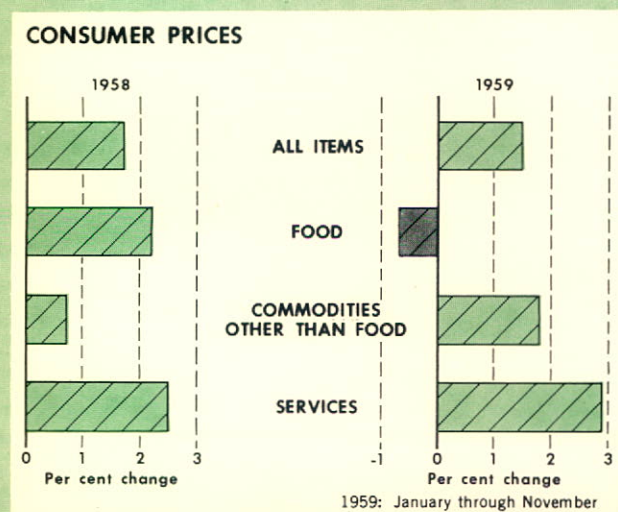
To be sure, long delays in the output and delivery of particular types of processed steel meant continuing shortages for many steel users. In some cases, this resulted in construction delays and curtailment of output during the balance of the year. A particularly important example was automobile production, which did not revive until mid-December. But the forces generated by the revival of steel production as well as by the recall of laid-off workers in allied industries gave a lift to the whole economy. In November industrial production edged up a little from the low reached in October, and in December production surged ahead, to within 1 per cent of the pre-strike high, as expansionary forces clearly regained the upper hand.

The Cost of Living Edges Up. The consumer price index, a rough measure of the average prices paid by consumers for all items, began to edge up toward the middle of 1959 after holding level for about a year following the business upturn in April-May 1958. During the period of stability in average prices, declining food prices had offset increases in most other cate-

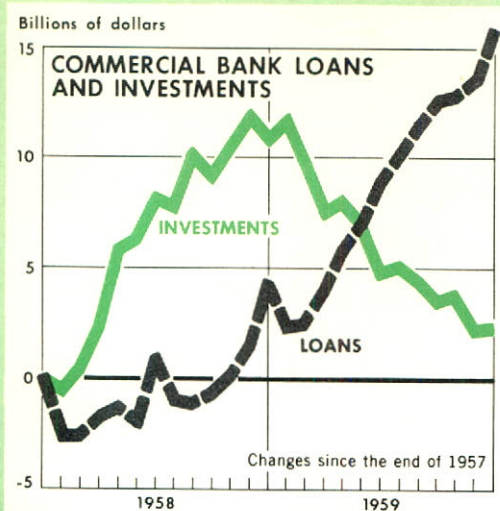
gories. The rise in prices was largest in consumer durables and, as usual, in services, where prices have been rising steadily for years. When the decline in food prices ended around midyear, the continued rise in other goods and services carried the index of all prices to a succession of new highs and to a 1½ per cent increase over the year as a whole. Although this was not a large increase, the fact that it occurred at a time when there was still unused plant capacity in most lines and a significant volume of unemployment had disturbing implications with respect to the problem of preventing inflation over the long pull.

The Credit Markets and the Fed. The pattern of economic activity in 1959 had its reflection in the credit markets. Over the year consumers added a near-record \$5 billion to their instalment debt, about one half of it to purchase automobiles, and beyond that there was a record rise of more than \$13 billion in home mortgage credit. The debt of governments—Federal, State, and local—rose by about \$13½ billion over the year, matching the unusually large increase (for peace time) posted in 1958. Although the volume of securities issues by business was not particularly large in 1959, the demand for short-term business credit was strong. And, taking all credit demands together, they added up to an imposing total.

Large amounts of new savings were available to meet a good part of these demands. However, the overflow of demands encountered a much less



The index of all consumer prices rose about as much in 1959 as in 1958. Food prices declined in 1959, but other commodities and services rose more than in 1958.



To finance a record volume of loans, banks sold most of the securities they had acquired in 1958 . . .

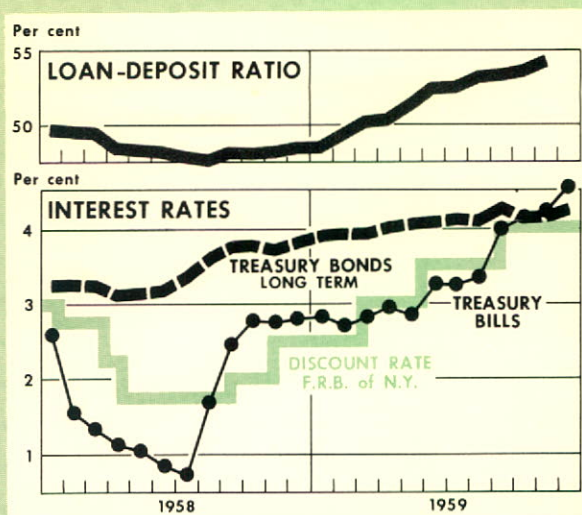
cordial market reception than in 1958, partly because the banking system was no longer in a position to enlarge substantially its over-all total of loans and investments. In 1958 commercial banks advanced \$15 billion of additional credit, enough to absorb the entire deficit of the Treasury in that year and then some; in 1959 total bank credit increased by only \$4 billion.

The modest increase in total bank credit during 1959 does not mean that the banks met only a small part of the loan demands. The loan increase was actually about \$12 billion, matching the 1955 record, but the banks financed most of this by selling securities. Since this liquidation came atop the heavy flotations of securities by governments and a record-breaking volume of consumer and mortgage loans, it was inevitable that interest rates would rise. This they did, reaching a succession of new peaks for the post-World War II period.

Why were the banks forced to finance most of the huge loan increase by selling securities? Essentially it was because the Federal Reserve permitted only a small increase in bank reserves, and much of that increase was, in effect, channeled through the "discount window". With competition for deposits increasingly severe, individual banks had greater need to acquire reserves for meeting temporary strains by borrowing from the Federal Reserve Banks for limited periods. The cost of such borrowing (the "discount rate"), which had been 2½ per cent when the year began, was raised by ½ per cent on each of two occasions during the months before the steel strike when the pace of business activity was quickening and loan demands were converging on the banks in unprecedented volume. In the fall the discount rate was raised once more (to 4 per cent) to keep it in line with sharply rising market rates.

. . . raising the loan-deposit ratio of all commercial banks to a new high for recent years.

These securities sales, along with the heavy volume of new issues, pushed interest rates up sharply.



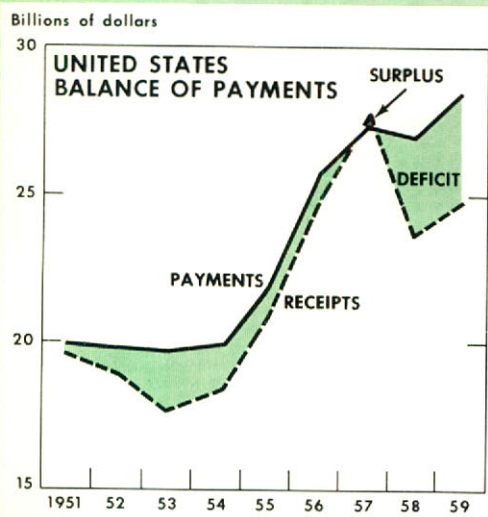
Why did the Federal Reserve keep the banks so pressed for reserves that they had to meet the bulk of their loan demands by liquidating securities? Not, of course, because the System was trying to prevent a needed expansion in economic activity. On the contrary, it was in fact doing all that it could to help keep the expansion going over the long pull. One of the gravest risks during any expansion is that the economy will try to meet all needs at once; take an overdose of credit in the attempt; become overstimulated; and then collapse. That is what the Federal Reserve was trying to avoid. It wanted to insure that no impulse from the financial side would foster inflationary tendencies and instability. By not making bank reserves more freely available, the System, in effect, allowed credit demands to create their own pressures on the market, thus allowing self-limiting forces to come into play.

The over-all effect of heavy credit demands pressing against a limited supply of loanable funds was to raise interest rates and make credit increasingly "tight". To be sure, if more of the postponable demands for borrowing money had voluntarily dropped out of the market, or if governments had not found it necessary to borrow so much, the upward pressures on interest rates would not have been so great. Or on the supply side, if people and businesses had saved more and the flow of loanable funds generally had been larger, the pressures would have been lessened. But given the demands that were there, and the actual volume of other credit that was forthcoming, any attempt by the Federal Reserve to keep interest rates down would have meant a big increase in the supply of money. Real restraining action would presumably then have been postponed until the inevitable happened, and sharp price increases actually took place. By then, though, inflationary credit forces

would have built up such a strong head of steam that only restrictive measures of paralyzing severity could stop them. As it was, even with a determined Federal Reserve policy, prices did rise somewhat. But the test cannot merely be in terms of what "was"; it must also include what "might have been".

Our Balance-of-Payments Deficit. Throughout the year, one problem which lurked in the background of all economic policymaking was the enlarged deficit in this country's balance of payments. In all but one of the past ten years the United States paid more to foreigners (in the form of payments for goods and services purchased, loans, gifts, and the like) than we received. To balance the books we paid foreigners with American dollar assets, and as usual some of them exchanged their dollars for some of our gold. In 1958 and 1959, our over-all deficit rose to about \$3½ billion per year, owing to smaller exports and larger imports. The size of the deficit was declining toward the end of 1959, however.

Why was this deficit a cause of genuine concern? Although our gold stock of \$19½ billion remained more than ample by any reasonable standard, large gold outflows to settle large balance-of-payments deficits obviously could not continue indefinitely. This pointed, as it had so often in other countries more dependent upon foreign trade, to a need for corrective action. That is why the United States sought to encourage other industrial countries, now fully recovered from the war and enjoying rapid growth, to assume a greater



We have had a deficit in our transactions with foreign countries in most recent years, but the deficit was of record proportions in 1958 and 1959.

share of the burdens of foreign aid. That is just one more reason why it was imperative for these same countries to abandon the remaining discriminations against purchases of the United States goods that had been imposed when they were impoverished. And that is why the United States had to look closely at its own competitive position in world trade and at influences pulling up, or pushing up, costs and prices and thereby jeopardizing not only its domestic growth but also its own international monetary reserves.

And 1960? As 1960 opens, the settlement of the labor-management dispute in the steel industry removes a big question mark. But the full implications of the settlement terms for steel prices and for costs and prices generally cannot as yet be evaluated. The settlement does, of course, give a green light for a further advance in economic activity. With inventories at low levels an inventory boom is clearly in prospect for 1960. But this in itself can not provide the basis for durable and sustainable growth. Of course, as of the end of 1959, business spending on new plant and machinery and consumer spending were both showing considerable strength. Important questions cannot yet, however, be answered: Will the expansionary forces quickly reduce the still sizable volume of unemployment? Will they be so strong as to generate demands that push hard against the real capacity of the economy? And will inflation, that inveterate pickpocket, become even more menacing as a consequence?

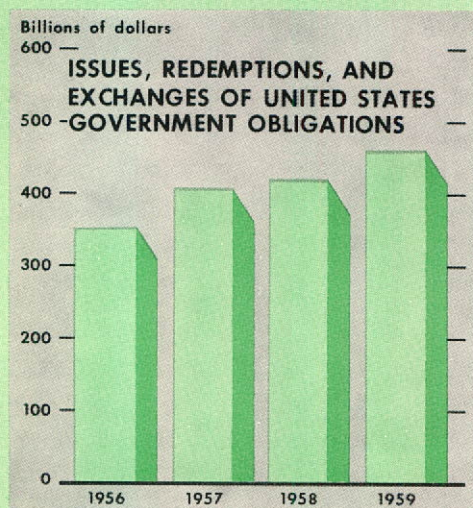
About This Bank. Because of its location in the heart of the Government securities market, this Bank buys and sells Government securities and bankers' acceptances for the entire Federal Reserve, as directed by the Federal Open Market Committee. These "open market" transactions, along with those for the Treasury, foreign central banks, and others, always aggregate many billions of dollars, and the total in 1959 was one of the largest.

Member banks gain reserves when the Federal Reserve buys; they lose them when it sells. But they can also acquire reserves through the "discount window" to meet temporary reserve needs. Since open market operations

last year were concentrated on keeping reserves scarce, there were many more instances of banks finding themselves short of required reserves. Thus, total member bank borrowing for the year (much of it in loans running only a few days) amounted to \$24 billion for this Bank alone, or more than twice that of the previous year when money was relatively easy.

As the Treasury's banker, all of the Reserve Banks issue, exchange, and retire a large volume of Government securities every year. The Reserve Banks also process a huge volume of checks; in 1959 this Bank alone processed about 627 million checks having a face value of \$415 billion. In addition, the Reserve Banks transfer Government securities and funds by mail or wire to different parts of the country; distribute currency and coin to the commercial banks; and perform innumerable other functions to help the nation's money system work better.

The entire Federal Reserve is run in the public interest rather than to make a profit, but the System usually earns a substantial profit. In 1959, this Bank's gross income totaled \$245 million while expenses amounted to \$29 million. Income arises mainly from interest earnings on Government securities holdings, but 1959 income included \$21 million which was transferred from contingency reserves as part of a reconstituting of reserve and surplus accounts. From net earnings of \$216 million, \$6½ million was distributed to member banks as the 6 per cent dividend on paid-in capital as provided by law and the balance of \$209½ million was paid to the United States Treasury. In addition, this Bank transferred to the Treasury at the year end another \$18 million, representing the Bank's share of a System-wide move to reduce surplus accounts to 100 per cent of subscribed capital.



The volume of Government securities handled by the Federal Reserve Bank of New York, on behalf of the Treasury, continued to increase in 1959.

